

ANNEX 04 – SUMMARY OF WIPS FINDINGS AND RECOMMENDATIONS

Working in Partner Systems (WiPS) assessments were commissioned by the health team between August – September 2013 to review the public financial management (PFM) and procurement systems; their capacity and associated risks that would be associated with the proposed performance-based grants component of the PERMATA program. These assessments were carried out by two independent teams of consultants and include meetings with national level (Ministry of Finance, Ministry of Health, BPK, AIPEG, AIPD) and sub-national level (Bupati office, Treasury, Bappeda, district health office and selected primary health care centres).

Full reports were submitted in early 2014 and were reviewed by the health team with support from AIPEG and AIPD advisers for the PFM assessments report and with support from the Canberra WiPS team for the procurement report. While there are some gaps of information in the PFM report it was agreed that with support from AIPEG and AIPD the health team would be able to use the report to finalise the design of the performance-based grants with the managing contractor of PERMATA.

SUMMARY OF PUBLIC FINANCIAL MANAGEMENT (PFM) ASSESSMENT

The terms of reference sought a Public Financial Management (PFM) risk assessment of a proposal by DFAT to provide performance based grants to District Governments in Indonesia, to be managed through their PFM systems, in support of better outcomes in the areas of maternal and neonatal health, childhood nutrition and family planning. These outcomes are to be more generally promoted under the new PERMATA program. The new program envisages expenditures of some \$165 million over 8 years, with the grants component possibly accounting for around 10% of this amount.

Since the management of the grant funds will basically be at the District level, and since there is no support for a possible alternative option of managing the monies through national government systems via disbursement through the Ministry of Health (MOH)¹, the assessment Team basically focussed on gaining understanding of the PFM systems, processes and risks at the District level.

CONTEXT

In general, Indonesia does not have a good reputation for probity in its management of public resources. Evident from a range of prominent sources, and from the many high profile cases currently being prosecuted, is that corruption is rife at the national level. By most accounts, including from discussions the Team had at the Regional and District levels, the problem is replicated or even magnified at the District level, particularly as the process of decentralising key government service responsibilities to District Governments has progressed (see page 8 of the full report for details). The Districts now account for some 40% of total government expenditures in Indonesia and have responsibility for service delivery in respect of such key areas as health and education.

Mitigating against the foregoing, however, is that Indonesia now has strong rules based systems of PFM which are continuing to be improved through an active PFM reform agenda.

The systems and processes now in place at the District level, including new systems of financial management and reporting, suggest that there is scope for DFAT to pursue its goal of channelling the proposed grants through, predominantly, District systems and processes of PFM, subject to a number of risk mitigation measures, detailed in particular, at Annex 1 of the PFM assessment report.

THE BENEFITS

The principal benefit seen in providing the grants is that they will give Districts a much needed source of discretionary funding with which to address blockages to better maternal and neonatal health outcomes which may be the result of factors outside of the health sector: for example, a lack of clean water supply for District Health clinics. Currently, most revenues of District governments are pre committed to funding personnel costs and expenditures earmarked or tied to a plethora of national government grants. The benefits of channelling the grants through District PFM systems are assessed in Section C of the report. In essence, they are judged to be medium to high, particularly in reducing transaction costs for Districts in allowing the funds to be managed through their well-defined systems of planning, budgeting and budget execution.

THE RISKS

Good, well-defined systems of PFM do not alone ensure good PFM. Of critical importance also is the extent to which the broader governance environment ensures compliance with those systems: comprehensiveness and reliability of reporting; auditing; and sanctions for deliberate non-compliance, especially. All are areas of apparent weakness at the District level. At the same time, good systems do provide the basis for effective risk mitigation.

The risks of channelling the proposed grants through District PFM systems are highlighted in Sections B and C of the full report. In essence, they relate to:

- “Additionality risk”- the possibility that funding from DFAT will lead District Governments to reduce their funding of health expenditure, a distinct possibility at the District level given their budget formulation processes.
- The possibility that grant funding releases will be unduly delayed by bureaucratic processes between the MOH and the Ministry of Finance (MOF).
- The possibility that the grants will be expended on low priority or political priorities rather than on the higher priorities identified through the community consultation processes (Musrenbang) mandated at the beginning of each budget cycle process.
- The formulation, formally by MOH, of guidelines to govern the expenditures that can be funded by the grants. It will be important to strike the right balance here between the objective of expenditure flexibility that the grants are intended to facilitate and the need for sufficient guidance for officials in order to avoid their inadvertently triggering charges of financial misconduct.²
- Unspent grant monies. If paid as a lump sum, there is a high risk that some portion of the grants will be unspent each year and accumulate in District Treasury bank accounts. This will not be a problem if the grants are paid on a reimbursement basis – that is, grant monies are paid to Districts to reimburse them for agreed expenditures initially funded from their own reserves – which is the approach strongly favoured by the MOF and recommended in this Report
- The likelihood that a significant portion of the expenditures ultimately funded by the grants will be effected through cash advances and cash reimbursements to entities at the District level means there is a high risk of fraud commonly encountered in this area.
- Reporting of grant expenditures may not be possible using District level accounting systems.
- The lack of effective District asset management policies and systems means there is a high risk that grant funded assets will be misappropriated or lost.

² Important to recognise here that “flexibility” in this context means the high degree of discretion that is intended to be allowed District governments in allocating, within their annual and semi- annual budgeting processes, the grant funds to activities deemed important to enhancing maternal and neonatal nutrition and health services delivery. As is noted later in this Report, once allocated in the Budget, it would not be possible to then reallocate the funds to meet possible changing priorities within any financial year, other than through the standard mid year revised budget process. In that sense, therefore, it is flexibility to allocate a year in advance of actual spending.

- Weak data collection and analysis will limit the scope and effectiveness of performance criteria.
- Insufficient capacity of internal audit authorities means that they cannot be relied upon to effectively monitor grant funds.

The remedies/controls proposed in respect of each of the foregoing are assessed to generally result in low to medium on-going or residual risks to the grants program.

In essence, the financial management framework recommended for the grants will involve:

- Endorsement/approval by the PERMATA Managing Contractor (MC) of the expenditures proposed to be funded by the grants, which will have been identified through normal District planning and budgeting processes;
- Approved expenditures being funded initially from District's own financial reserves, and through the normal processes of cash advances and cash reimbursements that universally operate between District Treasuries and District spending agencies.
- District Treasuries then seeking reimbursement of approved expenditures from the MOF up to the limit of the grants agreed with each District. As is the case at the District level, requests for reimbursement would be fully supported by receipts and any other relevant documentation; among other things, providing a robust basis for auditing of transactions. As is required under the grants (Hibah) regulations governing donor grants to Districts, the MOH will be required to provide endorsement to the MOF that the expenditures undertaken by the Districts is consistent with the policy intent of the grants/relevant budget line item. Exactly how this process will operate in practice is something that will need to be negotiated between DFAT, MOF and MOH as part of the Program design phase.

SUMMARY OF PROCUREMENT ASSESSMENT REPORT

SUMMARY OF FINDINGS

Indonesia has a national procurement system that is applied to the districts with limited scope for local adaptation. Differences in practice arise from incapacity or inexperience to implement features of the national system in full, for example to utilise all the features of the electronic procurement system.

The procedures and key requirements of the system are set out in Presidential Regulation No. 54/2010 as modified by Presidential Regulation No. 70/2012. Presidential regulations do not carry the full effect of a law. An important difference is that failure to comply does not attract sanctions and penalties. There had been the intention to enact a procurement law in 2014 but the LKPP was not optimistic that this target would be achieved.

Bids are invited on the basis of standard bidding documents for goods, civil works and consultancy services, which we have reviewed. These documents are thorough and provide a sound legal basis for the award of contract.

The LKPP is charged with developing the system and building capacity. External audit over the districts is carried out by the BPKP, whose financial reports are submitted in confidence to the Provincial Governor and only occasionally examine the workings of the procurement system. Neither the LKPP nor the BPKP is responsible for enforcement of the regulations, though the BPKP reported that if a crime were suspected they would make a report to the District Attorney. There is thus no clear link from system development, through investigation to enforcement of requirements. These problems are compounded by weak statistical data and unclear record keeping.

The national procurement system provides for an electronic procurement system (SPSE) to be the prime instrument for carrying out procurement. An electronic catalogue has also been developed for the procurement of certain items, including drugs. The introduction of the SPSE has regularised procurement in the districts of Indonesia procurement for values above IDR 200 million (AUD 19,000). The SPSE has presented problems for bidders who lack IT skills and Internet connectivity. There is little competition and low capacity among bidders in many districts.

Procurement practitioners are required to pass a basic competency test based on knowledge of the presidential regulations. However, broader professionalism is weak. Some districts have been unable to implement in full the electronic procurement system because of shortages of equipment, accommodation, IT connectivity and staff capabilities.

The planning mechanism is generally poor, as there is no consolidated procurement plan with time lines for actions. Clinics tend to be built following pressure at the village and sub-district levels without planning for related needs, such as utilities, staffing and the maintenance of equipment. Procurement up to IDR 5 billion (AUD 460,000) may be through simple bidding or direct selection. There is also “self-managed” procurement, which operates outside of the normal system utilising internal staff or community resources. These exceptions reduce the scope of competitive tendering.

Districts are required to spend their funds before the close of the financial year. Late release of funds compounded by inefficiencies in the districts, necessitate bidding for further funds to retender for work on uncompleted buildings. Consequently, completion may be carried out by a different contractor than the one who started the work. Such an arrangement is unlikely to achieve best value.

The pervasiveness of corruption in Indonesia has been revealed in several reports, including reports and surveys by the World Bank and Transparency International. We were warned at our discussions with representatives of the World Bank and the Corruption Eradication Commission (KPK) that corruption, though a national problem, is worse at the district level.

Investigative and control systems over corruption in the districts are weak. Indonesia lacks a fully independent appeals system, which is a generally accepted feature of a good procurement system, and leaves considerable power in the hands of the bidding committees without making effective safeguards.

Deployment of development aid funds through the national procurement system would be in line with good donor practice. Moreover, the World Bank and some other donors make use of the national system with safeguards and experience has been generally positive. Channelling aid through the national procurement system would provide opportunity for DFAT to monitor the Indonesian procurement system and to hold Indonesia to its reciprocal obligation under the Paris Declaration to continue with the procurement reform programme.

RECOMMENDATIONS

The Indonesian procurement system is at an intermediate stage in relation to international practice. There is a set of rules supported by standard bidding documents and we were impressed by the interest and commitment of most of the practitioners to operate the system effectively. Staff competence is tested through a certification system. Procurements appear to lead to effective contracts being made and the work is completed to a generally satisfactory standard, though not always within the same financial year. The weaknesses we saw, for example in the equipping of health centres, was attributable to inadequate linkage between equipment purchases and maintenance and servicing agreements rather than to failures in the procurement system itself.

Monitoring and enforcement are the main areas of weakness in procurement and this is important in a system that is vulnerable to corruption. However, these weaknesses are being addressed through the formation of ULPs that utilise an electronic procurement system and electronic catalogue. An electronic procurement system makes for conformity with the prescribed system and produces an audit trail that would enable deviations to be more readily detected. These features are gradually being rolled out to cover more districts and the Indonesian system will be strengthened as these developments progress. The recommendations we have made in this report provide for further safeguards that will support and be compatible with the developments within the Indonesian system.

We recommend that DFAT should channel a proportion of its development aid funds through the national procurement system only in districts where the following safeguards are in place:

1. It must be a prerequisite for all districts receiving performance-based grants to have a satisfactorily functioning ULP that meets the following criteria:
 - a. The electronic procurement system has been in operation for 12 months and is used for all procurement above IDR 200 million (AUD 19,000), the threshold value for use of competitive procurement;
 - b. The ULP is adequately staffed in accordance with the defined establishment; and
 - c. All staff in the ULP have been awarded the Procurement Competency Certificate.DFAT must undertake a procurement assessment of each district to ascertain that the above requirements are met.
2. DFAT funds used for procurement through the national system should be made subject to a special procurement audit each year, either by a procurement specialist trained in auditing techniques or by the BKP or Inspectorate. Subsequent recommendations address the need for specialized training in

procurement audit. Sanctions and blacklisting should be applied when corruption and other serious malpractices are discovered through the audit system.

3. For all procurement above IDR 500 million (AUD 47,000), a representative from the PERMATA program with procurement expertise or the procurement contractor should be present during tender evaluation to ensure that the whole process is carried out fairly and transparently and in accordance with the evaluation criteria.
4. A copy of the procurement plan and the bidding documents for all procurements above IDR 200,000 (AUD 19,000) must be submitted to PERMATA for authorisation.
5. PERMATA should prepare a detailed project operations manual for the procurements supported by DFAT funds. The manual should address some of the weaknesses identified in this report.

In addition to the above conditions for provision of DFAT grants through the national system, we have made additional recommendations for the longer-term development of the Indonesian procurement system, as set out in section 10 of the full report. We have also included in Annex H of the report a list of recommendations, together with equivalence measures that mitigate areas where the GoI Procurement Framework (GoIPF) falls short of the Commonwealth Procurement Rules (CPRs).

We also recommend that certain capacity building measures should be provided to districts selected as suitable to receive DFAT funds through the national procurement system:

1. Training in good procurement practice as developed internationally should be provided by international and national procurement specialists. Further details are provided in Annex E of the full report.
2. Training should be provided for members of the Inspectorate at both district and provincial level in procurement audit.

A full set of recommendations with justification is provided in Section 10 and Annex H of the procurement assessment report.