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**INDONESIA**

# PUBLIC EXPENDITURE AND FINANCIAL ACCOUNTABILITY

## PUBLIC FINANCIAL MANAGEMENT PERFORMANCE REPORT & PERFORMANCE INDICATORS

**31st October 2007**



THE WORLD BANK

**Currency Equivalents**
Currency Unit Rupiah (IDR)
US$1 = IDR 9100

**Fiscal Year :** January 1 to December 31**.**

## TABLE OF ABBREVIATIONS & ACRONYMS

| | |
|---|---|
| ADB | Asian Development Bank |
| AGA | Autonomous Government Agencies |
| APBN | *Anggaran Pendapatan dan Belanja Negara*, (State Budget of Central Government) |
| BAPPENAS | *Badan Pengawas Pembangunan Nasional*,(National Agency Development Planning or the Planning Ministry) |
| BUMN | *Badan Umum Milik Negara* (State Owned Enterprises) |
| BKN | *Badan Kepegawaian Negara* (Government Employee Administration Agency) |
| BOS | *Bantuan Operasional Sekolah*, (School Operational Support Fund) |
| BPK | *Badan Pemeriksa Keuangan, (*Supreme Audit Board for Indonesia*)* |
| BPKP | *Badan Pengawasan Keuangan dan Pembangunan* (Financial and Development Supervisory Board) |
| BPMIGAS | Badan Pelaksana Kegiatan Usaha Hulu Minyak Dan Gas Bumi *(*Oil & Gas Regulatory Authority*)* |
| COFOG | Classification of the Function of Government |
| DG | Directorate General |
| DIPA | *Daftar Isian Pelaksanaan Anggaran*, (Budget Execution Document) |
| DAU | *Dana Alokasi Umum*, (General Grant) |
| DMO | Domestic Market Obligation |
| DPR | *Dewan Perwakilan Rakyat*, (House of Representatives) |
| DSA | Debt Sustainability Analysis |
| GFMRAP | Government Financial Management & Revenue Administration Project |
| IDB | Islamic Development Bank |
| IDR | Indonesia Rupiah |
| IG | Inspectorate General |
| IMF | International Monetary Fund |
| FY | Fiscal Year |
| GDP | Gross Domestic Product |
| GFS | Government Finance Statistics |
| GFMIS | Government Financial Management Information System |
| GFSM | Government Finance Methodology |
| IPSAS | International Public Sector Accounting Standards |
| JBIC | Japan Bank for International Cooperation |

| | |
|---|---|
| KADIN | Indonesian Chamber of Commerce |
| KMK | *Keputusan Menteri Keuangan* (Decision issued by the Finance Minister) |
| KPP | *Kantor Pelayanan Pajak* (Tax Service Office) |
| KPPN | *Kantor Pelayanan Perbendaharaan Negara,* (Treasury Payment Office) |
| KTP | *Kartu Tanda Penduduk* (National Identification Card) |
| LKPP | *Laporan Keuangan Pemerintah Pusat*, (Financial Statements of the Central Government) |
| MDA | Ministries, Departments and Agencies |
| MOF | Ministry of Finance |
| MOH | Ministry of Health |
| MONE | Ministry of National Education |
| MPW | Ministry of Public Work |
| MSOE | Ministry of State Owned Enterprises |
| MTEF | Medium Term Expenditure Forecasting |
| NPPO | National Public Procurement Office |
| PE | Public Expenditure |
| PEFA | Public Expenditure and Financial Accountability |
| PLN | *Perusahaan Listrik Negara, (*State-owned Electricity Company) |
| PMK | *Peraturan Menteri Keuangan, (*Ministry of Finance Regulation) |
| PP | *Peraturan Pemerintah, (*Government Regulation) |
| PPP | Public-Private Partnership |
| RAPBN | *Rencana Anggaran Pendapatan dan Belanja Negara, (*Draft of State Budget) |
| RKN | *Rencana Kerja Pemerintah*, (Government Work plan) |
| RDI | *Rekening Dana Investasi* (Investment Fund Account) |
| RDA | *Rekening Pembangunan Daerah* (Regional Development Account) |
| RPJM | *Rencana Pembangunan Jangka Menengah* (Medium Term Development Plan) |
| ROSC | Report on the Observance of Standards and Codes |
| SATKER | *Satuan Kerja (*Work Units in spending Ministries). |
| SIKD | *Sistem Informasi Keuangan Daerah* (Financial Information System for Local Governments) |
| SNG | Sub national Governments |
| SOE | State-Owned Enterprise |
| SOP | Standard Operating Procedures |
| SPM | *Surat Perintah Membayar, (*Payment Order) |
| TIN | Taxpayer Identification Number |
| TSA | Treasury Single Account |
| UU | *Undang-Undang*, (Law) |
| VAT | Value Added Tax |

## Acknowledgments

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## SUMMARY ASSESSMENT

1. **The Public Expenditure and Financial Accountability (PEFA) assessment for Indonesia was undertaken by a team of World Bank staff and consultants with close involvement of counterparts from Government of Indonesia**. This Public Financial Management (PFM) Performance Report has utilized the *Public Expenditure and Financial Accountability* ("PEFA") measurement framework[1] to establish a baseline of indicators to measure Indonesia's performance in Public Financial Management ("PFM").

2. **The PEFA measurement framework has been developed after wide consultations with a group of donors, client countries and international professional organizations**. It provides an integrated, standardized and indicator-led methodology to measure and monitor PFM performance over time. Its objective is to help assess the performance of PFM systems, processes and institutions in each country and provides broad measures of PFM performance relative to system characteristics. The scoring methodology, covering a set of 31 high level indicators, emphasizes empirical and observable scores for each PFM area based on internationally recognized good practice. The framework was not designed to rank countries by means of an overall aggregate score for each country. The PFM performance report - which supports the scores and brings together an analytical summary - is not meant to judge policy actions of government nor provide explicit recommendations, but instead to support a strengthened approach to PFM reforms by facilitating dialogue between government and other stakeholders on PFM reforms

### (i) INTEGRATED ASSESSMENT OF PFM PERFORMANCE

3. **In recent years, Indonesia has made significant changes in the way its public finances are managed and in increasing transparency and independent oversight**. In particular, roles for Indonesia's Parliament and the government (through the Ministry of Finance) and spending agencies have been well reformed and articulated in new PFM laws. There has been a strengthening of the position and capacity of the external audit institution *Badan Pemeriksa Keuangan* (BPK), whose Constitutional mandate has been clarified and budgetary resources increased to enable it to function more effectively. Reforms in several other areas are at various stages of implementation.

4. **In this context, the results of this PEFA measurement, which has been conducted for the first time in the country, reflect a mixed picture**. Out of the 31 PEFA indicators 4 are scored A, 4 indicators score B, 12 score C, and 10 score D. One indicator, relating to the extent of unreported government operations, could not be scored due to non-availability of data. Key strengths pertain to transparency and comprehensive budget documentation, a well defined budget process with both executive and legislative adhering to the schedule, a classification which complies with international standards and a strengthened external audit function. Key weaknesses were identified across various dimensions of the budget execution such as financial reporting and internal controls.

5. **In almost all areas of PFM a sound regulatory framework is now in place.** Likewise the major reorganization of the Ministry of Finance, which is spearheading the reforms, along modern lines has increased its potential to successfully implement reforms. The challenge will now be to consistently implement this framework.

[1] See www.pefa.org for further information on this framework.

6. **Advances have been made in budget preparation–** instituting a State Budget which combines the previous separate recurrent and development budgets and significantly improving budget transparency. But more work is needed to implement performance based budgeting and a Medium Term Expenditure Forecasting (MTEF), where progress has been limited. In the area of budget execution, good progress has been made in the development and implementation of a Treasury Single Account to strengthen cash management. However due to procedural bottlenecks expenditure patterns remain skewed towards the second half of the fiscal year.

7. **Internal controls in the execution of the budget by spending agencies have not scored well overall.** Although the country has made good progress in ensuring timely availability of annual financial statements to the parliament and to the public, external audit reports indicate that further work is needed to ensure the reliability of these financial statements. If not addressed expeditiously, these weaknesses in budget execution could potentially threaten government's ability to maintain good fiscal discipline in future.

8. The summary assessment below summarizes the results based on the classification used in the PEFA PFM performance indicators, with the detailed scores across all indicators listed in Table 1 below.

- ***Credibility of the Budget***

9. **Although the Indicator Scores for PI 1-4 are low this largely reflects a previous policy of knowingly under-estimating oil prices, which determine a significant portion of budget revenues, both as a policy of fiscal prudence and as a means of restraining transfers of revenue to SNG** (as under current regulations transfers are based partly on budgeted rather than actual central government revenues). It can be noted that budget credibility has improved significantly since 2004, with the results for Indicators 1-3 in 2006 reflecting much lower and relatively small deviations in aggregate expenditures, composition of expenditures and composition of revenue out-turns. While fiscal discipline appears to be good, this may not necessarily be because government has applied all the right tools to achieve this (reference weak scores in indictors PI 9, PI12, PI 16, PI 20 (i) and PI 24). Instead, the reasons for this could include other factors such as cautious revenue estimates in face of constantly increasing oil prices in recent years and lack of spending capacity.

- ***Comprehensiveness and Transparency of the Budget***

10. **Indonesia scores well on a number of the indicators here, such as comprehensiveness of information in budget documents.** However it does not score well on comprehensiveness of the budget. Although the exact extent of extra-budgetary operations through line ministry off-budget bank accounts, military enterprises and (semi) government foundations cannot be quantified in the absence of reliable data, it is likely to be significant as suggested in the IMF ROSC [2]. Changes recently made in management of the Government Treasury, such as establishing a Treasury Single Account, the uncovering many off-budget ministry bank accounts and the incorporation of the regional development and investment accounts into financial reports and budget documents have also contributed to increased transparency.

11. **Indonesia has scored well overall in budget transparency, reflecting changes recently introduced in this area**. Budget documentation, including the annual budget law, the President's

[2] Indonesia, Report on the Observance of Standards and Codes (ROSC), Fiscal Transparency Module, IMF July 7, 2006. The Report is available at www.imf.org

budget speech and the detailed budget documents (Financial Notes) as well as the annual financial statements are publicly available on government websites. In addition the draft budget documents and the six monthly budget execution reports are all publicly available as written documents. To some extent this high level of budget transparency reflects the strong powers of Parliament in the budget process. The detail and quality of budget information has significantly improved in the past two years. For example the 2008 budget documents contain for the first time a statement of fiscal risk, which will be produced every year. A formal integration of the previously separate recurrent and investment expenditure budgets has now been made. Since 2005 there has been a consolidated state budget, although more work is required to ensure full integration of the processes underlying these two parts – "non-discretionary" or ongoing recurrent expenditures and "discretionary" or capital and new recurrent expenditures.

- ***Policy Based Budgeting***

12. **Policy based budgeting has been a weak feature of Indonesia's PFM system, despite the existence of a national planning system and tentative moves to performance based budgeting and an MTEF**. The budget dialogue, both within the executive branch and with the Parliament remains largely on inputs. However, there has been a greater focus on policy issues in the 2008 budget, as reflected in some significant reallocation of resources, based on more clearly articulated priorities in the government work plan (RKP) and through greater top-down political involvement in the budget.

13. Indonesia has long had a system of national planning administered by the national planning agency Bappenas. In principle this should provide some focus in the budget on policy and prioritization issues, and good analytical resources appear to be available within Bappenas. In practice the planning mechanism focuses on investment expenditures and new recurrent expenditure initiatives, and the link between the plan and the budget needs strengthening. However Bappenas is moving to strengthen its expenditure analysis and prioritization role through the establishment of a new evaluation directorate.

14. **Through Law 17/2003 on State Finances Indonesia has signaled a move to performance based budgeting and an MTEF. However, progress has been slow**. In principle the government wide work program (RKP) developed by Bappenas and issued as a Presidential decree in May preceding the fiscal year is intended to guide the determination of expenditure priorities, through the work plans required to be developed by each line ministry. However the link between them and any articulated government policies appears to be weak. In 2006 budget the government identified seven expenditure priority areas but again the link into the budget process has not been clear. On the other hand, several indicator scores (PI 22. PI 24, PI 25) suggest weaknesses that affect the integrity of fiscal data, which would have a bearing on the sequencing of performance budgeting reforms.

15. Under the move to performance budgeting ministries are required to develop output measures, and under the MTEF approach ministries can be expected to develop medium-term sectoral plans. However it is unclear what use is to be made of the performance indicators in expenditure allocation decisions and progress in developing costed ministry or sectoral plans has been slow. There is also a need for a revised and consistent program structure before performance budgeting and MTEF can proceed on a sound basis. Bappenas is now beginning this revision with a view to implementing it for the 2010-14 national plan and thus being available for the 2010 budget.

16. **The budget process is governed by a detailed calendar set out in Law 17/2003 on State Finances** The law provides authority to the President to exercise national fiscal management (Art 6), and delegates several responsibilities to the Minister of Finance. However the calendar does not specify the nature or timing of Cabinet involvement, although this occurs.

- ***Predictability and Control in Budget Execution***

17. **Revenue administration in major taxes is of generally good quality and useful reforms have recently been initiated.** There is a comprehensive legal framework for major taxes, good provision of information to taxpayers, an appeals system and a well functioning collections system. However there is a need to lessen the discretion of tax officials, to improve the taxpayer registration system, tax auditing and the reliability of data on tax assessment, collection and arrears.

18. **The provision of budgetary authority to line ministries through the Budget Execution Document (DIPA) at the beginning of the financial year, in principle provides for orderly and predictable funding for line ministries.** However, some DIPAs are withheld for up to a few months if the relevant parliamentary commission has not completed its budgetary review by the beginning of the fiscal year, or if line ministries have not re-appointed the staff in spending units (Satkers), who have authority in the implementation of the budget. Implementation of the budget is largely under the control of each line ministry. Payments are made by the government Treasury under Ministry of Finance (KPPN) based on payment orders submitted by line ministries, who are now accountable for ensuring validity and regularity of these payments and maintaining underlying internal controls. Payments in excess of the budget appropriation are rejected by the Treasury's payments system. Although there is no formal commitment control system the budget execution documents (DIPAs) represent the limit of authority to commit expenditures as well as to make payments.

19. **Controls in budget execution processes were generally rated low and could jeopardize gains from reforms introduced in other areas of PFM.** In practice budget implementation may be significantly delayed because of the lengthy procurement process and expenditure on goods and services and capital expenditures tends to be heavily bunched towards the end of the fiscal year. To a significant extent this is a matter of line ministries improving their internal management. However the lapse of all budget authority at the end of the fiscal year creates difficulties in the making of payments for longer-term projects. Capital expenditure allocations are frequently under-spent and on average about 50 percent of capital expenditures occur in the last quarter of the year. Improving the disbursement rate for investment projects is a key PFM challenge.

20. While there are detailed regulations prescribing the procedures for the payment of salary and non-salary expenditures, these are paper-intensive and inefficient. Based on findings of both the external auditor and internal auditors (IGs), there is significant non compliance with the regulations. Internal audit exists in all ministries but generally lacks capacity to carry out modern systems and risk based auditing. There are several internal audit institutions in the country, such as BPKP which reports to the President, Inspector Generals at MDAs and internal audit agencies at regional levels. However there are overlaps in mandates between some of them that reduce their effectiveness. The role of the former internal audit agency Financial and Development Supervisory Board (BPKP), which reports to the President and has some 5,500 audit staff, is currently under review. At present it provides internal audit services only in response to specific requests.

- ***Accounting, Recording and Reporting***

21. **There is no government wide Government Financial Management Information System (GFMIS) which provides information for budget management at all levels of national government.** Reforms have seen the streamlining of the payments processes with authority for approving payments delegated to line ministries. Current reforms are focused on the development of a system to support the Treasury Single Account, to strengthen cash management and transparency. Financial reports are prepared on a timely basis: MOF prepares a first semester (six months) report on budget execution which is provided to Parliament in unaudited form in August, and the annual financial statements which Parliament receives in audited form within six months of the end of the fiscal year. Individual spending units and their line ministries maintain their own budget realization reports for budget management and prepare their own financial statements for submission to MOF. However, scores indicate the need to further improve reliability of financial information across government, including spending agencies.

22. **Government accounting standards have been formally established and are being adhered to in several respects to produce comprehensive annual financial statements**. These Government accounting standards allow for a transition from cash to accruals basis of accounting, under which the government balance sheet is prepared on a modified accrual basis whereas the budget and the budget realization reports continue to be on a cash basis. Reconciling these two reports remains a challenge. Indonesia has committed itself to move to an accrual basis for accounting recognition of revenues and expenditures by 2008. However, this is unlikely to be achieved soon given current capacity constraints. Further, there are significant challenges in ensuring reliability of financial statements through consistent application of prescribed accounting standards and procedures. The annual financial statements have received a disclaimer audit opinion from the external auditor (BPK) due to this and to other deficiencies. Improvement in the aggregate financial statements to a position where they can receive an unqualified audit opinion is a matter of priority.

- ***External Scrutiny and Audit***

23. **Under the Constitution Parliament has a major role in the management and overview of the public finances**. It has full authority to make any changes to the proposed revenues and expenditures contained in the draft budget submitted to it. Its involvement in reviewing and approving the budget, through a network of budget commissions, is lengthy and detailed, involving not only a review of fiscal policy but also ministry work plans and details of revenues and expenditures of the level of individual spending units or Satkers, of which there are some 20,000. This detailed level of review appears excessive and uses large amounts of civil servants' time to little benefit in terms of either aggregate fiscal discipline or expenditure prioritization.

24. **Parliament also has extensive powers of ex post review of public finances, based on reports from the external auditor BPK**. In practice it shows limited interest in this follow up work. There is some review of BPK reports on line ministry's follow up of audit recommendations but there is no systematic reporting by commissions or Parliament as a whole on their conclusions from follow up work. The external auditor (BPK) has recently proposed to Parliament that it set up a separate Public Accounts Committee to carry out this ex post review work.

25. **The external audit organization BPK has in the past been significantly under-resourced, as well as lacking staff capacity, but has made some progress in recent years**. Recent laws have granted it independence from the executive in its funding and the appointment of

its board. It has recently received significant increases in funding to enable it to increase staff numbers and capacity and the number of regional offices. BPK has access to most government entities for purposes of audit, though in practice some restrictions apply in auditing government revenues. Modern auditing standards have recently been developed to guide audit methods and reports.

- ***Donor Practices***

26. **Indonesia is not a heavily aid-dependant country, with donor funds accounting for about 8% of primary government expenditure in 2006.** There is good predictability in budget support, though actual in-year disbursements are affected by delays in government meeting performance targets. It is estimated that just over 60% of aid disbursements from major donors rely upon country fiduciary systems, suggesting that there is considerable room for greater use of country systems. However the difficulty in determining this figure reflects the fact that the requirement of Government Regulation 2/2006 that all donor projects be reported in government financial reports is not fully observed in practice. That said, the five largest donors provide the government with comprehensive and accurate work plans in a timely manner and consistent with the budgetary cycle.

### (ii) Assessment of the Impact of PFM weaknesses

- ***Aggregate Fiscal Discipline***

27. **Indonesia has a strong record of aggregate fiscal discipline as reflected in low budget deficits** (less than 3 percent of GDP in every year since 1999) and a relatively low level of public debt (now less than 40 percent of GDP). As discussed in the 2007 Public Expenditure Review (PER) [3] its public finances are in a strong position, creating significant fiscal space for needed expenditures on infrastructure and other pro-poor spending.

28. **The PFM weaknesses identified in the discussion above do not currently work against this objective**. The past lack of realism in the budget reflected a conservative approach to budget revenue assumptions and overruns in the budget balance have not been significant. The extensive powers that Parliament has over the budget could lead to the passing of budgets which lack credibility, with revenue estimates inflated in order to justify higher expenditures, but in practice this has not happened. Indonesia has by law set fiscal targets for general government (i.e. including SNG) of a budget deficit of no more than 3 percent of GDP and net public debt of no more than 60 percent of GDP, and these targets are adhered to, despite the difficulty of monitoring this because of lack of timely general government financial statements during the year. However, if certain key fiscal assumptions turn adverse in the future, aggregate fiscal discipline could be jeopardized in the absence of all the right tools of budget management. Weaknesses in internal controls during budget execution and problems of data reliability in budget execution reports could in principle create some problems of control at the item level, but have less impact on fiscal data at the aggregate level.

29. **The monitoring of fiscal risks is being developed, thereby reducing threats to aggregate fiscal discipline**, as reflected in the past by the need for government funds for the rescue or restructuring of some state banks. Although a Fiscal Risk unit has recently been

[3] Spending for Development, Making the Most of Indonesia's New Opportunities, 2007

established in the Fiscal Policy Office of MOF charged with this role, lack of timely and regular audited financial statements from many of the state owned enterprises and from sub national government (SNG) increases the risk to aggregate fiscal discipline. Likewise the lack of a fully operational MTEF, with articulated medium term fiscal targets and detailed indicative revenue and expenditure figures at the MDA and program level may create some risk to medium-term aggregate fiscal discipline.

- ***Strategic Allocation of Resources***

30. **The weaknesses discussed above compromise good strategic allocation of resources**. However some significant reallocation of funds is proposed in the 2008 draft budget based on clearer priorities articulated by the government in the government work plan (RKP) and analysis of existing programs in terms of these priorities – although this has been carried out more through an ad hoc top down decision making process rather than through any systematic use of information in the budget system.

31. **The limited progress in the performance based budgeting and MTEF reforms are limiting moves to better prioritization of resources**. Although there appears now to be good collaboration between Bappenas and MOF in the development of the budget the budget system still lacks a holistic approach to expenditure analysis, with development expenditures reviewed mainly by Bappenas being regarded as discretionary expenditures, and recurrent expenditures as non-discretionary, with thus little attention to possible reallocation or prioritization.

- ***Efficient Service Delivery***

*32.* **The budget execution processes within line ministries appears to be a significant barrier to efficient service delivery.** Procurement processes lead to significant delays in the acquisition of goods and services and the implementation of capital projects. Capital expenditure appropriations are frequently under-spent. The limited flexibility to allocate resources during the year may also compromise efficient service delivery by limiting the ability to respond to changing needs or changing program performance. However it should be noted that much service delivery, for example in education and health is primarily the responsibility of SNG rather than central government.

**(iii) PROSPECTS FOR REFORM PLANNING AND IMPLEMENTATION**

33. **An important factor that has supported PFM reforms is the issue in November 2001 by MOF of a government endorsed White Paper on PFM reform in Indonesia**.[4] PFM reforms in Indonesia thus reflect the government's own reform plan. The White Paper set out the need for a new legal framework to replace the outdated legislative framework. New draft laws on State Finance, State Treasury and Audit were eventually passed in 2003-2004. The White Paper also identified the need for a institutional reorganization within MOF, a unified budget, an updated budget classification system, a move to performance based budgeting, a Treasury Single account to improve cash management, streamlining of payments processes, improving budget documentation and reporting and rationalizing and improving the auditing function, both external and internal.

[4] Ministry of Finance, Financial Management Reform Committee, White Paper on Reform of Public Financial Management System in Indonesia: Principles and Strategy, November 30, 2001 .

32. **The current institutional arrangements for PFM reform need to be strengthened by a clearer reform strategy or roadmap.** This should take into account new priorities, sequencing of the various components and developing greater understanding by key stakeholders, in particular line ministries, of the objectives and direction of the reforms. The reform agenda is led by MOF which has established a budget reform unit within DG Budget, focusing on performance based budgeting and MTEF. DG Treasury is developing the Treasury Single Account

34. **There appears to be good collaboration on an operational level between MOF and Bappenas**. However there appears to be limited engagement with line ministries at this stage, and overall a lack of 'socialization' of the reforms throughout the government. A Financial Management Reform Committee (FMRC) established in November 2001 to oversee and coordinate PFM reforms is no longer operational. The March 2007 joint Bank/IMF Report identified the need for a steering committee on budget reform, representing both MOF and Bappenas, to draft an overall reform agenda and implementation plan. It also developed an indicative sequence of reforms as a possible future road map. Among the 5 working groups it suggested should be established was one focusing specifically on outreach and socialization and another on capacity development. Neither of these issues has been addressed in the reform approach to date.

35. **Various donors, namely World Bank, International Monetary Fund (IMF), Asian Development Bank (ADB) and Australian Aid Agency (AUSAID), have been involved in providing technical assistance on PFM issues.** The Bank has been providing PFM technical assistance through the Government Financial Management and Revenue Administration Project (GFMRAP) to a variety of areas including the computerization of the central government accounting and payment system and support of budget reforms including performance based budgeting and MTEF, revenue administration, the FPO, the MOF Inspector-General, Bappenas and the Parliament. The IMF has been providing ongoing technical assistance on the Treasury Single Account, and currently has a peripatetic advisor in place. ADB has provided technical assistance in the audit function, covering both external and internal audit. AUSAID or departments of the Government of Australia have provided or are intending to provide assistance on a range of issues including debt management, performance based budgeting and MTEF. Canadian International Development Agency (CIDA) has also funded technical advice on performance budgeting and MTEF. The Initiative for Public Expenditure Analysis (IPEA) which is managed by the World Bank with multi-donor funding, has sought to raise awareness and skills among government officials on expenditure analysis issues through an ongoing program of workshops and training courses.

36. **By way of next steps, MOF has thus received different advice from a range of sources**. The government would benefit from taking a stronger lead in coordinating the technical assistance offered by different donors to ensure consistency of messages.

Table 1 - **Performance Indicators Summary**

NS = Not Scored

| PFM Performance Indicator | | Scoring Method[5] | Dimension Ratings[6] | | | | Overall Rating | Page |
|---|---|---|---|---|---|---|---|---|
| | | | i. | ii. | iii | iv | | |
| **A. PFM-OUT-TURNS: Credibility of the budget** | | | | | | | | |
| PI-1 | Aggregate expenditure out-turn compared to original approved budget | M1 | D | | | | **D** | Page 24 |
| PI-2 | Composition of expenditure out-turn compared to original approved budget | M1 | C | | | | **C** | Page 25 |
| PI-3 | Aggregate revenue out-turn compared to original approved budget | M1 | A | | | | **A** | Page 27 |
| PI-4 | Stock and monitoring of expenditure payment arrears | M1 | A | B | | | **B+** | Page 28 |
| | **B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency** | | | | | | | |
| PI-5 | Classification of the budget | M1 | A | | | | **A** | Page 28 |
| PI-6 | Comprehensiveness of information included in budget documentation | M1 | A | | | | **A** | Page 29 |
| PI-7 | Extent of unreported government operations | M1 | NS | C | | | **NS** | Page 30 |
| PI-8 | Transparency of inter-governmental fiscal relations | M2 | A | C | D | | **C+** | Page 31 |
| PI-9 | Oversight of aggregate fiscal risk from other public sector entities | M1 | C | D | | | **D** | Page 34 |
| PI-10 | Public access to key fiscal information | M1 | B | | | | **B** | Page 35 |
| | **C. BUDGET CYCLE** | | | | | | | |
| | **C(i) Policy-Based Budgeting** | | | | | | | |
| PI-11 | Orderliness and participation in the annual budget process | M2 | A | A | A | | **A** | Page 36 |
| PI-12 | Multi-year perspective in fiscal planning, expenditure policy and budgeting | M2 | C | D | C | D | **D+** | Page 37 |
| | **C(ii) Predictability and Control in Budget Execution** | | | | | | | |
| PI-13 | Transparency of taxpayer obligations and liabilities | M2 | C | B | B | | **B** | Page 39 |
| PI-14 | Effectiveness of measures for taxpayer registration and | M2 | C | C | C | | **C** | Page |

[5] Scoring method M1 is used for indicators where poor performance on one dimension of the indicator is likely to undermine the impact of good performance of other dimensions of the same indicator. Scoring method M2 is used where a low score on one dimension of the indicator does not necessary undermine the impact of a high score on another dimension of the same indicator.

[6] Each indicator includes one or more dimensions. A separate score is given for each dimension. Where there is more than one dimension, the overall score for the indicator is arrived at by combining the dimension ratings according to the prescribed methodology (M1 or M2) for the indicator.

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | tax assessment | | | | | | | 40 |
| PI-15 | Effectiveness in collection of tax payments | M1 | C | A | D | | **D+** | Page 41 |
| PI-16 | Predictability in the availability of funds for commitment of expenditures | M1 | C | A | A | | **C+** | Page 42 |
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## SECTION 1. INTRODUCTION

37. **This Public Expenditure and Financial Accountability (PEFA) assessment for Indonesia was undertaken by a team of World Bank staff and national and international consultants, with close involvement of counterparts from the Government of Indonesia**, including the Ministry of Finance, Ministry of Planning (Bappenas) and some line Ministries.[7] Discussions were also held with external audit agency (BPK) and a Member of Parliament. In line with its stated objectives, this PFM Performance Report has utilized the *Public Expenditure and Financial Accountability* (PEFA)[8] measurement framework to establish a baseline of indicators to help measure Indonesia's performance in Public Financial Management (PFM).

38. **This performance report can be used by the Government as well as other stakeholders to monitor progress and effectiveness of the ongoing PFM reform program.** It could also be used to expand and refine this program. The objective of the assessment is to prepare an integrated, standardized, indicator-led assessment of PFM systems, processes and institutions as a whole against best international practices.

39. **The government has collaborated extensively by providing necessary information and assigning MOF staff to work alongside the Bank-led team**. This PEFA assessment has been funded by the Bank and a multi-donor trust fund, supported by contributions from the European Union and the Netherlands. It also has the full support of the IMF. An orientation seminar was held in Jakarta in May 2007 for stakeholders to explain the objectives, concepts and methodology underlying the PEFA framework and to discuss a Concept Note for its application in Indonesia. This seminar was held jointly with MOF and included participants from MOF, Bappenas, selected line ministries and the donor community. A separate detailed briefing was also held in May 2007 for a larger group of donors. Upon receiving formal confirmation from Government of their interest in this exercise in July 2007, extensive fieldwork was undertaken during August and September 2007, involving Bank staff and a team of consultants assigned full time for discussions with relevant staff at the Ministries[9], the Supreme Audit Board and a Member of Parliament. Discussions were also held with donor partners and some external stakeholders, including professional firms and the Indonesian Chamber of Commerce[10]. The draft scores and assessment were discussed with a core team of officers from MOF at a workshop in Jakarta in August 2007 and again in September 2007, in which Bank staff and consultants participated. Both the indicator assessment and the draft performance report were discussed with a group of senior MOF officials at a closing workshop in October 2007 before finalization. The report has also been peer reviewed by the PEFA Secretariat, Bank staff and staff from IMF and ADB.

40. **This report has been prepared on the basis of PFM practices demonstrated and observable at the time of the assessment**. Several on-going and wide ranging PFM reforms that are in various stages of implementation during this assessment were taken into consideration to the extent possible for purposes of the performance assessment. Extensive discussions were held with government stakeholders to determine the score for each indicator. A large amount of documentary

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[7] Discussions were held with Ministry of Finance, Ministry of Planning, ministry of Public Works, Ministry of Health and Ministry of Education.
[8] For more information on this framework, please visit www.pefa.org
[9] Discussions were held with Ministry of Finance, Ministry of Planning, Ministry of Public Works, Ministry of Health and Ministry of Education.
[10] Please see Annex A for a detailed list of Sources of Information and Main References.

evidence was provided by the Government. The team also made use of analytical work done by donor partners and in some cases, additional evidence was sought from external sources to corroborate the findings.

41. **The extensive PFM analytical studies for Indonesia that have been prepared by the IMF, ADB and the Bank since 2003 were also used as sources of information**. The most recent reports include the joint World Bank/IMF report "Indonesia: Budget Reform Strategy Priorities" of March 2007, the IMF study "Indonesia, Statement of Fiscal Risks" of February 2007 and the IMF's fiscal transparency study "Report on the Observance of Standards and Codes (ROSC), Fiscal Transparency Module", of July 2006. The Bank's 2007 Public Expenditure Review prepared in collaboration with the government, has also provided important information, particularly on issues of expenditure allocation. In addition IMF PFM mission reports of 2003 and 2004 also provide valuable information. Recent Bank-funded consultancy reports on performance based budgeting, MTEF and budget virement have also been referred to. Reference to analytical reports has been supplemented by Indonesia laws and other documents and discussions with key officials as set out in Annex B.[11]

42. **The scope of this assessment is confined to the Central Government**, comprising Ministries, Departments and Agencies (MDAs) although sub national governments (SNGs) have assumed greater importance in the PFM system following the substantial decentralization program since 2001[12]. Some performance indicators score only some aspects of decentralization - such as PI 8 ('Framework for inter government fiscal relations'); PI 9 ('Fiscal risks arising from sub national governments'); and PI 23 ('Availability of information on resources at front line service delivery units'), though this would not be a substitute for a more comprehensive measurement of PFM processes at local governments.

*43.* **Apart from central government ministries and their departments there are also a number of central government autonomous government agencies** (AGAs or Badan's) such as the Aceh Reconstruction Agency (BRR); institutions (Lembaga and Komisi) such as The Constitution Court, State Intelligence Bureau and National Archives; and public service agencies ("Badan Layanan Umum") such as hospitals. All of these agencies (AGAs) are funded through the national budget, but enjoy greater financial autonomy than line ministries. They account for a relatively small but unknown share of public expenditure.

44. Indonesia also has a large state owned enterprise (SOE) sector, spread over 37 business sectors, varying in size from large monopolies and infrastructure enterprises to relatively small service companies. The largest SOEs are Pertamina (the state oil company), PLN (electricity), Garuda Indonesia Airways and Bank Mandiri. As they are owned by the central government their financial accountability and relationship with the budget, including monitoring of any fiscal risks to central government arising from their operations, are part of this PFM assessment.

[11] Annex A sets out documents used in support of the scoring of each indicator.

[12] Sub national governments currently account for some 40 percent of total public expenditure. (Indonesia Public Expenditure Review 2007).

**Table 2: Entities included as MDAs**

| Institutions | Number of Entities |
|---|---|
| Central Government * | 74 |
| State-owned enterprises (majority owned by government) | 139 |
| Other State owned enterprises (minority share) | 21 |
| Local and Provincial Governments | 473 |

## SECTION 2. COUNTRY BACKGROUND INFORMATION

### 2.1 Country Economic Situation

45. **Ten years after the Asian financial crisis Indonesia has resumed sustained economic growth**. Prudent fiscal and macroeconomic policies, particularly low budget deficits have been instrumental in this recovery. This is despite several shocks in the past three years, including repeated natural disasters and various terrorist strikes. Since 1999 successive democratically elected governments have moved forward on broad structural and institutional reforms, including rapid decentralization and moves to reform governance and address endemic corruption.

46. **In the past few years the economy has grown steadily – GDP growth was 5.1% in 2004 and is estimated at 6% for 2007.** Approximately 18% of the population lives below the poverty line but Indonesia appears on track to achieve a targeted reduction of the poverty rate to 7.5 percent by 2015. However there are substantial regional differences in both economic growth and poverty levels.

**Table 3: Macro-Economic Trends**

| | | 2004 | 2005 | 2006 |
|---|---|---|---|---|
| GDP in current prices (Rp Trillion.) | | 2296 | 2785 | 3338 |
| Real GDP Growth % p.a. | | 5.1 | 5.6 | 5.5 |
| Inflation % p.a. (Annual Avge. CPI) | | 6.4 | 17.1 | 6.6 |
| External Debt % GDP | | 52 | 45 | 33 |
| Exchange Rate Rp / US$ | | 8978 | 9751 | 9141 |

*Source: Annual Financial Statement LKPP 2006*

47. **The reduction in 2005 of fuel subsidies initially led to a spike in inflation, but helped create fiscal space of approximately USD 10 billion for greater pro-poor expenditures in 2008**. An additional USD5 billion annually is now available due to increasing revenues and declining debt service expenditures.

48. **The 2007 PER identifies the need for improved access to clean water, electricity and health care and to reduce regional disparities in service delivery, much of which involves greater expenditure on various types of infrastructure**. Public investment as a share of GDP has returned to pre-crisis levels with sub-national governments emerging as key drivers of investment expenditures**.**

49. **The central government's debt situation has improved significantly, as reflected in stock and flow indicators**. Sub-national government debt is negligible. Macroeconomic stability and fiscal consolidation have been the underlying reasons for this improvement along with better

debt management by the central government. Although the 2005 increase in domestic fuel prices freed up US$10 billion from subsidies, Indonesia still spends US$9 billion annually on subsidies, mainly on fuel and electricity**.** Several factors have prevented the government from taking full advantage of higher oil prices; oil production volume has steadily declined over the past 10 years (by 40 percent) and spending capacity has proven to be more limited than expected. Finally, the electricity subsidy—a regressive transfer—has constituted a rising financial burden on the budget.

## 2.2. Budgetary Outcomes[13]

50. Robust economic performance and sound fiscal management have put Indonesia in a strong fiscal position. The central government expenditure/GDP ratio has been stable at 20% over the past few years, which is medium to low for a country of its per capita income. The revenue to GDP ratio is only slightly lower and as a consequence Indonesia has sustained low deficits in the range of 1 percent of GDP witnessing the government's disciplined fiscal management. This together with strong economic growth reduced Indonesia's debt stock to GDP from 80 percent in 2000 to 37 percent in mid 2007. The overall budget deficit is projected to widen to 1.6 percent of GDP in 2007 mainly due to large, one-off settlements of arrears in VAT refunds (in the range of IDR 10 Trillion or 0.5 percent of GDP) and increased spending on infrastructure. In support of better economic growth the government continues moderately expansive fiscal policies in the outlook for 2008 with a projected deficit of 1.7 percent of GDP. The deficit is primarily financed by domestic sources, with government bonds accounting for an increasing portion. While the government continues to borrow internationally to meet its gross financing needs, international net financing over the past few years has consistently been negative (higher principal repayments offset new debt) reflecting a government effort to reduce external vulnerabilities and exchange rate risk.

**Table 4. Overall Budgetary Trends** *(2004-2007)*

| | 2004 (Actual) | | 2005 (Actual) | | 2006 (Actual) | | 2007 (Mid Year Revision) | |
|---|---|---|---|---|---|---|---|---|
| | IDR Trillion | % GDP | IDR Trillion | % GDP | IDR Trillion | % GDP | IDR Trillion | % GDP |
| **Total Revenues and Grants** | **400.6** | **17.6%** | **495.4** | **18.2%** | **659.1** | **21.1%** | **684.5** | **18.0%** |
| *Own Revenue* | *400.3* | *17.6%* | *494.2* | *18.1%* | *654.9* | *21.0%* | *681.8* | *17.9%* |
| *Grants* | *0.3* | *0.0%* | *1.3* | *0.0%* | *4.2* | *0.1%* | *2.7* | *0.1%* |
| **Total Expenditure** | **424.0** | **18.7%** | **508.9** | **18.6%** | **699.1** | **22.4%** | **746.4** | **19.6%** |
| *Primary Expenditure* | *361.5* | *15.9%* | *451.1* | *16.5%* | *616.6* | *19.8%* | *660.1* | *17.4%* |
| *Interest Expenditure* | *62.5* | *2.7%* | *57.9* | *2.1%* | *82.5* | *2.6%* | *86.3* | *2.3%* |
| **Primary Balance** | **39.1** | **1.7%** | **44.4** | **1.6%** | **42.5** | **1.4%** | **24.3** | **0.6%** |
| **Deficit** | **(23.4)** | **-1.0%** | **(13.5)** | **-0.5%** | **(40.0)** | **-1.3%** | **(62.0)** | **-1.6%** |
| **Net Financing** | **20.4** | **0.9%** | **19.0** | **0.7%** | **40.0** | **1.3%** | **62.0** | **1.6%** |
| *Domestic Net Financing* | *48.9* | *2.1%* | *30.3* | *1.1%* | *55.3* | *1.8%* | *74.6* | *2.0%* |
| *Foreign Net Financing* | *(28.5)* | *-1.3%* | *(11.3)* | *-0.4%* | *(15.3)* | *-0.5%* | *(12.6)* | *-0.3%* |

***Source:*** MOF. World Bank Staff Calculations. Amounts at current prices.

51. Central government revenues derive largely from tax revenue which account for about 85 percent of total revenues with the remaining 15 percent coming from non-tax revenue, primarily

[13] Data and analysis includes information obtained from the Public Expenditure Review 2007 (World Bank)

royalties from natural resources. Indonesia's tax system is based on consumption (VAT) and income taxes (corporate and individual) which make up 51% and 29% of tax revenues respectively. A statutory VAT at a 10% rate extends through the retail stage and corporate and individual income taxes have maximum marginal rates of 30% and 35% respectively. Tax revenues have been increasing and a revenue generation program with nation-wide campaigns to register additional taxpayers, measures to extend audit coverage and activities to increase arrears collection has yielded additional revenues of about 0.5% of GDP per year. Nevertheless, the tax bases remain narrow as the numbers of individual and corporate tax payers are still relatively limited. Indonesia's dependence on oil and gas revenues has been gradually reduced. However, while non-oil & gas revenues increased from 11% of GDP in 2004 to a projected 12.5 of GDP in 2007, roughly one third of state revenues (equal to 5.5% of GDP) are still derived from oil and gas tax and non-tax revenues.

**Table 5. Government Expenditures by Economic Classification**
(Percent of Total Expenditures)

| | 2004 (Actual) | 2005 (Actual) | 2006 (Actual) | 2007 (Mid year Revision) |
|---|---|---|---|---|
| Transfer to Regions | 30.7% | 29.9% | 31.6% | 33.8% |
| Subsidies | 21.6% | 23.8% | 15.4% | 14.1% |
| Interest Payments | 14.7% | 11.4% | 11.8% | 11.6% |
| Personnel | 11.6% | 11.0% | 11.3% | 13.4% |
| Material | 3.8% | 6.0% | 8.0% | 8.4% |
| Social Assistance | | 5.3% | 5.9% | 6.4% |
| Capital | | 6.7% | 10.0% | 9.2% |
| Other | 17.6% | 6.0% | 6.0% | 3.2% |

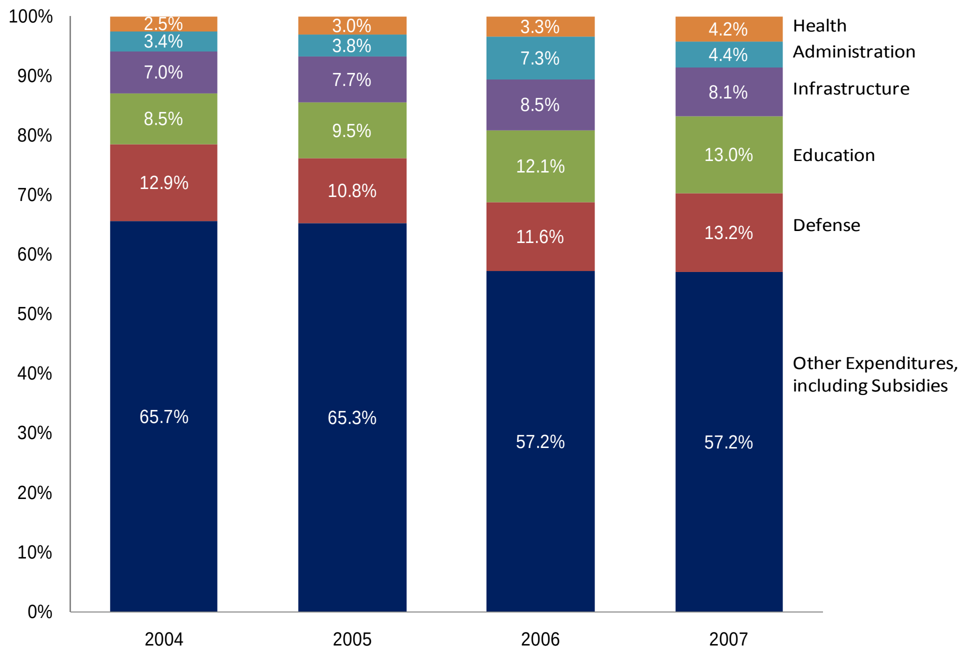
***Source:*** Ministry of Finance.
***Note:*** 2004 follows previous non-GFS consistent classification. Capital expenditures and social assistance spending were not classified separately.

52. There have been structural changes on the expenditure side. Primary expenditures had contracted as a result of the financial crisis in 1997/98 causing under-investment particularly in infrastructure. Interest payments soared to roughly one quarter of total expenditures in the post crisis years (1999-2003) but are now down to around 11 percent. At the same time the sweeping decentralization reforms in 2001 substantially increased the size of intergovernmental transfers. Today, transfers to the regions are the largest expenditure item absorbing one third of total government expenditures, followed by spending on subsidies, personnel expenditures and interest payments.

53. With primary expenditures as share of total expenditures up to pre-crisis levels Indonesia now faces the challenge of steering public investment towards sectors that support sustained medium term growth and the social development objectives of the government. Weak infrastructure and inadequate human resources are consistently mentioned in business surveys as key constraints to more private investment. In response Indonesia has been increasing spending on public services and capital expenditures, financed primarily through savings from fuel subsidies, debt servicing and targeted allocation of revenue increments. The reduction in fuel subsidies in 2005 put the government in a position to allocate increased resources to priorities such as basic

human services, infrastructure development and health. Education spending in particular has increased steadily since 2004. The budgets for 2007 and 2008 expand public investment and infrastructure spending in vital areas of economic infrastructure - roads, bridges and irrigation systems. At the same time, the civil service wage bill is rising and is now the third largest expenditure item of the central government at 13½ % of total public spending. Spending on poorly targeted regressive subsidies remains high, and this will continue if oil prices stay at current levels.

**Table 6 Central Government Primary Expenditures by Function**
*(Percent of Primary Expenditures)*




***Source:*** Ministry of Finance. World Bank staff estimates.

## 2.3. Legal and Institutional Framework for PFM

54. **Following the financial crisis and political turmoil in 1997/98 Indonesia went through a decade of sweeping reforms that fundamentally altered the environment in which fiscal decisions are made.** The emergence of democratic institutions made the allocation of public resources subject to increased electoral contestability and competition, while at the same time empowering the Parliament to scrutinize and approve the state budget and to hold the executive accountable. The far-reaching decentralization policies, which transferred the responsibilities and fiscal resources for key state functions to sub-national governments, were supported by new laws. Sub-national governments now account for about 40 percent of total public expenditures, compared with 17 percent a decade ago. Their budgets are approved by and the local executives are accountable to locally elected parliaments and must adhere to centrally enacted PFM laws.

55. **The 1945 Constitution, which includes amendments enacted during 1999-2002, contains basic provisions on public finance, specifying the role of the President to propose the budget and its consideration by Parliament. A mandate for external auditing has been assigned to BPK over all public finance**. The government introduced a new legal framework for its PFM reforms in 2001 which was approved by the Parliament during 2003 and 2004, namely :

- State Finances Law 17/2003 which provides for the unification of the previous separate "routine" and "development" budgets, the use of a macro-economic framework in developing the budget, GFS consistent classification system, and performance based budgeting. It also sets out the role of the Minister of Finance, the procedures for the preparation and adoption of the State budget, the financial relationship between central government and other organs of central government and SNG, and a requirement for annual audited financial statements to be submitted by the President to Parliament.
- State Treasury Law 1/2004 which provides for a Treasury Single Account through centralizing cash management in MOF, and more generally for streamlining budget execution, improving reporting on budget execution and improving government financial reporting through the implementation of government accounting standards, based initially on modified accrual accounting but moving to full accrual accounting by 2009.
- State Audit Law 15/2004 which provides the operational framework of the external audit institution BPK, to establish it as a professional and independent institution required to submit its reports to Parliament. Additionally, Law 15/2006 was adopted to replace the internal governance arrangements for BPK that had been established in Law 5/1973.
- State Development Planning Law 25/2004 which provides the legal basis for the national development planning process, the role of Bappenas and the preparation and approval of annual, 5 year and 20 year national development plans.

Each of these laws is required to be supported by detailed implementing regulations, many of which have been completed and adopted.

56. **Prime responsibility for the management of the public finances rests with the Ministry of Finance.** The Ministry was extensively reorganized in 2003 to change the previous duplicative and unclear organizational structure. This saw the creation of separate directorates for budget development (DG Budget) and budget execution, cash management and accounting (DG Treasury). In addition the DG Fiscal Balance is responsible for inter-government fiscal transfers. Responsibility for the development of the macro-economic framework of the budget now also clearly rests in the Fiscal Policy Office (FPO) within MOF. FPO was established in 2006, at the same time as a new DG Debt Management was created to consolidate the management of both domestic and external debt.

57. **The state planning agency Bappenas also has a major role in the budget**. Previously it was responsible for the preparation and implementation of the development budget. It is now responsible for the development of the annual, five year and 20 year plans which articulate the priorities of the President and for reviewing the annual work plans prepared by line ministries. The latter task involves it in the budget process as work plans are intended to be the basis for the development of expenditure estimates. In practice Bappenas continues to take the lead role in the development of the "discretionary" element of budget expenditures and on expenditure prioritization generally and has responsibility for the program structures in the budget, given that these apply mainly/only to discretionary expenditures. It also has input into the development of the macroeconomic framework.

58. **MOF and Bappenas appear to collaborate well in the budget process**. They jointly issue the budget circular in February/March preceding the fiscal year and both review the work plans and budgets submitted by line ministries in June/July through tri-lateral discussions. In the

2008 budget preparation Bappenas took the lead in spending priorities and reallocation while MOF took the lead in the macro-fiscal framework.

59. **Line ministries are responsible and accountable for their own financial administration**. Within each line ministry spending unit or Satker, a finance unit is responsible for financial control and the approval of payments, including the payroll. Payment requests are then forwarded to DG Treasury's field offices for the payment to be made. Ministries are also required to prepare annual financial statements to be submitted to MOF. Each line ministry includes an internal audit unit (Inspector-General or IG), which reports directly to the responsible minister and is responsible for performance and financial audits.

60. In addition to line ministries, as discussed in paragraph 43 above, there are a number of autonomous government agencies (AGAs) such as universities, research institutes and training organizations. They receive greater budgetary flexibility than line ministries but in return are required to prepare and submit annual and semi-annual financial reports to DG Treasury in MOF, which is charged with the oversight of AGAs.

61. **The external audit organization BPK has a clear mandate to audit all central government organizations and the power to obtain all necessary information to do this**. It reports to Parliament mainly through a semester report (six months through the year) covering audit issues it wishes to bring to Parliament's attention, and through its audit report on the government's annual financial statements.

# SECTION 3. ASSESSMENT OF PFM SYSTEMS, PROCESSES AND INSTITUTIONS

## Section 3.1 Budget Credibility

### PI-1. Aggregate expenditure out-turn compared to original approved budget

**62.** The credibility of the approved budget is the foundation of a sound public financial management system. While some revisions to the original approved budget may be necessary and desirable, excessive use of supplementary estimates and excessive switching of budgetary provisions between items of expenditure cause difficulties in budget implementation and usually indicate a lack of budget planning and budget discipline. In the aggregate, budget outturn indicators have deviated from the originally approved budget by more than 15% in two of the observed years and by more than10% in all three observed years (Table 7). Each year has seen significant midyear revisions with substantial supplementary budget provision. Foremost, budget credibility was undermined by unrealistic oil price assumptions.

**Table 7 PI-1 Aggregate Budget Outturns FY 04-06** (in Bln. IDR)

| | **2004** | **2005** | **2006** |
|---|---|---|---|
| Budgeted Primary Expenditure | 169,286.70 | 180,519.7 | 321,111.2 |
| Actual Primary Expenditure | 218,247.08 | 271,376.4 | 355,135.8 |
| Deviation | 48,960.38 | 90,856.7 | 34,024.7 |
| Percent | 28.9% | 50.3% | 10.6% |

***Source:*** MOF. LKPP 04, 05, 06. Nota Keuangan APBN 2004 and UU 28/2003, Nota Keuangan APBN 2005 and UU 9/2004, Nota Keuangan APBN 2006 and UU 13/2005. Figures used in the calculations exclude donor funded Project expenditures.

63. The deviation was more pronounced in FY 2004 and FY 2005 with the credibility of the budget undermined by a substantial underestimation of the oil price underlying the initial budget (Table 8). The budget is highly sensitive to changes in the oil price, on both the revenue side through the oil and gas tax and non tax revenues and the expenditure side through the fuel subsidy, electricity subsidy, and general allocation grant to sub-national governments. On the expenditure side, spending on subsidies, the largest spending item in the central government budget, more than tripled in both FY04 & FY05 compared to the budgeted amount, as the government had to compensate state utilities and consumers for a growing difference between fixed domestic retail prices and increasing international market prices. In addition the Tsunami which struck Aceh in late 2004 required substantial revisions to the 2005 budget.

**Table 8** Oil Price Assumptions and Realization FY 04-06 (in USD/Bln.)

| **Oil price USD/Barrel** | | | |
|---|---|---|---|
| | Budgeted | Realized | Difference (%) |
| 2004 | 22 | 37,2 | 69,1 |
| 2005 | 24 | 51,8 | 115,8 |
| 2006 | 57 | 56,8 | 0,4 |

***Source:*** MOF. LKPP 04, 05, 06. Nota Keuangan APBN 2004 and UU 28/2003, Nota Keuangan APBN 2005 and UU 9/2004, Nota Keuangan APBN 2006 and UU 13/2005.

64. The government has underestimated oil prices primarily to manage the negative fiscal risks related to increases in oil prices.[14] Law 33/2004 requires that 27 percent of *budgeted* net revenues rather than realized net revenues have to be transferred to sub-national governments. A higher oil price assumption in the budget would thus require higher intergovernmental transfers and make the overall balance of the central government budget more sensitive to oil price changes through the year. This is partly rectified in the mid-year revised budget that is approved by Parliament each August.

65. In FY 2006 aggregate budget outturns have been substantially closer to the original budget. The revised budget for FY 2007 suggests that this trend is being sustained.[15] Following fundamental changes in the expenditure structure, namely the cut in fuel subsidies in 2005, fiscal risks arising from oil price fluctuations have declined. In addition, the oil price assumption has been at a more realistic, although still conservative, level, thereby improving aggregate outturns compared to the original approved budget.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-1 Aggregate expenditure out-turn compared to original approved budget.** [M1]<br>The difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges, but also excluding externally financed project expenditure). | D | Deviation between domestically financed actual primary expenditures and originally budgeted primary expenditures exceeded 15 % in two of the observed years.<br><br>2004- 28.9%<br>2005- 50.3%<br>2006- 10.6%<br><br>Outturn indicators have improved substantially in 2006 and 2007 suggesting a positive trend line. |

## PI-2. Composition of expenditure out-turn compared to original approved budget

66. The analysis of expenditure outturns at the disaggregated level indicates that the weak budget credibility translated into significant re-allocations between budget heads. The variance that can be attributed to re-allocation between budget heads exceeds 5% in only one of the observed years (Table 9).

[14] In 2007, for example, a US$1/bbl increase in oil prices would increase revenues by Rp.3.8 trillion (oil and gas tax revenues by Rp.0.7 trillion; non-oil and gas tax revenues by Rp.3.0 trillion and DMO (domestic market obligation) by Rp.0.1 trillion). This increase is more than offset by an increase in expenditures by Rp.4.4 trillion (fuel subsidy by Rp.2.6 trillion, electricity subsidy by Rp.0.4 trillion, revenue sharing by Rp.0.6 trillion and Intergovernmental transfers by Rp.0.8 trillion). However, as mentioned above, DAU is fixed after the budget is approved. In this regard, a US$1 dollar/bbl increase in oil prices would have a positive impact on budget balance by Rp.0.2 trillion after budget approval.

[15] In the revised budget submitted to the Parliament (DPR) in August 2007 the oil price assumption has been revised downwards from $63 to $60 a bll., meaning that in this year the revised budget is close to the original.

**Table 9** Expenditure Deviations between Original Budgeted and Actual Outturns for 20 largest Budget Heads

| | **PI-1** | | **PI-2** |
|---|---|---|---|
| Year | Total primary exp. deviation | Total primary exp. variance | Variance in excess of total deviation |
| 2004 | 28.9% | 44.6% | 15.7% |
| 2005 | 50.3% | 54.2% | 3.9% |
| 2006 | 10.6% | 11.6% | 1.0% |

***Source*: *MOF. LKPP 04, 05, 06. Nota Keuangan APBN 2004 and UU 28/2003, Nota Keuangan APBN 2005 and UU 9/2004, Nota Keuangan APBN 2006 and UU 13/2005*. Figures used in these calculations exclude donor funded Project expenditures.

67. The variances largely result from substantial overspending on subsidies triggered by the higher than assumed oil price and under-spending on other items. Given the high proportion of subsidies in central government expenditures, the overspending on subsidies accounts for roughly 75% and 79% of total primary expenditure variance in 2004 and 2005 and for roughly 50% in 2006. At the same time, a majority of the 20 largest budget heads were under-spent.[16] Most notably, actual discretionary capital and goods/services expenditures are often lower than initially budgeted caused primarily by two factors. First, under-estimation of the oil price has led to substantial mid-year budget revisions (issued in August of each year) that made implementation difficult, as only four months remained to implement a substantially revised and often increased budget. Second, under-spending reflects lack of implementation capacity within agencies, in particular limited capacity for timely completion of procurement processes.

68. The overall performance on this score is also affected by the unallocated expenditures that account for between 7-9 percent of primary expenditures. Actual spending under this item is consistently and significantly lower than initially budgeted. This line item includes the contingency fund and since allocations from the contingency fund are not reported separately, overall variances may be overstated to some extent. However it is not possible to accurately determine the extent to which this has caused any overstatement.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-2 Composition of expenditure outturn compared to original approved budget.** [M1] | C | Excess variance in budget outturn based on administrative classification of the 20 largest budget heads exceeds overall deviation in primary expenditures by 10 percentage points in one of the three observed years. |
| Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure during the last three years. | | 2004- 15.7%<br>2005- 3.9%<br>2006- 1.0%<br><br>Variance has decreased significantly in 2005 and 2006 rendering a positive trend line. |

[16] In 2004, outturns for 18 of the 20 largest budget heads was lower than budgeted, whereas in 2005 the under-spend was in 12 budget heads and 7 in 2006.

## PI-3. Aggregate revenue outturn compared to original approved budget

69. Revenue outturns were higher than initially budgeted in two of the observed years. In all three years the difference between aggregate budgeted and realized revenues was above 97%.

70. The higher than budgeted revenue outturns are due to an underestimation of the oil price in the initial budget (see PI-1 discussion for rationale for underestimation). Roughly one third of state revenue is derived from oil and gas through tax (VAT and income) and non tax sources (production sharing and royalties). As is the case in many countries rich in natural resources, actual revenue outturns are highly vulnerable to volatile international commodity prices. In such a fiscal environment, reasonably conservative oil price assumptions are prudent fiscal management. However, as can be seen under PI 1 the conscious substantial underestimation of revenue forecasts in 2004 and 2005 heavily affected the overall creditability of the budget.

**Table 10 Revenue outturn compared to budgeted revenues FY 2004-2006 (Bln IDR)**

| | 2004 | | | 2005 | | | 2006 | | |
|---|---|---|---|---|---|---|---|---|---|
| Revenue Source | Budget | Actual | Percent | Budget | Actual | Percent | Budget | Actual | Percent |
| Total Revenue | 349,934 | 400,589 | 114% | 380,377 | 495,446 | 130% | 659,115 | 637,987 | 97% |
| Income Tax | 133,968 | 118,923 | 89% | 142,193 | 175,380 | 123% | 213,698 | 208,833 | 98% |
| Non-Oil & Gas | 120,835 | 95,700 | 79% | 128,624 | 140,394 | 109% | 175,012 | 165,645 | 95% |
| Oil & Gas | 13,133 | 23,224 | 177% | 13,569 | 34,986 | 258% | 38,686 | 43,188 | 112% |
| VAT | 86,273 | 98,683 | 114% | 98,828 | 101,295 | 102% | 132,876 | 118,240 | 89% |
| Other Taxes | 43,904 | 46,444 | 106% | 46,551 | 53,975 | 116% | 60,325 | 82,130 | 136% |
| Non Tax Revenue | 77,125 | 124,576 | 162% | 81,783 | 147,317 | 180% | 229,829 | 226,950 | 99% |
| Oil and Gas | 44,002 | 85,259 | 194% | 47,121 | 103,738 | 220% | 159,789 | 158,086 | 99% |
| Other | 41,787 | 51,279 | 123% | 45,684 | 61,059 | 134% | 68,367 | 68,864 | 101% |

***Source:*** MOF. LKPP 04, 05, 06. Nota Keuangan APBN 2004 and UU 28/2003, Nota Keuangan APBN 2005 and UU 9/2004, Nota Keuangan APBN 2006 and UU 13/2005.

71. Further, a disaggregated analysis of revenue sources shows that while oil and gas tax and non tax revenues have typically been greater than the initial budget, shortfalls have occurred for major tax revenues. In particular there have been shortfalls in non oil and gas income tax and VAT in a number of years. Given the more realistic estimation of oil and gas revenues in 2006, the shortfalls in non oil income tax and VAT resulted in overall shortfall of revenues below the indicator threshold figure of 97 percent. The reasons for this underperformance in tax collection are manifold. Tax revenue targets are used as performance incentives for the tax administration and are thus purposely set at a level above the technical forecasts. At the same time, weakness in the tax administration system, e.g. tax payer registration (see PI 14 and PI 15) have limited the ability to expand tax collections, particular of income taxes. Moreover, the observed shortfall in 2006 VAT collection is partly due to a significant pay out of refund arrears that had been built up in previous years.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-3 Aggregate revenue outturn compared to original approved budget.**<br>[M 1] | A | Actual domestic revenue collection was above 97% of budgeted domestic revenue in all three observed years:<br><br>2004- 114%<br>2005- 130% |

| | | |
|---|---|---|
| Actual domestic revenue collection compared to domestic revenue estimates in the original approved budget. | | 2006- 97% |

### PI-4. Stock and monitoring of expenditure payment arrears

72. While expenditure arrears could occur in cash strapped budgetary environments, they do not appear to pose a major problem in Indonesia, where the government typically holds a positive cash position. As discussed in PI-16 the DIPA constitutes the limit of legal authority to commit expenditures and if the related regulations on budget execution are observed arrears should do not normally arise, unless there are delays by MDAs in submitting claims for payment, or in line ministries "re-certifying" the finance and procurement staff of their spending units (Satkers) at the beginning of the year.

73. The cash based government accounting system does not record expenditure arrears on a systematic basis. However, in six monthly financial reports and in the annual financial statements the accrued short term liabilities to third parties are reported by each MDA and aggregated by the Ministry of Finance. These include liabilities not yet due for payment as well as those that are overdue and could be considered as arrears for purposes of this scoring. In the absence of precise aggregate information on arrears, this figure has been used to determine the likely extent of arrears. Financial reports for the first semester of 2007 disclose accrued short term liabilities to third parties totaling Rp 3.8 Trillion (1.4% of expenditure), which had declined from Rp 11.7 Trillion (1.7%) as at 31st December 2006.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-4 Stock and monitoring of expenditure payment arrears.** [M1] | **B+** | |
| (i) Stock of expenditure arrears (as a percentage of actual total expenditure for the corresponding fiscal year and any recent change in stock | **A** | Expenditure arrears are included in accrued and unpaid payables to third parties and reported in six monthly financial statements. These are at less than 2% of expenditure for previous 2 fiscal years. |
| (ii) Availability of data for monitoring the stock of expenditure payment arrears | **B** | The cash based accounting system does not record expenditure arrears on a regular and reliable basis. Stock of liabilities to third parties, which includes arrears, is reported by MDAs and aggregated in the six monthly and annual financial statements. |

## Section 3.2 Comprehensiveness and Transparency

### PI-5. Classification of the Budget

74. According to Law 17/2003 the budget is appropriated based on organizational units, function, sub-function, program, activity and economic classification. The budget document submitted to parliament presents the budget in functional (including sub-functions), programmatic

and economic classification and all mid year and annual financial reports of the government are produced using this classification.

75. The functional classification follows a COFOG standard with the exception that religion is treated as a separate function. There are 11 functions complemented by 79 sub-functions. The economic classification system follows GFSM 2001 with five expenditure classes (capital, goods and services, interest, subsidies, civil service wages, others). Both functional and economic classification are embedded in the chart of accounts (PMK 13/PMK.06/2005).[17] Administratively, the Budget classification system also allows tracking of expenditures and revenues at the level of spending units, echelon I units and ministries and agencies.

76. Indonesia has also developed a program structure with 160 programs that are embedded in the governments five year development plan (RPJM) and annual work programs (RKP) as well as the chart of accounts. The programs are further grouped according to government priorities. In principle this system allows government to track expenditures for selected groups of expenditures, including poverty alleviation. However there is no common approach to program classification between ministries. Bappenas is beginning an exercise to revise the program structure to a more consistent basis.[18] There is currently no clear link between organizational units and the program structure, as many programs cut across ministry boundaries.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-5 Classification of the Budget.** [M1]<br><br>The classification system used for formulation, execution and reporting of the central government's budget. | **A** | Budget formulation and execution is based on administrative, economic and functional classification consistent with COFOG/GFSM2001 standards including sub-functional and programmatic classification. The classification system is fully embedded in the chart of accounts. Budget documents are consistently produced according to these standards. |

### PI-6. Comprehensiveness of information included in the budget documentation

77. Comprehensive budget documentation informs the executive, the legislative, and the general public and assists in informed budget decision making and transparency and accountability. Indonesia's budget documents comprise the annual budget law, the presidential speech and the budget document (Financial Notes) which are all submitted to Parliament. Reforms in recent years have greatly strengthened the comprehensiveness and quality of information included in the budget documents. However, information on financial assets are only reported ex post in the annual financial statements of government, and not in the budget documents. Budgetary implications of new initiatives are only covered on a selective basis. For example the 2007 financial notes broadly outline the effects of tax reform packages and cuts in tariffs on state revenues, but information on major initiatives on the expenditure side is not yet systematically reported.

[17] IMF Fiscal Transparency ROSC notes that detailed economic classification is not yet fully consistent with GFSM, though these inconsistencies were not elaborated.
[18] The problem of identifying pro-poor expenditures is also exacerbated by inappropriate definitions or use of the classification system.

**Table 11 Comprehensiveness of Budget documentation**

| | Item | Included | Source |
|---|---|---|---|
| **1** | Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate | Yes. | Financial Notes |
| **2** | Fiscal deficit, defined according to GFS or other internationally recognized standard | Yes. | Financial Notes. |
| **3** | Deficit financing, describing anticipated composition | Yes. | Financial Notes |
| **4** | Debt stock, including details at least for the beginning of the current year | Yes. | Financial Notes. |
| **5** | Financial Assets, including details at least for the beginning of the current year in a timely manner. | No. | No ex ante reporting in Financial Notes. However Financial Assets are reported in the annual financial statements. |
| **6** | Prior year's budget outturn, presented in the same format as the budget proposal | Yes. | Two previous years reported for both revenue and expenditure outturns in the Financial Notes. |
| **7** | Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal | Yes. | See item 6. |
| **8** | Summarized budget data for both revenue and expenditure according to the main heads of the classifications used, including data for the current and previous year | Yes. | See item 6. |
| **9** | Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs | No. | Some explanation of revenue measures but no systematic explanation of expenditure measures in Financial Notes |

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-6 Comprehensiveness of information included in the budget documentation.** [M1]<br><br>Share of the listed information in the budget documentation most recently issued by the central government (in order to count in the assessment, the full specification of the information benchmark must be met). | **A** | Recent budget documentation fulfills 7 of the 9 information benchmarks, as indicated in Table 5 above. Financial Notes present budget implications of new policy changes on a selective basis. |

## PI-7. Extent of unreported government operations

78. There appear to be a large number of off-budget government operations, managed by line ministries, agencies, the military and semi governmental organization, such as government endowed foundations, as well as unreported bank accounts held by MDAs as discussed under PI-17. Information on such operations is not disclosed in government financial statements or other fiscal reports, nor is any reliable data available from elsewhere on their size. Therefore no score is awarded to the first dimension of this indicator or to the overall indicator.

79. However, progress is being made in reducing the extent of unreported operations. For example, loans[19] are extended under one extra-budgetary expenditure programs, the regional development loans and investment accounts (RDI/RDA), which are revolving off-budgetary loan operations managed by the Ministry of Finance. These transactions and balance for these loans are now reported in the annual financial statements (LKPP). The projected income and outflows for RDA/RDI are also reported in the budget (2008 Financial Notes, Annex 3 p.130) and their transactions discussed by parliament. The balances for some other off-budget revolving funds managed by line ministries are also reported in the annual financial statements (LKPP). There are some items that are currently not included in fiscal reports, such as expenditures relating to the military (but not police) enterprises and the Housing Fund for civil servants. The size of these extra-budgetary activities is not known. Government has also determined, through Regulation 34/2004 that all eligible military (but not police) enterprises are to be transferred to government and thus become part of fiscal reporting.

*80.* Government regulation No. 2/2006 on Foreign Grants and Loans requires all donor projects, including donor-executed projects, to be reported in government financial reports. However, adequate reporting arrangements with donors on planned and actual expenditures reporting have not been set up. As discussed under indicator D2, while income and expenditure for all loan-funded projects and government-executed grant-funded projects are recorded in the government accounting system and reported in financial statements, most donor-executed grant-financed projects are neither recorded nor included in government financial reports. The latter include the major share of bilateral technical assistance.

| Indicator | Score | Brief explanation |
|---|---|---|
| PI-7 **Extent of unreported government operations.** [M1] | **Not scored** | |
| (i) The Level of extra-budgetary expenditure (other than donor funded projects) which is unreported, i.e. not included in fiscal reports | **Not scored** | No systematic data was available to the team to allow quantification or even to demonstrate if it is more than 10%, the threshold for a D score. |
| (ii) Income/Expenditure information on donor-funded projects which is included in fiscal reports | **C** | Complete income/expenditure data for all loan financed and government executed grant funded projects is included in fiscal reports.<br><br>Government Regulation 2/2006 sets the regulatory framework for full reporting of grant funded projects, but so far reporting on donor executed grants remains incomplete, which appear to be below 50% by value, which is the minimum threshold for a B score. |

## PI-8. Transparency of Inter-Governmental Fiscal Relations

81. Indonesia's recent move to decentralization has greatly increased the responsibilities of the 440 districts and to a lesser extent of the 33 provinces. Sub-national governments now account for about 40% of total consolidated general government expenditures. Transparent intergovernmental

[19] PEFA guideline states that loans extended under government managed credit programs are to be treated as expenditures.

fiscal relations and decentralized public financial management are critical to ensure sound macro-economic and fiscal management in this decentralized environment.

82. Law 33/2004 on intergovernmental relations sets out a transparent and rule based system for intergovernmental transfers, covering both horizontal and vertical allocation of the major transfers (at least 90% by value) from the central government. This is particularly important as government revenues remain highly centralized with only a limited sub-national tax base, with local governments, and to a lesser extent provincial governments relying heavily on transfers from the central government.

83. There are three kinds of transfers: (1) shared revenues and taxes, (2) General Allocation Grant (DAU), and (3) Specific Allocation Grant (DAK) as set out in Table 12 below. For shared revenues and taxes Law 33/2004 (Art 12-24) specifies sharing arrangements and amounts to be shared for 11 types of shared revenues and taxes. For the General Allocation Grant (DAU), which is by far the largest component of the transfer system a formula based allocation system, aimed at aligning fiscal capacity to fiscal needs of local governments has been set up by Law 33/2004 Art 27-37. The allocation for an individual district or province consists of two components, a base allocation compensating for civil service salaries and an equalizing amount to address the fiscal gap by taking into consideration fiscal capacity, and fiscal needs. Fiscal needs are estimated based on a weighted average of population size, land area, construction cost index, per capita gross regional domestic products and Human Development Index. The general structure of the formula is embedded in Law 33/2004. There are four phases to determine DAU Formulation Policy: the first phase is an academic phase "to accommodate academic analysis and opinion from selected universities"; the second one is an administrative phase "to reconcile data supplied by legal government institutions"; next is a political phase "to acquire political judgment from the Budget Committee of Parliament according to its legislative discretion; and finally the allocation phase "to reconcile data and set out the DAU allocation based on the agreement documented in the form of Presidential decree mandated by Law 32/2004 Art 35. The central government and parliament have discretion in deciding each year the weights assigned to each of the components of the expenditure need index. While weights have changed throughout the last three years, the impact on allocations has been marginal. The Specific Allocation Grant (DAK) is allocated based on general, specific, and technical criteria set out in Law 33/2004 (Art 38-42). While they are in principle rule based, DAK allocations are more prone to political discretion, as they are not formula driven.

**Table 12 Intergovernmental Transfers (Trillion IDR, 2006)**

| | | |
|---|---|---|
| Shared Taxes and Revenues | 58.1 | 27% |
| General Allocation Grant (DAU) | 145.7 | 68% |
| Special Allocation Grant (DAK) | 11.6 | 5% |
| Total Transfers | 215.3 | 100% |

84. In addition, central government departments, including education, public works and health, continue to directly undertake de-concentrated spending on mandates that are legally decentralized. Although not formally construed as transfers, some central government ministries reportedly transfer funds ("*anggaran belanja tambahan*") to local governments. These transfers are allocated in a non-transparent and discretionary way. While no systematic data is available to quantify the extent of such operations, these transfers are estimated to be marginal (less than 10%)

compared to overall transfers. Based on Law 33/2004 the government is increasingly channeling such spending to the more transparent special allocation grant mechanism (DAK).

85. Law 33/2004 (Article 10) requires SNGs to adopt their budgets for the upcoming year by 31 December of the previous year. However firm and reliable information on transfers to individual SNGs are not established until October when the central government annual budget (APBN) is passed, leaving two months for SNGs to enact their annual budget law. During the past three years the draft budget law (R-APBN) has included exact numbers for the aggregate allocations of the general allocation grant and the special allocation grant which are appropriated in the budget. However the central government is hesitant to issue earlier indicative figures for individual SNGs because of concern that SNGs might treat them as definite commitments. Changes in allocations to individual SNGs typically occur during legislative deliberations before the passing of the budget. The exact amounts for shared taxes and revenues for individual SNGs are established and communicated even later - typically in March/ April of the relevant fiscal year because they are based on the actual amount of taxes and revenues collected in the previous years.

86. While SNG's planning and budget cycle commences much earlier, October of the preceding fiscal year is generally too late for the SNG budge cycle to be completed before the beginning of the budget fiscal year. As a result some SNGs do not enact their budgets on time.

87. Art 102 Law 33/2004 and Government Regulation No. 11/2001 require SNGs to submit annual financial reports to the central government. However, there is a lack of compliance by SNGs, and as at August 2007 only about 420 of the 473 SNG had submitted their reports for FY 2005. While Law 33/2004 allows the central government to apply sanctions if SNGs do not meet their reporting requirements, this is not done in practice. Accounting standards and classification systems for SNGs have been adapted to national standards, but are not yet consistently applied throughout all SNGs. No consolidated general government reports have been produced due to lack of timely reporting by SNG, but MOF is now preparing a consolidated statement for 2005 based on the data received from SNGs.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-8 Transparency of Inter-Governmental Fiscal Relations. [M2]** | **C+** | |
| (i) Transparency and rules based systems in the horizontal allocation among SN governments of unconditional and conditional transfers from central government (both budgeted and actual allocations) | **A** | Horizontal and vertical allocation of all transfers from the central government is determined by transparent and rule based systems.<br><br>Some line ministries operate departmental cash transfers to local governments based on non-transparent and discretionary allocation mechanisms. While the exact extent of these operations is unknown they are likely to be marginal, less than 10% of overall transfers. |
| (ii) Timeliness of reliable information to SN governments on their allocations from central government for the coming year | **C** | Allocations for individual SNG are issued for major transfers (70% of total) in October with enactment of the annual budget law leaving only two months for SNG to complete their budgets. Precise allocations for shared revenues and taxes are issued even later, typically March/April of current fiscal year. |
| (iii) Extent to which consolidated fiscal data (at least revenue and expenditure) is collected and reported for general government | **D** | While there are legal requirements for SNG to provide financial statements to central government, these are not always observed and reports are submitted with long delays. As a result no consolidated general government reports have been produced although work is now |

| | | |
|---|---|---|
| | | under way on the consolidated statement for 2005. A higher score would require fiscal reporting by SNGs that is consistent with central government fiscal reporting for at least 60% by value of SNG expenditure and their consolidation into an annual report. |

**PI-9. Oversight of aggregate fiscal risk**

88. Sound fiscal management requires the government to closely monitor and report fiscal risks and to develop appropriate risk management strategies. In this context, the Government has established a Fiscal Risk Unit in the FPO of MOF that is charged with identifying, analyzing, monitoring and reporting on fiscal risk. Also, for the first time a fiscal risk statement was included in the 2008 budget document submitted to parliament in August 2007. This statement provided a consolidated assessment of fiscal risks arising from various contingent liabilities, including implicit government guarantees for state owned enterprise debt, public service obligations (PP 45/2005) with SOE utility providers such as PLN and Pertamina, guarantees on liabilities and non performing assets of state owned banks, unfunded pension obligations, guarantees and comfort letters in infrastructure projects (PPP), as well as implicit guarantees on outstanding debt of sub-national entities (including enterprises owned by sub-national entities).

89. There are 139 state owned enterprises and 21 enterprises with minority government share. Law 19/2003 and Ministry of State Owned Enterprises (MSOE) Ministerial Decree 100/2002 provide a sound basis for the monitoring of SOEs. They require each SOE to submit financial statements quarterly to the MSOE and the relevant line ministry and to issue audited financial statements (operating statement and balance sheet) annually as part of its annual report. However, financial statements are sometimes issued with long delays and audits of SOEs are also frequently late. The largest SOE, the state oil company (Pertamina) has not produced audited financial statements since 2005. MSOE Ministerial Decree 100/2002 requires regular assessments of the financial health of SOEs based on set of eight standard financial criteria and in practice some rudimentary assessments are carried out by both MSOE and MOF.

*90.* Government Regulation 23/2005 set up a new framework for government agencies, such as universities, laboratories, and training institutions. Also as discussed in paragraphs 43 and 60, these semi-autonomous entities enjoy greater flexibility than MDA in their financial management requirements. In return for this flexibility Ministry of Finance Decree No. 466/KMK.01/2006 sets out clear reporting requirements, including submission of annual and semi-annual financial reports to DG Treasury, which is charged with financial oversight of AGAs. In practice there are delays in the submission of reports and there appear to be some instances of non-submission of reports, although the position is not systematically monitored. This situation clearly inhibits the ability to monitor underlying fiscal risks.

91. For SNG, Law 33/2004 mitigates fiscal risk arising from direct liabilities incurred in financial markets by establishing a tight regulatory framework that limits direct access of SNGs to capital markets. While SNGs are allowed to borrow and issue municipal bonds, prior approval by Ministry of Finance is required. In practice SNG debt levels are very low - less than 0.4 percent of GDP. However fiscal risks may arise from other SNG contingent liabilities such as sub-national pension obligations where there may be an implicit central government guarantee. Due to lack of

timely and reliable reporting by sub-national governments (as outlined in the discussion on PI-8) these risks are not monitored systematically.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-9 Oversight of aggregate fiscal risk from other public sector entities.** [M1] | **D** | |
| (i) Extent of central government monitoring of AGAs and Public Enterprises | **C** | Most major State Owned Enterprises submit annual financial reports but there are delays in providing audited financial statements and a consolidated overview is not prepared. For AGAs it has been difficult to assess the overall position in the absence of information to allow systematic monitoring by government. For budget year 2008 the government has prepared for the first time a consolidated fiscal risk overview as part of the budget documents.<br><br>The inclusion of fiscal risk statement in budget document is a positive step. |
| (ii) Extent of central government monitoring of SNG fiscal position | **D** | Monitoring of SNGs fiscal position is significantly deficient due to lack of timely reporting by SNGs. |

### PI-10. Public Access to key fiscal information

92. Public access to key fiscal information is an important pillar of the budget process in democratic societies to assist in holding the government accountable for the use of public resources. Indonesia meets 4 of the prescribed information benchmarks (Table 13).

**Table 13 PEFA Information Benchmarks**

| No. | Item | Available | Source |
|---|---|---|---|
| 1 | Annual Budget Documentation | Yes. | Nota Keuangan. Both proponed and approved budgets are available online when submitted to the Parliament:<br><br>www.djapk.depkeu.go.id/**apbn** |
| 2 | In year execution reports | Yes. | Semester Report (Laporan Realisasi Anggaran) published and submitted to DPR starting 2007, as required by Law 17/2003, within 6 weeks of period-end. |
| 3 | Year-end financial statements 6 months after end of fiscal year | Yes. | LKPP<br>Available Online after completion of external audit, within 6 months after end of fiscal year.<br><br>http://www.perbendaharaan.go.id |
| 4 | External Audit Reports | Yes. | LKPP<br>Available Online after submission of audit report to Parliament.<br><br>www.bpk.go.id/doc/ikhtisar/**lkpp2006** |
| 5 | Contract Awards | No. | This information is required by Presidential decree to be published but the decree has not yet been implemented. |
| 6 | Resources available to primary service units | No. | |

Budgetary information, including the budget law, the Presidential speech, the budget document and annual financial statements are available through websites. The semester (mid year) budget execution report is not posted on the MOF website, but hard copies are available upon request. At the time of this report (October 2007) information on contract awards was not readily available. While Presidential Decree 80/2003 requires that contract awards above a threshold of IDR 50 million to be made publicly available, this has not been implemented. While the websites of major departments have a subsection on procurements, no information on contract awards is currently available.

93. As also discussed under PI-23, information on resources received by primary service providers is not available, although some aggregate figures of budget allocations to schools and hospitals are included in the budget document and some information is available on central government hospitals and educational institutions which are AGAs. Under Indonesia's decentralized fiscal framework, most primary service providers are located at SNG level and receive funding from several levels of government, making it difficult to obtain comprehensive information on their funding.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-10 Public Access to key fiscal information.** [M1] | **B** | 4 of the 6 benchmarks are met.<br><br>Contract awards will be published in the near future, when the Presidential decrees implemented. |
| Number of the above listed elements of public access to information that is fulfilled (in order to count in the assessment, the full specification of the information benchmark must be met). | | |

## Section 3.3. Policy Based Budgeting

### PI-11. Orderliness and participation in the annual budget process

94. The budget cycle follows a calendar outlined in Law 17/2003 on State Finances. The budget preparation commences in February preceding the fiscal year and culminates in adoption of budget law by Parliament in October, two months prior to the beginning of the fiscal year. Specific dates are set for each phase of the budget cycle including issuance of budget circulars, preparation of budget requests by line ministries, and legislative involvement. Both the executive and the legislature adhere to the statutory budget calendar and the budget was enacted on time in the last three years. [20]

95. The Executive issues two budget circulars to guide budget preparation by Ministries and agencies: (1) circular on indicative ceilings issued jointly by the Ministry of Planning and the Ministry of Finance in February/March preceding the fiscal year and (2) circular on temporary

[20] However in 2005 delays occurred in the issuance of budget implementation documents (DIPA) – for some MDAs these were not issued until May 2006.

ceilings issued by Ministry of Finance in mid June. This practice gives ministries and agencies sufficient fiscal guidance and time to meaningfully complete their detailed budget requests. Circulars on budget ceilings are approved by the President and Cabinet before being issued.

96. Law 17/2003 does not regulate formal involvement of the Cabinet / President in the budget process, but Law 25/2004 on national planning requires the executive to issue a government work-plan (RKP) as Presidential decree, typically in mid-May preceding the fiscal year. The government work-plan (RKP) provides the general framework for the preparation of the state budget and includes indicative ceilings for both programs and MDAS which translate policy priorities into public spending. However, the involvement of the political executive appears to be fairly late in the budget cycle as the Presidential decree on the government work plan is issued after ministries have already prepared their annual work-plan based on the indicative ceilings issued in February/March. This has resulted in last minute changes, for example substantial re-allocations to capital expenditures late in the 2008 budget preparation cycle.

97. Law 17/2003 on State Finances defines the roles of the executive and legislature in general terms, but there is no clear definition of the level of detail of legislative involvement and the organizational level at which the budget is appropriated (ministry or spending unit). In practice this has resulted in a very detailed legislative review and appropriations, as outlined in PI-27. While the budget has been passed on time during the past three years parliament has in some instances where sectoral commission did not finish their budget reviews of line ministries, blocked certain parts of the budget from execution until the completion of these reviews. In 2007 about 4 percent of total expenditures and 6 percent of capital/materials expenditures were blocked in this way (see also discussion under PI-16).

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-11 Orderliness and participation in the annual budget process. [M2]** | **A** | |
| (i) Existence of and adherence to a fixed budget calendar | **A** | A clear statutory budget calendar is stipulated in Law 17/2003 on State Finances and is adhered to, giving MDA more than 6 weeks from receipt of budget circular to submit their detailed budget requests. |
| (ii) Guidance on the preparation of budget submissions | **A** | Comprehensive and clear budget circulars are issued in two stages to guide preparations. President/Cabinet reviews and approves ceilings before the budget circulars are issued. |
| (iii) Timely budget approval by the legislature | **A** | The Budget was approved before the beginning of the fiscal year during the last three years (2005, 2006, 2007) |

## PI-12. Multi-Year Perspective in fiscal planning, expenditure policy and budgeting

98. A modern budget system places annual appropriation within a multi year perspective to allow for prudent control of multi-year commitments in line with projected revenues and to facilitate medium-term sustainability of fiscal choices. Typically, this entails a top-down estimate of available resources over the medium-term based on macro-economic forecasts; bottom-up estimates of the costs of carrying out policies, both existing and new; a framework that reconciles these costs with aggregate resources.

99. In the past budget submissions were strictly annual and only included outturns for two previous fiscal years, but no forward estimates. The 2008 budget submitted to Parliament in August 2007, included for the first time aggregate revenue and expenditure forward estimates for the following two years, 2009 and 2010, but not disaggregated by function. However it is not clear what use will be made of this information, in particular whether it will roll-over to be the starting point for the 2009 budget.

100. While implementing regulation 21/2004 requires MDAs to set out expenditure projections based on current policies and known new commitments, this has not been implemented by line ministries, partly because of capacity constraints, and partly because of lack of enforcement by MOF. However all line ministries prepare fixed five year strategic plans and some of the larger line ministries, including Education and Public Works, representing around 20 percent of primary expenditure, have developed costed medium-term plans.

101. No debt sustainability analysis (DSA) has been undertaken by Government during the past three years, either for external and domestic debt. Ministry of Finance is now preparing a framework for carrying out a DSA as required under Finance Minister Decree No. 447/KMK.06/2005 on Government Debt Management Strategy 2005-2009. A partial DSA was conducted in 2007 for the 2008 Budget and was included in the Fiscal Risk Statement submitted to Parliament with the draft 2008 budget in August 2007. MOF is reportedly planning to conduct a full DSA in 2008.

102. Law 17/2003 on state finances requires a unified budget process starting in 2005. However in practice capital and re-current budgeting processes are not yet fully integrated. For example, in the preparation of indicative ceilings for MDAs, MOF continues to be responsible for non-discretionary (routine) expenditures while the Ministry of Planning (BAPPENAS) takes the lead on discretionary (development) expenditures. Moreover, large parts of non-discretionary spending are allocated to a separate program and consequently many programs do not reflect full (capital and recurrent) costs.

103. Under the practice described above the link between capital and re-current budgeting is rather weak. There is no overall medium term expenditure framework that links capital expenditures and re-current expenditures at MDA level in the medium term through a commitment base and projections of the available resource envelope in out-years. However, budgeting for some major capital and recurrent expenditures such as road construction and road maintenance are linked at the MDA level.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-12 Multi-Year Perspective in fiscal planning, expenditure policy and budgeting. [M2]** | **D+** | |
| (i) Muti-Year fiscal forecasts and functional allocations | **C** | The 2008 Budget includes fiscal forecasts at the aggregate level for two out-years for an economic classification. No functional classification is included. |
| (ii) Scope and frequency of debt sustainability analysis | **D** | No full DSA has been undertaken by Government during the last three years. A partial DSA was conducted in 2007 for the 2008 budget. |

| | | |
|---|---|---|
| | | However a DSA is stated by MOF to be under preparation for 2008. |
| (iii) Existence of costed sector strategies | **C** | All line ministries prepare fixed five year strategic plans. Some of the larger line ministries, including education and public works, (representing around 20% of primary expenditure) have costed out those plans. |
| (iv) Linkages between investment budgets and forward expenditure estimates | **D** | There is a partially unified budget process for capital and re-current expenditures and the link between capital and re-current budgeting is weak. |

## Section 3.4 Predictability and Control in Budget Execution

### PI-13. Transparency of taxpayer obligations and liabilities

104. The revenue administration comprises Taxation and Customs and Excise as separate Directorates under the Ministry of Finance. A legal framework exists for all major taxes (including income tax, value added tax (VAT), customs and excise, and land & buildings tax) comprising legislation, implementing regulations and administrative decrees that provide for definitions, characteristics, scope and rates of taxes as well as for exemptions, implementation procedures, penalties and discretionary powers[21]. But delays in issuing of implementing regulations sometimes occur. In addition, there are instances where decrees and implementing regulations conflict with their enabling legislation. Discussions with the Indonesian Chamber of Commerce and tax advisors to the business community indicate that the tax payer community considers the discretionary powers of tax officials to be substantial and checks and balances through formal objections against tax assessments to the revenue administration are not considered to be consistently effective. For example, the tax payer community maintains that detailed explanations underlying decisions made on tax assessments are not always provided to tax payers, although a Ministerial decree on tax audit procedures and accompanying implementing regulations have been issued requiring tax auditors to inform tax payers in writing about the results of the audit. As a result, transparency and clarity of tax payer obligations may be compromised. However recent taxation legislation that will become effective in 2008 contains provisions that are expected to lessen the degree of discretion given to tax officials.

105. Taxpayers have easy access to comprehensive, user friendly and up-to-date information on tax liabilities and administrative procedures for major taxes through various means, such as web access and print publications. These are frequently supplemented by public education efforts including special seminars. However, for Customs and Excise and some taxes like land building tax, information available to tax payers is limited.

106. A credible tax appeals system has been established under Law 14/2002. The first step in the appeal process is to file an objection with the Director General of Taxation. If the tax payer is not satisfied with this decision, the next step is to file an appeal with the Tax Court, which is part of the country's judicial system and is independent of the Directorate General of Taxation. Transparent administrative procedures for the appeals process are in place, though there are occasional complaints that the basis for appeal decisions is not fully communicated to tax payers. Appeals filed by tax payers to the Court account for 90% of cases handled by the Court and are

[21] The largest proportion of Taxation Revenues is from taxes on income (52% in 2006) and value added tax (28%) and Customs & excise (12%).

generally resolved within one year. However, access to the appeals process may in practice be somewhat limited by the costs involved.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-13 Transparency of Taxpayer Obligations and Liabilities. [M2]** | **B** | |
| (i) Clarity and comprehensiveness of tax liabilities | **C** | A comprehensive legal and regulatory framework exists for major taxes, although some inconsistencies between administrative decrees and enabling legislation arise. Discretionary powers of Tax Officers in the implementation of tax assessment procedures are considered substantial. As a result, the clarity of the legislation and fairness of the system is compromised. |
| (ii) Taxpayers' access to information on tax liabilities and administrative procedures | **B** | Taxpayers have easy access to information on tax liabilities and administrative procedures for all major taxes, including income tax and VAT, and this is supplemented by tax payer education programs. Information for other taxes is limited. |
| (iii) Existence and functioning of a tax appeals mechanism | **B** | An independent tax appeals system is in place. However, it appears that access may be limited by the costs involved. |

### PI-14. Effectiveness of measures for taxpayer registration and tax assessment

*107.* Every taxpayer is required to register and obtain a Taxpayer Identification Number (TIN). DG Tax maintains a central database of TINs for all taxpayers. The register reportedly contains some duplicate TINs and others that are no longer active and needs a thorough review to eliminate such errors. A long standing practice is to require each branch of a firm to register separately at the local level with DG Tax and file VAT returns separately, unless specifically authorized by the Department to file a consolidated tax return. Furthermore, the tax payer database is not linked to other Government registration systems such as national identification (KTP) and others that involve elements of taxable turnover and assets (such as business licenses and opening of bank accounts). As a result some tax payers may be able to avoid registration while others may maintain multiple registrations.

*108.* The Law 16/2000 provides for the structure, levels and administration penalties for non compliance with tax regulations. In some cases penalties set are too low to encourage compliance, for example penalty for not filing a VAT return is Rp 50,000 or approximately US$5. The low level of penalties is one factor possibly contributing to the low number of registered tax payers complying with their obligation to regularly file tax returns (45% in 2006*)*. For other aspects such as under-reporting of taxable income, the need for higher penalties has been recognized by government and concrete proposals in this regard have been included in a new Law on Taxation recently passed. In addition, systems to enforce penalties during and after assessment, including regular management reporting and review of outstanding cases, need strengthening.

*109.* The DG Tax operates a structured audit plan as a part of the self assessment process. Criteria have been defined to identify tax payers for audit, such as past compliance record of the tax payer and the amount of tax refund claimed. However such criteria are not always based on a systematic assessment of risk. For example all returns involving tax refunds are required to be audited irrespective of other criteria. DG Tax is able to audit less than 5% of tax returns filed annually due to resource constraints, and most of these audits are refund cases.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-14. Effectiveness of measures for taxpayer registration and tax assessment. [M2]** | **C** | |
| (i) Controls in the taxpayers registration system. | **C** | The TIN is administered in a central database of tax payers but there are no linkages to other registration requirements outside the Tax Directorate. |
| (ii) Effectiveness of penalties for non-compliance with registration and tax declaration | **C** | Penalties for non-compliance generally exist, but require changes in structure, administration and enforcement to have greater impact on compliance. |
| (iii) Planning and monitoring of tax audit programs. | **C** | Tax audits and fraud investigations based on general selection criteria are undertaken. Although audit criteria are defined, these are not fully risk based. Due to inadequate staff numbers less than 5 percent of tax returns are audited each year. |

### PI-15 Effectiveness in collection of tax payments

110. The total amount of tax arrears for the last two years is moderate (about 10% of the total annual tax revenues at end of 2005 and 7.5% at end of 2006). The collection ratio for gross tax arrears for these two years averaged 66%, based on figures submitted by the Tax Directorate.

111. Taxpayers pay their taxes directly into Treasury bank accounts or through commercial banks that are authorized by Treasury to receive tax payments at their branches across Indonesia. Income Tax offices do not accept any tax payments. Commercial banks transfer collections to the Treasury bank account at the central bank twice a week and report the receipts to the local Treasury branch office. A zero-balance regime is also currently being implemented to allow daily transfers of funds from commercial banks to the Treasury. Treasury branch offices inform tax branch offices (KPP) the details of tax collections on a daily basis. Branch offices (KPP) are responsible for maintaining the integrity of data on tax assessments and arrears.

112. Tax collections and related records, which are under the control of Treasury, are reconciled monthly between the local Treasury office (KPPN) and the branch tax office (KPP), and based on which monthly reports on collections and arrears are submitted to the central tax directorate. At the aggregate level a complete reconciliation of the Tax Directorate's data with the central Treasury is attempted monthly but is not systematically carried out. In practice differences between tax collection, assessments and arrears often arise and have been reported by external auditors[22] (BPK). These differences have been about three to five percent of aggregate tax revenues. To resolve these differences, a new computerized government revenue accounting system (MPN) is being introduced and managed by Ministry of Finance and is at an early stage of implementation. This system will record all payments made by taxpayers and will be accessible online by the tax offices. However, given the complexities arising from its large scale and geographic spread, this program is not expected to be operational till 2008.

[22] In their report on the financial statements for 2006, the auditors reported that tax revenues as determined by DG Tax was higher than that reported by Treasury by Rp 1.9 Trillion (0.5% of aggregate revenues).

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-15. Effectiveness in collection of tax payments. [M1]** | **D+** | |
| (i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years). | **C** | The average tax collection ratio for tax arrears for last 2 years is 66% (source, MOF) |
| (ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration. | **A** | Taxpayers pay their taxes directly into Treasury bank accounts or at commercial banks that are authorized by Treasury to receive such funds, and which then remit these to Treasury, twice weekly. |
| (iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury. | **D** | Complete reconciliation is not being done annually within 3 months of the year end. Reconciliations are prepared on a monthly basis at branch office level, but aggregate information is not reconciled and there are differences between data on tax assessments and arrears Treasury and DG Tax. |

### PI-16 Predictability in the availability of funds for commitment of expenditure

113. Annual cash flow forecasts are prepared based on the budget execution documents (DIPAs). However, the Treasury has yet to implement a reliable and comprehensive forward cash planning system at more frequent intervals, although preliminary steps to develop such cash planning including a Treasury Single Account have been taken. The national revenue forecast comes from DG Tax. The national monthly expenditure forecasts are required to be provided by the 20,000 spending units to their local MOF accounting office (KPPN). However with number of spending units complying with this requirement at a low 10 percent, the expenditure forecast is far from reliable. Treasury ensures the availability of cash to meet claims on the government by the simple expedient of maintaining at all times significant cash reserves. The Treasury has not experienced shortage of cash in recent years.

114. For this reason, in practice there is full predictability of the availability of funds within the limit of the DIPA – although this cannot be reflected in the overall scoring for this Indicator which is premised on regular cash flow forecasting and monitoring.

115. The Treasury monitors cash flows and balances in all bank accounts under its control on a daily basis and generates fortnightly reports on the flows and balance. Pursuant to Law 1 of 2004 on State Treasury, soon after the budget is approved by Parliament, budget execution documents (DIPAs) are issued to formally authorize MDAs to commit expenditure up to the budget appropriation for the year. The Treasury does not administer cash ceilings on disbursements and no monthly/quarterly ceilings on expenditure are prescribed. Although in 2005 delays occurred in the issuance of budget implementation documents (DIPA) – for some MDAs these were not issued until May 2006, for 2006 and 2007 DIPAs have been issued on time. As a result MDAs generally receive reliable information on approved appropriations within which they can commit expenditure for the full year, with the limited exceptions where parliamentary commissions may not have completed all of their budget deliberation, as noted in the discussion under indicator PI-11.

116. The annual budget is revised half way through the year to reflect changes in macroeconomic and fiscal assumptions. Line ministries are fully involved in formulating revised budget estimates based on guidelines issued by MOF.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-16 Predictability in the availability of funds for commitment of expenditure. [M1]** | **C+** | |
| (i) Extent to which cash flows are forecast and monitored | **C** | Annual cash forecasts are prepared based on budget authorizations (DIPAs) and partially updated during the year. Comprehensive forward cash planning at more frequent intervals at the Treasury is at an early stage of development. |
| (ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment | **A** | MDAs have full authority to commit expenditures within the full amount of the annual appropriations. |
| (iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs. | **A** | The annual budget is revised at mid-year in participation with the MDAs.. The procedures for revision of the budget are transparent and predictable and are observed. |

### PI-17. Recording and management of cash balances, debt and guarantees

117. Public debt in domestic and foreign currency raised by the government is recorded and managed by the newly established DG Debt Management in MOF. Standard operating procedures (SOP) on debt management have not so far been approved.

118. Based on the audit report from BPK on the 2006 financial statements the quality of data on domestic debt is acceptable and regular reports are generated. However the quality of data on foreign loans needs improvement. Although reports on foreign loans are generated, these are not reconciled with and differ somewhat from donor records.

119. Under the State Treasury Law the MOF has exclusive authority to contract loans and to provide guarantees on behalf of the government. A clear limit on the issuance of debt has been prescribed in Government Regulations # 23 of 2003, which stipulates that the overall general government public debt should not exceed 60 per cent of gross domestic product. While this ceiling is being adhered to, in the absence of any financial statements for general government it is not systematically reported or monitored. No overall fiscal ceilings have been set for guarantees that may be issued or outstanding.

120. Pursuant to President Regulation # 67 of 2005, the Minister of Finance may provide financial support in the form of financial guarantees to PPP infrastructure projects which satisfy criteria described in the PMK # 38 of 2006. The Presidential regulations on specific infrastructure projects stipulate that guarantees may be issued by the Minister when certain criteria, which would be prescribed in an MOF regulation, have been met.

*121.* The Risk Management Unit of MOF is responsible for recording, monitoring and reporting of the guarantees. These guarantees are disclosed in the Financial Notes submitted to the Parliament, starting from the 2008 budget.

*122.* Government cash balances under the control of the Treasury and MDAs are currently fragmented in thousands of bank accounts. BPK reports for 2004-2006 indicate that MDAs continue to maintain a significant number of bank accounts which remain outside government accounts. Following the issuance of PP # 39/2007 on cash management in July 2007, the MOF has recently issued PMKs # 57 and 58 to gather data on unreported bank accounts of MDAs and to close those that lack justification. Significant progress has been made in uncovering such bank accounts and MOF expects to complete this exercise before the end of 2007. Following the enactment of Treasury Law # 1 of 2004, reforms are underway to consolidate government balances into a Treasury Single Account (TSA). Most expenditure accounts have now been integrated into the TSA regime, with zero balance arrangements but for some accounts (e.g., salary accounts), zero end-day balances are not yet established.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-17. Recording and management of cash balances, debt and guarantees. [M2]** | **D+** | |
| (i) Quality of debt data recording and reporting | **D** | Audit reports indicate that while data and reports on domestic debt are reliable, those for foreign loans are not reliable and differ from donor records and are not annually reconciled. |
| (ii) Extent of consolidation of the government's cash balance | **C** | Calculation of cash balances in Treasury bank accounts occurs daily. However, there are many bank accounts managed by outside Treasury's purview on which reliable information is not available. A higher score would require at least monthly consolidation of most government cash balances. |
| (iii) Systems for contracting loans and issuance of government guarantees. | **C** | The contracting of loans requires MOF approval. MOF is responsible for managing and issuing government guarantees. Criteria have been prescribed for guarantees for infrastructure projects, but no overall ceilings have so far been set. |

## PI-18. Effectiveness of Payroll Control

123. The Government Employee Administration Agency (*Badan Kepegawaian Negara* or BKN) endorses the appointment, recruitment, promotion, demotion, and retirement of staff at MDAs and all local governments and maintains central personnel records reflecting these authorizations. The formal authorization letter for these changes is however issued by the MDA's secretary general and the change is then recorded by the MDA's personnel bureau in its own system. However the records at BKN and those at MDAs are not reconciled to ensure that the latter accurately reflect the BKN authorizations, thereby weakening internal control.

124. Generally there is a delay of about 2-3 months in updating the records of new personnel after the secretary general's authorization is received. For higher level appointments the approval

of the President is required. Retroactive adjustments (*rapel)* to update the MDA personnel database are frequently indicating delays in maintaining the database.

*125.* Prior to end of month, based on records at the MDA personnel bureau, the Salary Expenditure Treasurer (*Bendaharawan Gaji*) within the MDA prepares the payroll (gross salary amount and deductions) which is then submitted as a payment request (SPM) to the Treasury Office (KPPN). KPPN transfers the authorized amounts directly to each individual's own bank account or through a transitory account for subsequent payment either to an individual bank account or in cash. Under current practice many civil servants are paid salaries and allowances in cash, which lessens the effectiveness of payroll controls.

*126.* A review of the work programs of selected Inspectorate-Generals (IGs) of MDAs indicates that they rarely perform substantive payroll audits[23]. BPK audit reports for the past three years have not included any findings on payroll. In the absence of reconciliation of personnel records or a systematic payroll audit it is not possible to systematically identify ghost workers. Reflecting the systemic risk discussed above, the Head of BKN conducted its own review and reported to the parliament in early 2007 that out of 240,000 assistant teachers, 102,000 were fictitious. Salaries of teachers are disbursed by local governments from the general allocation transfer (DAU) from the central government. Systems application to regularly reconcile payroll data between MDAs and KPPN is under development.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-18. Effectiveness of Payroll Control. [M1]** | **D+** | |
| (i) Degree of integration and reconciliation between personnel records and payroll data. | **D** | The personnel record is maintained at the personnel bureau of MDAs. BKN which decides the MDA's level of staff and approves staff status change maintains a separate central personnel information system. However, the records at the BKN and personnel bureau are not reconciled. |
| (ii) Timeliness of changes to personnel records and the payroll | **C** | Changes to staff records status are often delayed up to 3 months. As a consequence, "rapel" or retroactive adjustment to the salary payment frequently happens. |
| (iii) Internal controls of changes to personnel records and the payroll. | **A** | Authority to change records and payroll is restricted to BKN and results in an audit trail. |
| (iv) Existence of payroll audits to identify control weaknesses and/or ghost workers. | **C** | IGs rarely perform separate payroll audits. There have been no BPK audit findings on payroll over the past three years. BPK has however conducted its own review and reported discrepancies in 2007. Higher scores would require regular audits of the payroll function. |

### PI-19. Competition, value for money and controls in procurement

127. The Government has strengthened procurement practices over the past three years. Government Regulation No.80/2003 was issued as a national standard regulation (i) promoting

[23] Sector Report on Accountability and Audit in Indonesia, Asian Development Bank, January 2007

basic principles of procurement, viz. transparency, open and fair competition, efficiency (value for money), non-discrimination, and accountability, and (ii) committing to the future establishment of a National Public Procurement Organization (NPPO). Since then the National Development Planning Agency (Bappenas) has established an interim Center for the Development of Public Procurement Policy covering procurement of goods and services by all government entities (including line ministries, local governments, the Central Bank, State Owned Enterprises, Local Government owned Enterprises, State Owned Legal Entities (BHMN) and other related government institutions). This regulation is supplemented by various decrees and circulars issued by MDAs.

128. The Regulation mandates open competition for procurement of goods and services costing Rp. 50 million or more. Exceptions to this rule are allowed if justified in writing and in specific kinds of procurement, viz (i) emergency situations or natural disasters; (ii) procurements of goods or services for which prices are regulated by government, such as electricity; (iii) national security purposes such as defense equipment. A review of a sample of formal records maintained at selected line ministries indicates that more than 50% of contracts above the mandated threshold are currently awarded on the basis of competitive tender..

129. Discussions with some line ministries such as MoNE and MPW indicate that the mandated tendering procedures are generally followed. However internal and external audit agencies regularly report widespread collusion in tendering processes although this is difficult to identify in the tender documents. Data on procurement under various procurement methods is available in spending agencies, but its reliability is difficult to assess and it is not formally reported to management. At present reasonably complete data is not available on an aggregate basis to determine the extent to which public procurement contracts are awarded on a competitive basis.

*130.* The Regulation outlines procedures for submitting and addressing complaints on the procurement process. Complaints generally appear to be resolved in a timely manner, except when taken to a higher level or when legal recourse is sought. All complaints are received by the tender committee and are referred to a higher authority within the spending agency. However this process lacks sufficient independence. The operation of the complaints system may also be weakened by the absence of public disclosure of data on complaints received and resolved by some MDAs. Above this level, complainants may use an arbitration process or seek redress through the judicial system. Indonesia has an arbitration Law that is consistent with the generally accepted practices of neutrality, due process etc, and international arbitration is acceptable to GOI for ICB. In addition, procedures exist through the judicial system to enable the winner of any dispute to seek enforcement of the outcome. However there is no formal monitoring process of dispute resolution and its enforcement, and associated costs are likely to limit the practical use of this remedy.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-19. Competition, value for money and controls in procurement.** [24] **[M2]** | **C** | |
| (i) Use of open competition for award of contracts that exceed the | **D** | Regulations prescribe clear thresholds above which competitive procurement procedures should be adopted. |

[24] To assess the performance of a country's procurement system on the basis of PI-19 could result in a score that may be misleading and may result potentially in an incorrect perception as to the status of a country's procurement system.

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|---|---|---|
| nationally established monetary threshold for small purchases. | | There is insufficient data available to assess on an aggregate basis the extent to which competitive methods were used to award public contracts. . |
| (ii) Justification for use of less competitive procurement methods. | **B** | The procurement regulation describes procedures for using less competitive methods and the justification to be provided. Interpretation of this regulation is sometimes augmented by decrees and circulars issued by MDAs. Tests at selected ministries indicate the required justification is documented in practice. |
| (iii) Existence and operation of a procurement complaints mechanism. | **C** | The regulation outlines procedures for submitting and addressing complaints on the procurement process and requires their timely resolution. However resolution of complaints is normally carried out by a higher authority within MDAs, which may not be sufficiently independent. |

## PI-20. Effectiveness of internal controls for non-salary expenditure

131. There is no formal commitment control system at Satker and MDA levels that records, reports, monitors, or controls spending commitments during the year against approved budgets and cash availability. The DIPA documents, which are detailed down to the spending unit or Satker level, prepared by the MOF establish annual budgeted ceilings on expenditure commitments. These procedures DIPAs, generally prevent MDAs from placing orders above the approved budgets (DIPA limits) for particular spending items. As an exception to this control, interest on the public debt is paid irrespective of the limits prescribed in DIPA. Though the Treasury has in recent years ensured availability of cash so long as the requests for payment presented by MDAs are within budget allocations in DIPA, the current system does not ensure that commitments at the spending agency or 'satker' level are limited to actual cash availability.

132. MOF Regulation No.134/PMK.06/2005 and DG Treasury Regulation No. PER-66/PB/2005 prescribes detailed procedures for payment of salary and non-salary expenditures, which supplement other written procedures on accounting and recording transactions. The processes are however paper intensive and involve inefficient use of staff resources. For example the supporting documentation required for payment of goods and services covers multiple documents which duplicate information, with weak audit trails and accounting evidence.

133. BPK's audit report for 2006 records numerous instances of non compliance with rules for processing and recording transactions such as non-compliance with procurement procedures, payments not supported by adequate documentation and overpayments. Weaknesses in the country's internal audit function would imply that the degree of non-compliance to rules would be higher than would be otherwise evident.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-20. Effectiveness of internal controls for non-salary expenditure. [M1]** | **D+** | |
| (i) Effectiveness of expenditure commitment controls. | **C** | There is no formal commitment control system at Satker and MDA levels that records, reports, monitors, or controls spending commitments during the year. Procedures at the spending unit or 'satker' level are generally applied to restricting expenditure commitments to approved budget allocations. But procedures do not exist to limit |

| | | |
|---|---|---|
| | | commitments by Satkers or MDAs to cash availability. |
| (ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures. | **B** | Regulations and control procedures are comprehensive but paper and staff intensive and inefficient. |
| (iii) Degree of compliance with rules for processing and recording transactions. | **D** | BPK audit reports numerous cases of non compliance with regulations and control procedures. |

### PI-21. Effectiveness of internal audit

134. The country's institutional structure for internal audit is characterized by weak capacity. A national internal audit institution (*Badan Pengawasan Keuangan dan Pembangunan* or BPKP) was established in 1983 as an internal audit body reporting to the President. Earlier, with a mandate to audit all of government its functions overlapped with those of BPK. However with the passing of the State Audit Law 15/2004 it has lost its formal mandate for internal audit and it currently performs internal audits only upon specific request by MDAs or local governments. It has some 7,000 employees, including 5,500 certified auditors. Government is currently considering options in defining its future role. For the purpose of this assessment it is not regarded as a functioning internal audit organization.

135. Inspectorate Generals (IGs) have been established in all MDAs by virtue of President Regulations No 9 and 10 of 2005, which define the internal audit functions of each IG. Financial audits, performance audits and some special audits are the kinds of audits defined in the Indonesian audit standards ('SPKN'). In principle IGs have a mandate to audit all MDA activities as requested by the agency's Minister, with the exception of MOF-IG who does not have access to taxpayer information and cannot therefore audit tax revenues. Unlike BPK, IGs do not provide an opinion on the agency's financial statement but may perform a review of these statements. In practice most of the audits are compliance on technical audits and reviews of internal control systems are rarely carried out. The audit annual plan of each IG takes into consideration factors such as the amounts of budget expenditure of individual departments and units of the MDA and a broad assessment of risks associated with different activities. However a more systematic risk-based approach to internal audits is still in its infancy. Not all IGs have or employ internal audit standards, although some have checklists that are used as audit guidelines. Starting from 2006, IGs also review their MDA's annual financial statements, to ensure their reliability and integrity, prior to their submission to DG Treasury in MOF.

*136.* Audit reports of the IG are submitted to the agency's Minister. There is no requirement for submission of IG audit reports to the MOF and to BPK, though BPK has access to them. There is no audit committee within MDAs charged to assist in follow up of IG reports. IGs are expected to monitor action taken on their audit findings. However such actions are often significantly late. For example monitoring by IG of MOF shows delays in corrective action of up to three years.

*137.* The Sector Report on Accountability and Audit in Indonesia issued by the ADB in January 2007 has identified a lack of staff capacity (rather than staff numbers) in IGs as a constraint to fulfill their mandate on auditing. Sub-national governments have their own internal audit agencies (Bawasda's).

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-21. Effectiveness of internal audit. [M1]** | **D+** | |
| (i) Coverage and quality of the internal audit function | **D** | Most audits are confined to compliance and technical issues. Risk-based review of internal control systems is rarely performed. |
| (ii) Frequency and distribution of reports. | **C** | The audit reports are submitted to the minister, and BPK has access to the reports. |
| (iii) Extent of management response to internal audit findings. | **C** | Management's actions on audit findings are often significantly late. |

## Section 3.5. Accounting, Reporting and Auditing

### PI-22. Timeliness and regularity of accounts reconciliation

138. For bank accounts which it controls the Treasury has a reliable system for monitoring and reconciling the balances. This exercise is carried out monthly by the provincial offices of KPPN. A large number of imprest or advance accounts are also maintained at MDAs and these are not subject to regular reconciliations. Treasury Regulation #02/PB/2005 requires that such imprest advances at MDAs are cleared at the end of the fiscal year. In practice however amounts remain outstanding at the year-ends in some agencies and are generally subsequently either accounted for or returned to the KPPNs within 10 days after the end of the fiscal year or deducted from the following year's imprest funding..[25] Government financial statements have also reported unexplained balances in 'suspense' accounts at the year end, representing accounting differences between the Treasury and MDAs.[26] Though these amounts are immaterial, they could represent weaknesses in underlying control processes.

| Indicator | Score | Brief Explanation |
|---|---|---|
| **PI-22. Timeliness and regularity of accounts reconciliation. [M2]** | **B** | |
| (i) Regularity of bank reconciliations | B | The Treasury reconciles all its bank accounts at least monthly. However there are many bank accounts operated by MDAs which are not regularly reconciled. |
| (ii) Regularity of reconciliation and clearance of suspense accounts and advances. | B | Imprest accounts are reconciled annually. Some immaterial balances in 'Suspense' accounts have been reported in annual financial statements, reflecting unreconciled differences in the budget realization reports of Treasury and MDAs. |

### PI-23. Availability of information on resources received by service delivery units

139. Primary and secondary education is the responsibility of the city/district governments (with the exception of Islamic schools which are the responsibility of central government Ministry of Religious Affairs) and schools receive funding mainly from the provincial government and city/district budgets. Recently the central government also directly transferred a BOS (*Bantuan*

[25] These unsettled imprest balances in aggregate was Rp 1,457 billion as at end December 2006, representing 0.2% of aggregate annual expenditure during 2006".

[26] The unreconciled balance in Suspense accounts as at end 2006 amounted to Rp 916 billion or 0.13% of aggregate expenditure.

*Operasional Sekolah*) school operational support fund to schools in cities and districts. The BOS expenditure information is available at MoNE.

140. Although all local governments budgets and budget realizations are compiled and reported by MOF using the Local Government Financial Information System (*Sistem Informasi Keuangan Daerah*-SIKD), the system does not track how much is eventually channeled to individual schools. There is no accounting or reporting system at either MOF or MONE to regularly compile this information.

141. Some hospitals are operated by central government and information is available on their expenditures. However the great majority of hospitals and health centers are operated by local governments. While much of their operations are funded from the central government budget there is no information available on the total resources received by each institution, nor by their expenditure.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-23. Availability of information on resources received by service delivery units. [M1]** | **D** | |
| (i) Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (focus on primary schools and primary health clinics) in relation to the overall resources made available to the sector(s), irrespective of which level of government is responsible for the operation and funding of those units. | **D** | Responsibility for operation and funding of service delivery units is primarily at the city/district level. Information on total funds provided to or spent by primary education providers, such as primary school, is not readily available funds available to and from the accounting system. Nor is information available on expenditure by primary health providers, except for hospitals operated by central government. |

## PI-24. Quality and timeliness on in-year budget reports

142. Based on Law 17/2003 article 27(1), the central government prepares a first semester (six months) budget realization report. The first semester reports for both 2006 and 2007 became available in August and were sent to the Parliament, the line ministries and to Supreme Audit Board (BPK). They are also made available to the public in published document available on request. The classification of accounts in the report adheres to the MOF Regulation No. 59/PMK.06/2005 on Central Government Accounting System, presenting the appropriations and actual expenditures on the same basis.

143. DG Treasury produces central government's budget realization reports, based on an aggregation of data received from Treasury field offices (KPPNs). Spending units (or satkers) at MDAs also record expenditure in their own accounting system which has been developed by the DG Treasury but is not integrated with the Treasury's system. This accounting application provides a continuous budget realization monitoring tool for the MDA's based on an aggregation of budget realization records generated at the regional and satker levels, and is able to produce financial reports comparing budgets and actual expenditures at each level of the MDA. The

accounting system in use at MDAs is not integrated between the centre and the regional offices of each MDA which creates the risk of errors.

144. Every month budget realization reports of MDA's offices are sent to the corresponding level of DG Treasury offices, i.e. satker's report to KPPN, MDA regional offices report to DG Treasury regional office, MDA in total reports to DG Treasury, Directorate of Accounting and Financial Reporting (Directorate APK). The various reports are reconciled at different intervals. Satker and KPPN reports are reconciled every month, MDA regional office and DG Treasury regional office reports are reconciled every quarter, and MDA in total and Directorate APK's reports are reconciled every semester.

*145.* However in practice unreconciled differences between the budget realization reports of the Treasury and those of the MDAs continue. These differences are reported as a suspense item in the budget realization reports which have been disclosed in the annual financial statements since 2004. The suspense amount has increased from Rp 10.3 billion at 31 December 2004 to Rp 916.7 billion at 31 December 2006.. These amounts are not disclosed in the first semester reports as these reports are based on Treasury records only and are not reconciled with those of MDAs. However these amounts are a small percentage of total expenditures, amounting to only 0.13 percent for 2006

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-24. Quality and timeliness on in-year budget reports. [M1]** | **C+** | |
| (i) Scope of reports in terms of coverage and compatibility with budget estimates | **C** | The 2006 and 2007 First Semester Reports follow the structure of the annual financial statements, presenting the actual against the budget for all budget items. However the reports do not include expenditure commitments. |
| (ii) Timeliness of the issue of reports | **B** | The 2006 and 2007 First Semester Reports were delivered within 4 to 6 weeks of the semester-end. Accounting systems at MDAs are able to produce financial reports comparing budgets and realizations at each level of the MDA, though these are not aggregated or used for budgetary control within MDAs. |
| (iii) Quality of information | **C** | Reports serve the purpose of facilitating comparison of actual expenditures with budget. Continuing unreconciled differences between the Treasury and the MDA records and transactions from unreported bank accounts are a source of concern on reliability of information in Treasury reports. |

### PI-25. Quality and timeliness of annual financial statements

*146.* Government annual financial statements comprise a Balance Sheet, a Budget Realization report, a Cash Flow Statement and a set of explanatory notes to the financial statements. These statements contain comprehensive information on revenues, expenditures and financial assets and liabilities. The presentation of these financial statements complies with relevant Government accounting standards, though information on some elements of expenditure and assets were not complete. BPK disclaimed an audit opinion on the central government's 2006 financial statements. Among the reasons cited for this were serious internal control weaknesses in the preparation of the financial statements and instances of non compliance with applicable regulations.

147. Law 1/2004 article 55 requires unaudited financial statements to be submitted to BPK for audit no later than three months from the end of the fiscal year. Law 17/2003 requires the President to submit the budget accountability report containing the audited financial statement to the Parliament no later than sixth months from the end of the fiscal year. This requirement applies from the 2006 financial statements. The unaudited financial statements of 2006 were submitted to BPK on 28 March 2007, the audited statements to the parliament on 26 June 2007, thus meeting the timeliness requirements.

148. The MOF states in the 2006 financial statement that they were prepared in accordance with the Indonesian Government Accounting Standards which are promulgated through Government Regulation 24 of 2005 and are based on selected International Public Sector Accounting Standards (IPSAS). BPK audit reports indicate some areas that were not in compliance with the applicable national accounting standards, such as valuation of assets and investments in state-owned enterprises, universities, and multilateral organizations.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-25. Quality and timeliness of annual financial statements. [M1]** | **C+** | |
| (i) Completeness of the financial statements | **C** | Financial statements prepared annually are comprehensive. There are serious audit concerns mainly on reliability of information on assets and liabilities. Some omissions of expenditure and assets, have been reported by external audits. |
| (ii) Timeliness of submission of the financial statements | **A** | The financial statements for 2006 were submitted by the Government to BPK and Parliament within 6 months. |
| (iii) Accounting standards used | **B** | The Indonesian Government Accounting Standards, which are based on IPSAS, are applied, though some exceptions in application of standards have been reported by auditors. |

## Section 3.6 External Scrutiny and Audit

### PI-26. Scope, nature and follow-up of external audit

149. The Audit Board (BPK) was established under the Constitution and its roles and responsibilities are set out in Law No.15/2004. The organizational structure of BPK is outlined in the Decree of Secretary General No. 34/2007 and No. 39/2007 and its governance arrangements have been set out in Law 15/2006. BPK has a mandate to audit all government entities including MDAs as well as state owned enterprises (SOEs). Its independence from the Executive branch is reflected in its board members being appointed by the Parliament. It has recently received significant increase in its operating budget to fund an increase in the number of auditors and administrative staff as well as the number of regional offices.[27] All expenditures, revenues and assets/liabilities of the Government are subject to its audit. However since 2006 BPK has not been able to audit income tax revenues because access to individual tax payer records has been denied. This situation has arisen from the requirements enacted in taxation laws (No. 6/1983 and 16/2000)

[27] The total annual budget for BPK has in creased from Rp 234 billion in 2004 to Rp 690 billion in 2006. The number of regional offices has increased from 7 (2004) to 17 (2006).

under which only the Minister of Finance can authorize access to individual tax payer records, on a case by case basis. As a result, BPK has been unable to audit taxation revenues, which represent about 70% of central government revenues.

150. BPK performs financial, performance and special purpose audits. The audits are undertaken in accordance with the BPK Auditing Standards which are stipulated in BPK Regulation No.1/2007 on State Finance Auditing Standards. These standards are generally in line with international standards and have been applied since the 2006 fiscal year.

151. The audit report on the financial statements is submitted to the legislature within 5 months after the end of the fiscal year. Law No. 1/2004 requires that Government submit the financial statements to BPK within 3 months after the fiscal year end and BPK is required to submit the audited statements to Parliament within 2 months after their receipt (Law 15/2004). In the past three years the submission of the audited financial reports to Parliament has been timely. BPK also submits interim audit reports to the Parliament every six months on irregularities and inefficiencies it has identified at MDAs.

152. Auditees generally submit formal responses on audit recommendations and their implementation to BPK. The extent of follow up is regularly monitored by BPK and reported in its interim audit reports. Records maintained at BPK indicate that on an average of 80% of audited entities submit formal responses on follow up of audit findings. However this may not reflect the relative importance of recommendations. For example the audit report on the government financial statements for 2006 indicates that significant weaknesses in internal controls reported in earlier years have not been effectively addressed.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-26. Scope, nature and follow-up of external audit [M1]** | **C+** | |
| (i) Scope/nature of audit performed | **C** | Audits conducted by BPK cover all government entities including SOEs and AGAs. The limitation on the audit of 70% of tax revenues effectively limits the scope of audit to less then 75% of the aggregate auditable revenue and expenditure amounts. Audits generally adhere to stated auditing standards and raise systemic issues. |
| (ii) Timeliness of submission of audit reports to legislature | **A** | The audit reports on the annual financial statements were submitted to the legislature within two months of the receipt of the statements for the past 3 years, in compliance with the law. |
| (iii) Evidence of follow-up on audit recommendations | **B** | Follow up of audit recommendations by audited agencies is generally done formally and in a timely manner. The extent of follow-up is closely monitored and reported to the Audit Board. However the audit report on the government financial statements covering 2005 and 2006 fiscal years indicates that significant weaknesses in internal controls reported in earlier years have not been effectively addressed. |

## PI-27. Legislative scrutiny of the Annual Budget Law

153. The responsibility of Parliament to approve the annual Government budget are outlined in Laws 17/2003 and 25/2004. The relevant procedures are set out in detail in Parliament's Standing Orders and are often respected.

154. Budget documents submitted to the legislature include: (i) Government Work Plan (*Rencana Kerja Pemerintah or RKP*) as outlined in Article 25 of Law 25/2004, which is the basis for preparing the draft budget (RAPBN); (ii) Budget and Work Plans of line ministries and agencies as outlined in Article 14 of Law 17/2003, Government Regulation No. 21/2004 and Decree of Finance Minister No.54/PMK 02/2005. Parliament's powers to amend the proposed budget are unlimited, which generally leads to a high degree of involvement in budget deliberations. Parliament's involvement covers some seven months of the budget cycle, beginning with the review of the macro framework in March and ending with the passing of the annual budget law (APBN) in October.

155. The review undertaken by Parliament covers the macro economic framework, main fiscal policies and expenditures and revenues. However, a medium term expenditure framework to the programmed MDA level is not available for review. A detailed discussion of the annual work plans of MDAs takes place directly with the relevant parliamentary sectoral budget commissions. These discussions take place during June and August, as set out in Article 14 of Law 17/2003. A final review of budget appropriations, which includes appropriations classified by organizational units, functions, programs, activities and types of expenditure, is undertaken at a plenary session of the Parliament in accordance with Article 15 of Law 17/2003. In practice, parliamentary committees are often involved in details, down to the level of individual line items in the budget.

156. Procedures for the legislature's review are broadly defined in Articles 14 and 15 of Law 17/2003 and are generally respected. However, there are no detailed procedures specified for matters such as the conduct of negotiations during budget discussions, whereas it appears that in practice negotiations do occur. Capacity for research and analysis to support reviews is limited. Members are keenly aware that they lack sources of information and analysis[28]. Different Parliamentary Commissions appear to approach the budget review role differently. In practice, these factors reduce the effectiveness of the legislative scrutiny. As noted in the discussion on PI-11 some Commissions may not complete their review before the budget is passed in October, leading to "freezing" of some DIPAs until this is done.

157. Article 27 of Law 17/2003 clearly states rules for in-year budget amendments. These cover changes in budget appropriations caused by changes in the macro-economic assumptions and main fiscal policies and by inter-unit budget transfers. The law allows for reallocation of expenditures within approved programs and administrative units subject to approval by Ministry of Finance. Reallocation between different Ministries requires Parliamentary approval. Further, an increase in aggregate expenditure, for instance due to a budget surplus, is allowed when an excess budget balance (*Saldo Anggaran Lebih*) occurs, which requires Parliamentary approval. In practice these

[28] Report on capacity building needs of the DPR Secretariat to support DPR Committees and Commissions on the review of BPK reports. (Dr. S. Sherlock, Consultant to ADB, May 2006).

rules have been consistently respected. Ministerial regulations prescribe intra-agency in-year transfers within specified authority limits.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-27. Legislative Scrutiny of the Annual Budget Law [M1]** | **C+** | |
| (i) Scope of the legislative scrutiny | **B** | The review undertaken by Parliament covers macro economic framework, main fiscal policies and expenditures and revenues. A detailed discussion of the annual work plans of line ministries and AGAs takes place directly with the relevant parliamentary sectoral budget commissions. A complete medium term fiscal framework going to the program or MDA level is not yet in place. |
| (ii) Extent to which the legislature's procedures are well established and respected | **C** | Procedures for legislature review are broadly defined and are generally respected. However, there are no detailed procedures specified for matters such as negotiations during budget discussions. Research and analysis capacity of DPR Secretariat is also limited. These factors reduce effectiveness of Legislative scrutiny. |
| (iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined). | **C** | The budget review is undertaken over a period of about seven months. Parliament has some 6-8 weeks to review the draft budget once it is tabled in August until it is formally adopted in October. |
| (iv) Rules for in-year amendments to the budget without ex-ante approval by legislature | **A** | Clear rules exist for both inter and intra unit budget amendments and reallocations. In practice these rules have been consistently respected. |

## PI-28. Legislative scrutiny of external audit reports

158. Parliament is required by Article 21 of Law 15/2005 to review the implementation of interim and final audit recommendations with MDAs. In practice this is done through various Parliamentary sectoral budget commissions. However the Law does not set out the period within which the review process should be completed and it could take up to one year in practice. Twice a year before the recess period the sectoral commissions obtain from BPK an update on progress of implementation of audit findings.

159. Parliamentary commissions to hold hearings to discuss audit findings with responsible officials of MDAs, though this is not always done as a routine with formal procedures. The rigor and level of scrutiny varies between commissions and may sometimes be constrained by parliamentary staff capacity. MDAs may be asked to submit evidence and supporting documents related to the audit findings. The hearings normally involve not only MOF but also other entities and their officials and are based on the perceived seriousness of the issues to be discussed.

160. Article 16 of Law 15/2004 requires BPK to make recommendations on its audit findings. While the law contains no provision for the legislature to make recommendations on follow-up

actions, in practice this is occasionally done and agreements may be reached with MDAs to reinforce follow up actions on major audit findings. However there is no systematic reporting by commissions or Parliament as a whole on their conclusions or recommendations.

| Indicator | Score | Brief explanation |
|---|---|---|
| **PI-28. Legislative Scrutiny of external audit reports [M1]** | **C+** | |
| (i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years). | **C** | In practice the legislature completes its review of audit reports within 12 months and discusses the issues directly with the MDAs. |
| (ii) Extent of hearings on key findings undertaken by the legislature | **C** | Parliamentary commissions hold hearings to discuss audit findings with responsible officials of MDAs though this is not always done as a routine with formal procedures. The rigor with which this is done varies from commission to commission. The hearings may involve not only MOF but also other entities and their officials. |
| (iii) Issuance of recommended actions by the legislature and implementation by the executive | **B** | While the law contains no provision for the legislature to make recommendations on follow-up actions, this is occasionally done in practice. However there is no systematic reporting by commissions or Parliament as a whole on their conclusions, |

## Section 3.7. Donor Practices

### D-1. Predictability of Direct Budget Support

161. The government has received external financial assistance by way of direct budget support from the World Bank, Asian Development Bank (ADB), Japan Bank for International Cooperation (JBIC) and the Islamic Development Bank (IDB) during the past three years. Direct budget support funds contribute about 1.3% - 2.14% of the total central government expenditure budget. For the past three years budget support funds actually disbursed by donors exactly equaled annual donor projections, as indicated in the table below:

**Table 14 Aid Disbursements**

| | 2004 | 2005 | 2006 |
|---|---|---|---|
| Projections (USD million) | 500.0 | 692.8 | 1500.9 |
| Outturns (USD million) | 500.0 | 692.8 | 1500.9 |
| % difference | 0% | 0% | 0% |

162. The provision of budget support against planned revenues over the past three years as shown in the budget document (APBN) indicates that Government has reasonably good information in aggregate on the likely amount of direct budget support for the coming year. Donors provide projections of the amount and timing of direct budget support including any performance based tranches, at least one month before the budget is presented to Parliament. However actual in-year disbursements are less predictable and delays of 1-3 quarters occur, often due to delays in Government meeting performance targets. On an average at least 30% of the

actual disbursements planned for the second quarter get delayed to the fourth quarter. This appears to affect the overall level of in-year predictability of these flows for the budget.

| Indicator | Score | Brief explanation |
|---|---|---|
| **D-1 Predictability of Direct Budget Support. [M1]** | **D+** | |
| (i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature. | **A** | For the past three years budget support funds actually disbursed by donors exactly equaled donor projections. |
| (ii) In-year timelines of donor disbursements (compliance with aggregate quarterly estimates). | **D** | Actual in-year disbursements are less timely and delays of 1-3 quarters occur, often due to delays in Government meeting performance targets. On an average at least 30% of the actual disbursements planned for the second quarter get delayed to the fourth quarter. |

## D2. Financial Information provided by donors for budgeting and reporting

*163.* For the year 2006 the five largest donors (World Bank, ADB, JBIC, Islamic Development Bank and European Union) provided annual work plans to the government containing comprehensive and accurate quarterly budget estimates on disbursement of project aid flows for the coming year. A meeting between MOF and major donors is held every year. Information has been provided by donors at least two months before the beginning of the fiscal year and in a timely manner during the budget cycle and consistent with the Government's budget classifications. [29]

164. As discussed under PI-7 Government regulation No. 2/2006 on Foreign Grants and Loans requires all donor projects, including donor executed projects, to be included in government financial reports, but adequate reporting arrangements with donors have not yet been set up. To the extent that national procedures are not used, the frequency and coverage of donor reports of actual disbursements vary among donors. Some donors provide reports on a real-time basis, whilst others provide monthly or quarterly reports generally within 30 days. However, such reports are generally not consistent with Government's budget classification.

| Indicator | Score | Brief explanation |
|---|---|---|
| **D-2 Financial Information provided by donors for budgeting and reporting. [M1]** | **C+** | |
| (i) Completeness and timeliness of budget estimated by donors for project support | **B** | The five largest donors have provided to the Government comprehensive and accurate annual work plans in a timely manner within the budget cycle and consistent with the Government's budget classification. |

[29] Aggregate aid disbursed by these largest donors amounting to $3.3 billion covered about 80% of total aid.

| | | |
|---|---|---|
| (ii) Frequency and coverage of reporting by donors on actual donor flows for project support | **C** | Frequency and coverage of donor reports of actual disbursements of donor executed projects vary among donors. Some donors provide reports on a real-time basis, whilst others provide monthly or quarterly reports generally within 30 days. However, such reports are generally not consistent with Government's budget classification. |

### D-3 Proportion of aid that is managed by use of national procedures

165. Information for the five largest donors indicates that direct budget support, which uses national procedures in all respects, accounted for about 51% of total donor aid in 2006. For project assistance through both loans and grants national procedures are only partially used to varying degrees by different donors. Procurement arrangements for these funds generally do not use national procedures, nor generally do reporting arrangements. Authorization / accounting and auditing follow national procedures only for the World Bank and ADB projects. As a result, the overall proportion of project aid funds that use national systems for each of these four areas is estimated at 20%. The overall use of country procedures by these donors is therefore estimated at just over 60%.

**Table 15: Percentage of aid funds used through Govt. procedures**

| | Budget Support | Project Aid |
|---|---|---|
| World Bank | 100 | 50 |
| ADB | 100 | 50 |
| JBIC | 100 | 0 |
| IDB | 100 | 0 |
| AusAid | 0 | 0 |
| Proportion of Aid | 51% | 49% |
| Weighted Avge % using national procedures | 100% | 20% |

*Source: Govt Debt statistics issued by Ministry of Finance (DG External Funds***)**

| Indicator | Score | Brief explanation |
|---|---|---|
| **D-3 Proportion of aid that is managed by use of national procedures. [M1]** | **C** | The overall proportion of aid funds that use national systems for each of the four areas of procurement, authorization / accounting, auditing and reporting is estimated at 60%. |

## Section 3.8 Country Specific Issues

### Sub-national governments

166. A PFM assessment tool for Indonesian sub-national governments developed in 2005[30] has been used in assessing the PFM systems of some 30 sub-national governments in the provinces of

[30] Indonesia: Local Government Financial Management – A Measurement Framework November 2005 (The World Bank)

Aceh, Gorontalo and Sulawesi. Results from this assessment indicate that more than five years after the implementation of fiscal and political decentralization, financial management capacity remains weak and varies widely across local governments. Average scores were found to be low across most local governments, with particular weaknesses in budget execution, accounting and reporting, cash management and audit. Lack of PFM capacity in sub-national governments in some cases limits their ability to spend the increased funds which have been provided to them, resulting in budget and cash surpluses.

### Management of Oil Revenues

**167.** Revenues from oil and gas under production sharing contracts form a significant proportion (about one third) of State revenues. Information on oil and gas production and cost recovery is compiled by a body specifically assigned to the task of measuring and monitoring actual costs and revenues for oil and gas (Oil & Gas Regulatory Body or BPMIGAS). Actual realization of revenues however is not prepared in a form that is widely available or permits checking of prices and volumes. As a result, MOF does not have a clear basis to build revenue projections and assess fiscal risks.[31]

## SECTION 4 GOVERNMENT REFORM PROCESS

### 4.1. Description of Recent and Ongoing Reforms

168. Successive governments in the last several years have embarked on PFM reforms consistent with the 2001 White Paper. These followed the important political reforms introduced since 1998—including major decentralization and the direct election of the President. Key areas of progress so far include the following:

- Adopting a new legal framework for planning, budgeting, treasury management, and external audit. New laws were adopted during 2003–04 and government implementing regulations were issued thereafter.
- Restructuring the Ministry of Finance**.** A first restructuring occurred in 2003, when the Directorate General (DG) of Treasury was established, separate from DG Budget. A second restructuring occurred in 2006, when a new Fiscal Policy Office (FPO) was established with a focus on macro-fiscal policies and projections, and a new DG Debt was created by splitting off two directorates from DG Treasury, with external and domestic debt management consolidated in one DG.
- Formally unifying the previous routine and development budgets into a single State Budget document, with effect from the 2005 budget.
- Introducing as from the 2005 annual budget, a new economic and functional classification for budgetary expenditures, based on the IMF's Government Finance Statistics Manual (GFSM 2001) system.[32]
- Beginning a process of rationalizing government bank accounts and improving cash management**.**[33] A principal objective is to establish a treasury single account (TSA) and to

[31] Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module. IMF 2006
[32] Indonesia: Treasury Modernization and Related Reforms, (IMF, April 2005), and Report on the Government Finance Statistics Mission, (IMF January 11–24, 2006).

close government bank accounts outside the DG Treasury's control (or, if they remain open, to reduce the balance to zero at the end of each business day).

- Issuing government accounting standards, based on modified accrual accounting, as a transition towards full accrual standards at a later date. Templates for accounting statements to be used by central and local governments have also been issued.
- Finalizing plans for the computerization of treasury operations (the SPAN project) which is part of the Government Financial Management and Revenue Administration Project (GFMRAP) which is funded by the Bank. The GFMRAP also includes components to support change in the budget system—within the MOF and BAPPENAS—as well as for improving parliamentary involvement and oversight of the budget approval processes.
- Issuing by Presidential Decree *(80/2003)* several good practices in the procurement regime and laying out a plan for establishing a national Public Procurement Organization as a policy formulation and oversight agency. An omnibus procurement law is envisaged for consolidating, clarifying and simplifying the numerous procurement rules and regulations. This law, currently under preparation, would further strengthen the legal foundation for modernizing public procurement.
- Strengthening the mandate of external audit institution (BPK). *The State Audit Law* legislated in 2004 lays out the broad framework for the operation on the supreme audit institution, BPK[34], to reinforce its position and mandate as an external audit institution reporting to Parliament. A separate law (BPK Law) was passed in 2006 to cover the institutional arrangements for the management and oversight of BPK.
- Enhancing parliamentary oversight of budget processes**.** Parliamentary commissions have become particularly active in scrutinizing and amending the government's draft annual budget.

169. Progress towards developing performance based budgeting and an MTEF has been limited. However the 2008 budget has seen some important steps towards a more policy based budget that seeks to link budget allocations more closely with the government work plan (RKP). The RKP identifies four broad priority areas or development categories (basic services, poverty and equity; support for growth; security and support and other) covering a total of seven key objectives. This has resulted for the first time in some significant budget reallocations, following a review of the effectiveness of some existing programs in achieving these objectives. This change has seen the proposed 2008 budget allocations held to 2007 budget allocations for 11 line ministries and agencies and reduced for 10 line ministries and agencies. The quality of budget documentation now has been expanded to show more information including, for the first time, a statement of fiscal risks. The 2008 budget also included for the first time projections for the major budget aggregates for the two out years, although it remains unclear how this information will be used and the extent to which it will roll-over into the preparation of the 2009 budget.

## 4.2. Institutional Factors Supporting Reform Planning and Implementation

170. Government officials have referred on a number of occasions to the objective of Indonesia having a "world class" PFM system by 2008. The PFM reform agenda also appears to have high level political support through the active interest of the Minister of Finance. It also has strong potential linkages with the government's anti-corruption agenda, which reinforces this political

[33] Indonesia: Improving Cash and Debt Management, by I. Lienert et. al (IMF, March 2007).
[34] *Badan Permeriksa Keuangan*

support. In particular greater budget transparency, the procurement reforms, the development of the Treasury single account and the strengthening of the external audit institution have significant potential to reduce official corruption.

171. Donor involvement is another important factor in supporting the PFM reform agenda. Both the Bank and the IMF have assisted the government to carry out significant PFM diagnostic work. Apart from the recent studies mentioned in Annex A the IMF in particular has reviewed PFM reforms and needs in a series of technical missions in over the past four years [35] when Indonesia was party to an IMF agreed program.

172. However in some other areas institutional factors could work against the PFM reform agenda. For example, there is a lack of a clearly articulated reform strategy or "road map", setting out the content and sequence of individual reform initiatives and the role to be played by all parties (MOF, Bappenas, line ministries, BKN, Ministry of Administrative Development and desirably also BPK and Parliament). Such a strategy would help ensure that individual initiatives are appropriately sequenced and coordinated between different players. It would help socialize the PFM reform program to a wider group of stakeholders and participants who are directly involved in its implementation.

173. A final key barrier to the implementation of PFM reforms is lack of technical capacity – in MOF, Bappenas and line ministries to both design and implement the reforms. In principle the IPEA, is a vehicle for this training but only limited progress has been made so far. The MOF Training and Education Agency (STAN) also has a potentially important role.

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[35] Indonesia, Capacity Building to Support Treasury Modernization and Related Reforms August 2004; Indonesia, PFM Reform, Next Steps, September 2003; Indonesia, Action Plans to Improve Public Expenditure Management, April 2003; IMF FAD/World Bank Report on Budget Reform Strategy Priorities 2007; IMF FAD Technical Assistance Report Statement of Fiscal Risks 2007; Indonesia: Report on Observance of Standards & Codes – Fiscal Transparency Module.

## Annex A: Sources of Information and Main References - by Indicator

| Indicator | Specific Information Sources Used |
|---|---|
| **A. Credibility of the Budget** | |
| 1. Aggregate expenditure out-turn compared to original approved budget | LKPP 04, 05, 06.<br>Nota Keuangan APBN 2004 and UU 28/2003<br>Nota Keuangan APBN 2005 and UU 9/2004<br>Nota Keuangan APBN 2006 and UU 13/2005.<br><br>Public Expenditure Review 2007<br>IMF FAD/World Bank Report on Budget Reform Strategy Priorities 2007 |
| 2. Composition of expenditure out-turn compared to original approved budget | LKPP 04, 05, 06.<br>Nota Keuangan APBN 2004 and UU 28/2003<br>Nota Keuangan APBN 2005 and UU 9/2004<br>Nota Keuangan APBN 2006 and UU 13/2005. |
| 3. Aggregate revenue out-turn compared to original approved budget | LKPP 04, 05, 06.<br>Nota Keuangan APBN 2004 and UU 28/2003<br>Nota Keuangan APBN 2005 and UU 9/2004<br>Nota Keuangan APBN 2006 and UU 13/2005. |
| 4. Stock and monitoring of expenditure payment arrears | Interviews with Hekinus Manao, Paruli Lubis |
| **B. Comprehensiveness and Transparency** | |
| 5. Classification of the Budget | PMK 13/PMK.06/2005 (Chart of Accounts)<br>Nota Keuangan 04, 05, 06<br><br>IMF FAD/World Bank Report on Budget Reform Strategy Priorities<br>IMF Fiscal ROSC 2005 |
| 6. Comprehensiveness of information included in budget documentation | Nota Keuangan 04, 05, 06<br>LKPP 04,05,06<br><br>IMF FAD/World Bank Report on Budget Reform Strategy Priorities 2007<br>IMF Fiscal ROSC 2005 |
| 7. Extent of unreported government operations | LKPP 04/05/06<br><br>IMF Fiscal ROSC 2005<br>Report: Update on Govt. Financial reports – Richard Evans. Sept 2007. |
| 8. Transparency of Inter-Governmental Fiscal Relations | Law 33/2004 on Fiscal Balance<br>PP 3/2004 on General Allocation Grant<br>Nota Keuangan 05/06/07/08<br><br>Public Expenditure Review 2007<br>Eckardt/Shah 2007 Local Government Finance and Organization in Indonesia, in: Local Government Finance and Organization in Developing Countries. |
| 9. Oversight of aggregate fiscal risk from other public sector entities. | Nota Keuangan 2008<br><br>IMF FAD Technical Assistance Report Statement of Fiscal Risks 2007 |

| Indicator | Specific Information Sources Used |
|---|---|
| 10. Public access to key fiscal information | LKPP 04, 05, 06.<br>Nota Keuangan APBN 2004 and UU 28/2003<br>Nota Keuangan APBN 2005 and UU 9/2004<br>Nota Keuangan APBN 2006 and UU 13/2005.<br><br>IMF FAD/World Bank Report on Budget Reform Strategy Priorities 2007<br>Open Budget Index Indonesia 2006 |
| **C(i) Policy-Based Budgeting** | |
| 11. Orderliness and participation in the annual budget process | Law 17/2003 on State Finances<br><br>Public Expenditure Review 2007<br>IMF FAD/World Bank Report on Budget Reform Strategy Priorities 2007 |
| 12. Multi-year perspective in fiscal planning, expenditure policy and budgeting | Law 17/2003 on State Finances<br>PP 21/2004 on Budget Request Templates<br>Nota Keuangan APBN 2004 and UU 28/2003<br>Nota Keuangan APBN 2005 and UU 9/2004<br>Nota Keuangan APBN 2006 and UU 13/2005<br>Nota Keuangan APBN 2008<br><br>Public Expenditure Review 2007<br>IMF FAD/World Bank Report on Budget Reform Strategy Priorities 2007<br>Indonesia: PFM Reforms - Next Steps (IMF Sept. 2003)<br>Indonesia – Action Plans to Improve Public Expenditure Management (IMF April 2003). |
| **C (ii) Predictability and Control in Budget Execution** | |
| 13. Transparency of taxpayer obligations and liabilities | • Law 6/1983, Law 16/2000 & Law 28/2007 on General Provisions & tax Procedures<br>• Law 7/1983 & Law 17/2000 on Income tax<br>• Law 8/1983 & Law 18/2000 on Value Added Tax & sales tax for Luxury Goods<br>• Law 12/1994 on Land & Building Tax<br>• Tax Brief (August 2007) by Center for Investment & Business Advisory – KADIN<br>• Briefing Material prepared by KADIN for IMF – FAD Mission<br>• Aide Memoire – Improving VAT Administration. IMF – FAD – January 2007.<br>• Discussion Notes with DG Tax.<br>• 2007 Taxpayers Education Program from DG Tax<br>• Law 14/2002<br>• Discussion with the Tax Court and DG Tax on the statistical data of cases handled by the Court.<br>• DG Tax Circular Letter (SE)-37/PJ/2007 dated 14 August 2007 on Standard Operating Procedures for filing an objection within the DG Tax. |

| Indicator | Specific Information Sources Used |
|---|---|
| 14. Effectiveness of measures for taxpayer registration and tax assessment | • DG Tax Circular Letter (SE)-37/PJ/2007 dated 14 August 2007 on Standard Operating Procedures for registering TIN<br>• Presentation on Satisfaction Survey – Medium tax Payers' office, March 2007. AC Nielson.<br>• Discussion Notes with the Indonesian Chamber of Commerce.<br>• Discussion with the DG Tax on the TIN Database.<br>• Summary of Type of Penalties Applied In Accordance to the Existing Laws (Internal Document from the DG Tax).<br>• Summary of Planning and Monitoring Mechanism of Tax Audit and Fraud Investigation Program from DG Tax.<br>• Risk Management Model of DG Tax for Risk Based Audit Approach. |
| 15. Effectiveness in collection of tax payments | • Reconciliation Process of Tax Revenue<br>• Statistical Data of Tax Revenue (5 years) and Arrears (3 years) from DG Tax<br>• Discussion Note with Directorate of Cash Management<br>• Discussion Notes with DG Tax<br>• Report: Update on Govt. Financial reports – Richard Evans. Sept 2007. |
| 16. Predictability in the availability of funds for commitment of expenditures | • Law 13/2005 on Government Budget for 2006<br>• Law 14/2006 on Revision of Government Budget for 2006<br>• Law 36/2004 on Government Budget for 2005<br>• Law 1/2005 on Revision of Law 36/2004 on Government Budget for 2005<br>• Law 9/2005 on Second Revision of Law 36/2004 on Government Budget for 2005<br>• Law 28/2003 on Government Budget for 2004<br>• Law 35/2004 on Revision of Law 28/2003 on Government Budget for 2004<br>• 2006 Central Government Financial Report (audited)<br>• Finance Minister regulation No 134/PMK.06/ 2005 on Guidelines for Budget Execution<br>• Circular Letter of Director General Treasury No. SE 02/PB/2006<br>• Interview with MPW-Head of Finance Bureau |
| 17. Recording and management of cash balances, debt and guarantees | • 2006 Central Government Financial Report (audited)<br>• Draft SOP on Debt Management<br>• BPK's Audit Report on Central Government Internal Control as at 31 December 2006<br>• Government Regulation 76/2005 on the accountability and publication of SUN Management<br>• Joint Regulation of Minister of Finance and Minister of National Planning regulation 185 /KMK.03 /1995 and KEP.031 /KET/5/1995 (which was amended by Joint Regulation No 459 / KMK. 03/1999<br>• Finance Minister Regulation 77/PMK.06/2006 on SUN Management Report<br>• Press release from Ministry of Finance – 20 Aug. 2007 on Govt. bank accounts<br>• Indonesia: Capacity Building to support Treasury Modernization & related Reforms: (IMF 2004) |
| 18. Effectiveness of payroll controls | • Interview with the MOH-General Affairs Bureau<br>• Interview with MOF-IG<br>• Parliament website : (http://www.dpr.go.id/buletinparlementaria/berita_isi.php?id=106&ed=12) |

| Indicator | Specific Information Sources Used |
|---|---|
| 19. Competition, value for money and controls in procurement | • Govt Regulation 80/2003.<br>• MPH Guidelines for Procurement Process.<br>• Minister of Public Health Decree No.323/2005 on Public Complaint and Handling for Procurement Process<br>• Procurement Data for Contract above Rp.50 million from MoH, MoNE and MPW<br>• Minister of Public Health Decree No.604/2005 on Procurement Audit.<br>• Discussion Notes with MoNE and MoH on the Procurement Process including complaints and handling.<br>• Discussion Notes with MoNE on the Procurement Process including complaints and handling.<br>• Discussion notes with BAPPENAS on the implementation of the Govt. Regulation 80/2003<br>• Snapshot Assessment of Indonesia's Public Procurement System– OECD / DAC Baseline Indicator Benchmarking Methodology. (June 2007) |
| 20. Effectiveness of internal controls for non-salary expenditure | • Minister of Finance, with the letter S-551/MK.06/2005 informed that 2006 DIPA was issued to all line ministries on January 2006<br>• 2006 Central Government Financial Report (audited)<br>• President Decree 80/2003 on Procurement of Goods and Services<br>• BPK Audit Reports on Central Government Financial Reports (2005, 2006) |
| 21. Effectiveness of internal audit | • The President Regulation 9/2005 on the structure of the line ministries<br>• The President Regulation 10/2005 on the structure and responsibility of the Echelon 1 Units at line ministries<br>• Interview with MOF-IG auditors<br>• STAR-SDP report "Sector Report on Accountability and Audit in Indonesia" issued in January 2007<br>• BPK's Government Auditing Standards (*Standar Pemeriksaan Keuangan Negara*-SPKN)<br>• MOF-IG monitoring report on the follow up status of 2006 audit findings |
| **C (iii) Accounting, Recording and Reporting** | |
| 22. Timeliness and regularity of accounts reconciliation | • Ministry of Finance Regulation No 59/PMK.06/2005 on Central Government Accounting System<br>• 2006 Central Government Financial Report (audited)<br>• 2005 Central Government Financial Report (audited)<br>• 2004 Central Government Financial Report (audited) |
| 23. Availability of information on resources received by service delivery units | • World Bank's Indonesia Public Expenditure Review 2007<br>• Local Government Financial Information System (Sistem Informasi Keuangan Daerah-SIKD) at MOF (available online at www.sikd.djapk.go.id) |
| 24. Quality and timeliness of in-year budget reports | • Law 17/2003 on State Finance<br>• Ministry of Finance Regulation No 59/PMK.06/2005 on Central Government Accounting System<br>• 2006 First Semester Budget Realization report<br>• Treasury Circular No 66/PB/2006 on reconciliation accounting records at the KPPN and DG Treasury's Regional Office levels<br>• Sample of Accounting Records Reconciliation Report (BAR-Berita Acara Rekonsiliasi) : Temporary and Final BARs |

| Indicator | Specific Information Sources Used |
|---|---|
| 25. Quality and timeliness of annual financial statements | • Law 17/2003 on State Finance<br>• Law 1/2004 on State Treasury<br>• BPK-RI Audit Reports for 2004, 2005, 2006<br>• Audit report date data from BPK-RI Audit Reports 2004, 2005, 2006<br>• Letter from the President to DPR RI No R-37/Pres/06/2007 dated 26 June 2007<br>• Information from Directorate APK's staff<br>• Report: Update on Govt. Financial reports – Richard Evans. Sept 2007. |
| **C (iv) External Scrutiny and Audit** | |
| 26. Scope, nature and follow-up of external audit | • Law 15/2004 on Audits of the State Finance Management and Accountability<br>• Law 15/2006 on the BPK Roles and Responsibilities<br>• Decree of the BPK Secretary General No.34/2007 and 39/2007 on the BPK Organizational Structure.<br>• Law 1/2004 on State Treasury<br>• Statistical data of BPK audited entities (2004-2006).<br>• BPK Interim Audit Report (HAPSEM) 2006<br>• Statistical data on follow up of the audit findings for year 2005 and 2006.<br>• Statistical data on the submission of audit report (audited LKPP) to Parliament (DPR).<br>• BPK Audit Report of the Government Financial Reports for 2006. |
| 27. Legislative scrutiny of the annual budget law | • Law 17/2003<br>• Law 25/2004<br>• Government Regulation No.21/2004<br>• Decree of Finance Minister No.54/PMK.02/2005<br>• Discussion Notes with Member of Parliament/Commission on the procedures for legislature review on the government budget. |
| 28. Legislative scrutiny of external audit reports | • Law 15/2004<br>• Discussion Notes with Member of Parliament/Commission on the follow up actions of the BPK audit recommendations.<br>• Report on capacity building needs of the DPR Secretariat to support DPR Committees and Commissions on the review of BPK reports. (Dr. S. Sherlock, Consultant to ADB, May 2006). |
| **D. Donor Practices** | |
| D-1 Predictability of Direct Budget Support | • Statistical Data of Direct Budget Support Funds Projections and Actual Disbursement for 2004, 2005 and 2006 (From Directorate of Debt Management).<br>• Data of the Disbursement Schedules of the Direct Budget Support. |
| D-2 Financial information provided by donors for budgeting and reporting on project and programme aid | • Discussion Notes with Directorate of Debt Management on Donor's Annual Work Plan (AWP), Donor's Reporting format, schedules and frequency.<br>• Government Regulation No. 2/2006; |

| Indicator | Specific Information Sources Used |
| --- | --- |
| D-3 Proportion of aid that is managed by use of national procedures | • Government Regulation No. 2/2006;<br>• Statistical Data on the Direct Budget Support (three years)<br>• Statistical Data on Government Budget (2005-2007)<br>• Discussion Notes with BAPPENAS and the State Secretariat on the process and recording of the external loans. |

## Annex B: PEFA Assessment Meetings: List of Persons Met

| Ser. No. | Institution | Department | Person | Designation |
|---|---|---|---|---|
| 1 | State Secretariat | Secretariat General | Rildo Ananda Anwar | Secretary General |
| 2 | State Secretariat | Secretariat General | Suharsono | Head of Finance Bureau |
| 3 | State Secretariat | Bureau for International Technical Cooperation | Suprapto | Head of Bureau |
| 4 | State Secretariat | Bureau for International Technical Cooperation | Arwindrija Rukma | Head of Multilateral Technical Cooperation Division |
| 5 | State Secretariat | Planning Bureau | Sukma Irawan | Head of Bureau |
| 6 | State Secretariat | Multilateral Technical Cooperation Division | Dr. Arwandrija Rukma | Division Head |
| 7 | State Secretariat | Internal Control Bureau | Guntur | Head of Internal Control |
| 8 | DPR | | Eva K. Sundari MA, MDE | Member of Parliament of RI |
| 9 | MOF | Secretary General's Office | Mulia Nasution | Secretary General |
| 10 | MOF | Secretary General's Office | Agus Suprianto | Director , PUSHAKA |
| 11 | MOF | Secretary General's Office | Adi Budiarso | |
| 12 | MOF | Fiscal Policy | Askolani | Ka Pusak Kebijakan Belanja Negara |
| 13 | MOF | DG Budget Development Allocation | Achmad Rochjadi | Director |
| 14 | MOF | DG Budget Development Allocation | Ernest Patria | |
| 15 | MOF | DG Budget Development Allocation | Hageng S. Nugroho | |
| 16 | MOF | DG Custom & Excise | Wahyu Purnomo | Director |
| 17 | MOF | DG Custom & Excise International Affairs Bureau | Hendi Budi Santoso | Deputy Director |
| 18 | MOF | DG Custom & Excise International Affairs Bureau – Multilateral section | Amelia Rose | Head |
| 19 | MOF | DG Debt Management | Tor Tobing | Director |
| 20 | MOF | DG Debt Management | Widjarnako | Director |
| 21 | MOF | DG Treasury | Hekinus Manao | Director pf Information & Accountancy |
| 22 | MOF | DG Finance Balancing | Kadjatmiko | Secretary |
| 23 | MOF | DG Finance Balancing | Mardiasmo | Director |
| 24 | MOF | DG Fiscal Risk Management | Rionald Silaban | Director |

| Ser. No. | Institution | Department | Person | Designation |
|---|---|---|---|---|
| 25 | MOF | DG Treasury | Herry Purnomo | Director General |
| 26 | MOF | | K. A. Badaruddin | Director |
| 27 | MOF | Inspectorate General | Permana Agung Daradjatun | Inspector General |
| 28 | MOF | DG Tax | Robert Pakpahan | Director-Business Process Transformation |
| 29 | MOF | | Luki Alfirman | |
| 30 | MOF | DG Tax – Audit Department | Asprilantomi | Head of Department |
| 31 | MOF | Directorate of Business Process Transformation | Hantriono Joko Susilo | |
| 32 | MOF | DG of Debt Management | Ayu Sukorini | Director |
| 33 | MOF | Directorate of Evaluation, Accounting and Settlement | Widjanarko | Director |
| 34 | MOF | Inspectorate General | Robert Gonijaya | Head of Section |
| 35 | MPW | Finance Bureau | Iwan Eddy Putranto | Head of Department |
| 36 | MPW | | Sudarmadi | Kabag Keuangan |
| 37 | MPW | | Raden Kenan | |
| 38 | MPW | Personnel Bureau | Yadi Sisyadi | Head of Bureau |
| 39 | MOH | Finance Bureau | Harmen Mardjunin | Head of Administration Section |
| 40 | MOH | General Affairs Bureau | Wandaningsih | Head of Bureau |
| 41 | MOH | Finance Bureau | Bagus Trihandono | Head of Verification Section |
| 42 | MONE | DG Management of Primary and Secondary Education | Renani Pantjastuti | Head of Finance Section |
| 43 | MONE | IG- Sub Directorate Audit Planning | Maralus Panggabean | Head of Department |
| 44 | BAPPENAS | | Wismana Adi Subrata | Director of Budget Development & Allocation |
| 45 | BAPPENAS | | Agus Rahardja | |
| 46 | BPK | Bureau for Public Relation-International Cooperation | Bernardus Dwita Pradana | Director |
| 47 | BPK | Tax Audit Sub Directorate | Gregory Novy Palenkahu | Head of Department |
| 48 | BPK | Office of the Audit Board Member (MoNE, MoH, Local Governments of Eastern Area of Indonesia) | Yusuf John | Head of Department |

| Ser. No. | Institution | Department | Person | Designation |
|---|---|---|---|---|
| 49 | BPK | Research and Development Bureau (auditing section) | Bachtiar Arief Rachmadi | Head of Department |
| 50 | Indonesian Chamber of Commerce and Industry | International Department | John A. Prasetyo | Chairman |
| 51 | Indonesian Chamber of Commerce and Industry | International Department | Munir M. Ali | Consultant |
| 52 | Indonesian Chamber of Commerce and Industry | International Department | Wilmar J Sidabutar | Member |
| 53 | Ernst & Young | Transaction Advisory Services | L. David Rimbo | Partner |
| 54 | Ernst & Young | Taxation | Rachmanto Surahmat | Senior Partner |
| 55 | Ernst & Young | Taxation | Ben Koesmodjana | Senior Manager |

## Annex C: PEFA Scoring Calibration of Individual Indicators

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
|---|---|---|
| **PI 1 [M1]** **Aggregate expenditure out-turn compared to original approved budget** (i) The difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges, but also excluding externally financed project expenditure). | **A** | (i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure. |
| | **B** | (i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 10 % of budgeted expenditure. |
| | **C** | (i) In no more than one of the last three years has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to 15% of budgeted expenditure. |
| | **D** | (i) In two or all of the last three years did the actual expenditure deviate from budgeted expenditure by an amount equivalent to more than 15% of budgeted expenditure. |
| **PI 2 [M1]** **Composition of expenditure out-turn compared to original approved budget** (i) Extent to which variance in primary expenditure composition exceeded overall devialtion in primary expenditure (as defined in PI 1) during the last three years. | **A** | (i) Variance in expenditure composition exceeded overall deviation in primary expenditure by no more than 5 percentage points in any of the last three years. |
| | **B** | (i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 5 percentage points in no more than one of the last three years. |
| | **C** | (i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than one of the last three years. |
| | **D** | (i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in at least two out of the last three years. |
| **PI 3 [M1]** **Aggregate revenue out-turn compared to original approved budget** (i) Actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget. | **A** | (i) Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years. |
| | **B** | (i) Actual domestic revenue collection was below 94% of budgeted domestic revenue estimates in no more than one of the last three years. |
| | **C** | (i) Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in no more than one of the last three years. |
| | **D** | (i) Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in two or all of the last three years. |
| **PI 4 [M1]** **Stock and monitoring of expenditure payment arrears** (i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the | **A** | (i) The stock of arrears is low (i.e. is below 2% of total expenditure)<br>(ii) Reliable and complete data on the stock of arrears is generated through routine procedures at least at the end of each fiscal year (and includes an age profile). |
| | **B** | (i) The stock of arrears constitutes 2-10% of total expenditure; and there is evidence that it has been reduced significantly (i.e. more than 25%) in the last two years.<br>(ii) Data on the stock of arrears is generated annually, but may not be |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
|---|---|---|
| stock.<br>(ii) Availability of data for monitoring the stock of expenditure payment arrears. | | complete for a few identified expenditure categories or specified budget institutions. |
| | **C** | (i) The stock of arrears constitutes 2-10% of total expenditure; and there is no evidence that it has been reduced significantly in the last two years.<br>(ii) Data on the stock of arrears has been generated by at least one comprehensive ad hoc exercise within the last two years. |
| | **D** | (i) The stock of arrears exceeds 10% of total expenditure.<br>(ii) There is no reliable data on the stock of arrears from the last two years. |
| **<u>PI 5 [M1]</u>**<br>**Classification of the budget**<br>(i) The classification system used for formulation, execution and reporting of the central government's budget. | **A** | (i) The budget formulation and execution is based on administrative, economic and sub-functional classification, using GFS/COFOG (Classification of Function of Govt.) standards or a standard that can produce consistent documentation according to those standards. (Program classification may substitute for sub-functional classification, if it is applied with a level of detail at least corresponding to sub-functional.) |
| | **B** | (i) The budget formulation and execution is based on administrative, economic and functional classification (using at least the 10 main COFOG functions), using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards. |
| | **C** | (i) The budget formulation and execution is based on administrative and economic classification using GFS standards or a standard that can produce consistent documentation according to those standards. |
| | **D** | (i) The budget formulation and execution is based on a different classification (e.g. not GFS compatible or with administrative break-down only). |
| **<u>P1 6 [M1]</u>**<br>**Comprehensiveness of information included in budget documentation**<br>(i) Share of the above listed information in the budget documentation most recently issued by the central government (in order to count in the assessment, the full specification of the information benchmark must met) | **A** | (i) recent budget documentation fulfils 7-9 of the 9 information benchmarks |
| | **B** | (i) recent budget documentation fulfils 5-6 of the 9 information benchmarks |
| | **C** | (i) recent budget documentation fulfils 3-4 of the 9 information benchmarks |
| | **D** | (i) recent budget documentation fulfils 2 or less of the 9 information benchmarks |
| **<u>P1 7 [M1]</u>**<br>**Extend of unreported government operations**<br>(i) The level of extra-budgetary expenditure (other than donor funded projects which is unreported i.e. not included in fiscal reports.<br>(ii) Income/expenditure | **A** | (i) The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of total expenditure).<br>(ii) Complete income/expenditure information for 90% (value) of donor-funded projects is included in fiscal reports, except inputs provided in-kind OR donor funded project expenditure is insignificant (below 1% of total expenditure). |
| | **B** | (i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 1-5% of total expenditure. |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
| --- | --- | --- |
| information on donor-funded projects which is included in fiscal reports. | | (ii) Complete income/expenditure information is included in fiscal reports for all loan financed projects and at least 50% (by value) of grant financed projects. |
| | C | (i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 5-10% of total expenditure.<br>(ii) Complete income/expenditure information for all loan financed projects is included in fiscal reports. |
| | D | (i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes more than 10% of total expenditure.<br>(ii) Information on donor financed projects included in fiscal reports is seriously deficient and does not even cover all loan financed operations. |
| **PI 8 [M2]**<br>**Transparency of Inter-Governmental Fiscal Relations**<br>(i) Transparency and objectivity in the horizontal allocation among SN governments | A | The horizontal allocation of almost all transfers (at least 90% by value) from central government is determined by transparent and rules based systems. |
| | B | The horizontal allocation of most transfers from central government (at least 50% of transfers) is determined by transparent and rules based systems. |
| | C | The horizontal allocation of only a small part of transfers from central government (10-50%) is determined by transparent and rules based systems. |
| | D | No or hardly any part of the horizontal allocation of transfers from central government is determined by transparent and rules based systems. |
| **PI 8 [M2]**<br>**Transparency of Inter-Governmental Fiscal Relations**<br>(ii) Timeliness of reliable information to SN governments on their allocations | A | SN governments are provided reliable information on the allocations to be transferred to them before the start of their detailed budgeting processes |
| | B | SN governments are provided reliable information on the allocations to be transferred to them ahead of completing their budget proposals, so that significant changes to the proposals are still possible |
| | C | Reliable information to SN governments is issued before the start of the SN fiscal year, but too late for significant budget changes to be made |
| | D | Reliable estimates on transfers are issued after SN government budgets have been finalized, or earlier issued estimates are not reliable |
| **PI 8 [M2]**<br>**Transparency of Inter-Governmental Fiscal Relations**<br>(iii) Extent of consolidation of fiscal data for general government according to sectoral categories | A | Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for 90% (by value) of SN government expenditure and consolidated into annual reports within 10 months of the end of the fiscal year. |
| | B | Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for at least 75% (by value) of SN government expenditure and consolidated into annual reports within 18 months of the end of the fiscal year. |
| | C | Fiscal information (at least ex-post) that is consistent with central government fiscal reporting is collected for at least 60% (by value) |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
|---|---|---|
| | | of SN government expenditure and consolidated into annual reports within 24 months of the end of the fiscal year. |
| | **D** | Fiscal information that is consistent with central government fiscal reporting is collected and consolidated for less than 60% (by value) of SN government expenditure OR if a higher proportion is covered, consolidation into annual reports takes place with more than 24 months delay, if at all. |
| **<u>PI 9 [M1]</u>**<br>**Oversight of aggregate fiscal risk from other public sector entities**<br>(i) Extent of central government monitoring of AGAs and PEs.<br>(ii) Extent of central government monitoring of SN governments' fiscal position. | **A** | (i) All major AGAs/PEs submit fiscal reports to central government at least six-monthly, as well as annual audited accounts, and central government consolidates fiscal risk issues into a report at least annually.<br>(ii) SN government cannot generate fiscal liabilities for central government OR the net fiscal position is monitored at least annually for all levels of SN government and central government consolidates overall fiscal risk into annual (or more frequent) reports. |
| | **B** | (i) All major AGAs/PEs submit fiscal reports including audited accounts to central governments at least annually, and central government consolidates overall fiscal risk issues into a report.<br>(ii) The net fiscal position is monitored at least annually for the most important level of SN government, and central government consolidates overall fiscal risk into a report. |
| | **C** | (i) Most major AGAs/PEs submit fiscal reports to central governments at least annually, but a consolidated overview is missing or significantly incomplete.<br>(ii) The net fiscal position is monitored at least annually for the most important level of SN government, but a consolidated overview is missing or significantly incomplete. |
| | **D** | (i) No annual monitoring of AGAs and PEs takes place, or it is significantly incomplete.<br>(ii) No annual monitoring of SN governments' fiscal position takes place or it is significantly incomplete. |
| **<u>PI 10 [M1]</u>**<br>**Public Access to key fiscal information**<br>(i) Number of the above listed elements of public access to information that is fulfilled (in order to count in the assessment, the full specification of the information benchmark must be met). | **A** | (i) The government makes available to the public 5-6 of the 6 listed types of information. |
| | **B** | (i) The government makes available to the public 3-4 of the 6 listed types of information. |
| | **C** | (i) The government makes available to the public 1-2 of the 6 listed types of information. |
| | **D** | (i) The government makes available to the public none of the 6 listed types of information. |
| **<u>PI 11 [M2]</u>**<br>**Orderliness and participation in the annual budget process**<br>(i) Existence of and adherence to a fixed budget calendar | **A** | A clear annual budget calendar exists, is generally adhered to and allows MDAs enough time (and at least six weeks from receipt of the budget circular) to meaningfully complete their detailed estimates on time. |
| | **B** | A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows MDAs reasonable time (at least four weeks from receipt of the budget circular) so that most of them are able to meaningfully complete |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
|---|---|---|
| | | their detailed estimates on time. |
| | C | An annual budget calendar exists, but is rudimentary and substantial delays may often be experienced in its implementation, and allows MDAs so little time to complete detailed estimates, that many fail to complete them timely. |
| | D | A budget calendar is not prepared OR it is generally not adhered to OR the time allowed for MDAs' budget preparation is clearly insufficient to make meaningful submissions. |
| <u>**PI 11 [M2]**</u><br>**Orderliness and participation in the annual budget process**<br>(ii) Guidance on the preparation of budget submissions | A | A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent) prior to the circular's distribution to MDAs. |
| | B | A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent). This approval takes place after the circular distribution to MDAs, but before MDAs have completed their submission. |
| | C | A budget circular is issued to MDAs, including ceilings for individual administrative units or functional areas. The budget estimates are reviewed and approved by Cabinet only after they have been completed in all details by MDAs, thus seriously constraining Cabinet's ability to make adjustments. |
| | D | A budget circular is not issued to MDAs OR the quality of the circular is very poor OR Cabinet is involved in approving the allocations only immediately before submission of detailed estimates to the legislature, thus having no opportunities for adjustment. |
| <u>**PI 11 [M2]**</u><br>**Orderliness and participation in the annual budget process**<br>(iii) Timely budget approval by the legislature | A | The legislature has, during the last three years, approved the budget before the start of the fiscal year. |
| | B | The legislature approves the budget before the start of the fiscal year, but a delay of up to two months has happened in one of the last three years. |
| | C | The legislature has, in two of the last three years, approved the budget within two months of the start of the fiscal year. |
| | D | The budget has been approved with more than two months delay in two of the last three years. |
| <u>**PI 12 [M2]**</u><br>**Multi-year perspective in fiscal planning, expenditure policy and budgeting**<br>(i) Multi-year fiscal forecasts and functional allocations | A | Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least three years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences explained. |
| | B | Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least two years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences are explained. |
| | C | Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis. |
| | D | No forward estimates of fiscal aggregates are undertaken |

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| **PI 12 [M2]** **Multi-year perspective in fiscal planning, expenditure policy and budgeting** (ii) Scope and frequency of debt sustainability analysis | **A** | DSA for external and domestic debt is undertaken annually. |
| | **B** | DSA for external and domestic debt is undertaken at least once during the last three years. |
| | **C** | A DSA for at least for external debt undertaken once during last three years. |
| | **D** | No DSA has been undertaken in the last three years. |
| **PI 12 [M2]** **Multi-year perspective in fiscal planning, expenditure policy and budgeting** (iii) Existence of costed sector strategies | **A** | Strategies for sectors representing at least 75% of primary expenditure exist with full costing of recurrent and investment expenditure, broadly consistent with fiscal forecasts. |
| | **B** | Statements of sector strategies exist and are fully costed, broadly consistent with fiscal forecasts, for sectors representing 25-75% of primary expenditure. |
| | **C** | Statements of sector strategies exist for several major sectors but are only substantially costed for sectors representing up to 25% of primary expenditure OR costed strategies cover more sectors but are inconsistent with aggregate fiscal forecasts. |
| | **D** | Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure. |
| **PI 12 [M2]** **Multi-year perspective in fiscal planning, expenditure policy and budgeting** (iv) Linkages between investment budgets and forward expenditure estimates | **A** | Investments are consistently selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector. |
| | **B** | The majority of important investments are selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector. |
| | **C** | Many investment decisions have weak links to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases. |
| | **D** | Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared. |
| **PI 13 [M2]** **Transparency of Taxpayer Obligations and Liabilities** (i) Clarity and comprehensiveness of tax liabilities | **A** | Legislation and procedures for all major taxes are comprehensive and clear, with strictly limited discretionary powers of the government entities involved. |
| | **B** | Legislation and procedures for most, but not necessarily all, major taxes are comprehensive and clear, with fairly limited discretionary powers of the government entities involved. |
| | **C** | Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to substantial discretionary powers of the government entities involved. |
| | **D** | Legislation and procedures are not comprehensive and clear for large areas of taxation and/or involve important elements of administrative discretion in assessing tax liabilities. |
| **PI 13 [M2]** | **A** | Taxpayers have easy access to comprehensive, user friendly and |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
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| **Transparency of Taxpayer Obligations and Liabilities**<br>(ii) Taxpayers' access to information on tax liabilities and administrative procedures | | up-to-date information tax liabilities and administrative procedures for all major taxes, and the RA supplements this with active taxpayer education campaigns. |
| | B | Taxpayers have easy access to comprehensive, user friendly and up-to-date information on tax liabilities and administrative procedures for some of the major taxes, while for other taxes the information is limited. |
| | C | Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date. |
| | D | Taxpayer access to up-to-date legislation and procedural guidelines is seriously deficient. |
| **PI 13 [M2]**<br>**Transparency of Taxpayer Obligations and Liabilities**<br>(iii) Existence and functioning of a tax appeals mechanism. | A | A tax appeals system of transparent administrative procedures with appropriate checks and balances, and implemented through independent institutional structures, is completely set up and effectively operating with satisfactory access and fairness, and its decisions are promptly acted upon. |
| | B | A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow up on its decisions need to be addressed.. |
| | C | A tax appeals system of administrative procedures has been established, but needs substantial redesign to be fair, transparent and effective. |
| | D | No functioning tax appeals system has been established |
| **PI 14 [M2]**<br>**Effectiveness of measures for taxpayer registration and tax assessment**<br>(i) Controls in the taxpayer registration system. | A | Taxpayers are registered in a complete database system with comprehensive direct linkages to other relevant government registration systems and financial sector regulations. |
| | B | Taxpayers are registered in a complete database system with some linkages to other relevant government registration systems and financial sector regulations. |
| | C | Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers. |
| | D | Taxpayer registration is not subject to any effective controls or enforcement systems. |
| **PI 14 [M2]**<br>**Effectiveness of measures for taxpayer registration and tax assessment**<br>(ii) Effectiveness of penalties for non-compliance with registration and tax declaration | A | Penalties for all areas of non-compliance are set sufficiently high to act as deterrence and are consistently administered. |
| | B | Penalties for non-compliance exist for most relevant areas, but are not always effective due to insufficient scale and/or inconsistent administration. |
| | C | Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance. |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
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| | **D** | Penalties for non-compliance are generally non-existent or ineffective (i.e. set far too low to have an impact or rarely imposed). |
| **PI 14 [M2]**<br>**Effectiveness of measures for taxpayer registration and tax assessment**<br>(iii) Planning and monitoring of tax audit programs. | **A** | Tax audits and fraud investigations are managed and reported on according to a comprehensive and documented audit plan, with clear risk assessment criteria for all major taxes that apply self-assessment. |
| | **B** | Tax audits and fraud investigations are managed and reported on according to a documented audit plan, with clear risk assessment criteria for audits in at least one major tax area that applies self-assessment. |
| | **C** | There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria. |
| | **D** | Tax audits and fraud investigations are undertaken on an ad hoc basis if at all. |
| **PI 15 [M1]**<br>**Effectiveness in collection of tax payments.**<br>(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years).<br>(ii) Effectiveness of transfer of tax collections to be Treasury by the revenue administration.<br>(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury. | **A** | (i) The average debt collection ratio in the two most recent fiscal years was 90% or above OR the total amount of tax arrears is insignificant (i.e. less than 2% of total annual collections).<br>(ii) All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily.<br>(iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least monthly within one month of end of month. |
| | **B** | (i) The average debt collection ratio in the two most recent fiscal years was 75-90% and the total amount of tax arrears is significant.<br>(ii) Revenue collections are transferred to the Treasury at least weekly.<br>(iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least quarterly within six weeks of end of quarter. |
| | **C** | (i) The average debt collection ratio in the two most recent fiscal years was 60-75% and the total amount of tax arrears is significant<br>(ii) Revenue collections are transferred to the Treasury at least monthly.<br>(iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least annually within 3 months of end of the year. |
| | **D** | (i) The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collections).<br>(ii) Revenue collections are transferred to the Treasury less regularly than monthly<br>(iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place annually or is done with more than 3 months' delay. |
| **PI 16 [M1]**<br>**Predictability in the availability** | **A** | (i) A cash flow forecast is prepared for the fiscal year, and are updated monthly on the basis of actual cash inflows and outflows.<br>(ii) MDAs' are able to plan and commit expenditure for at least six |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
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| **of funds for commitment of expenditures**<br>(i) Extent to which cash flows are forecast and monitored.<br>(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment.<br>(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs. | | month in advance in accordance with the budgeted appropriations.<br>(iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a transparent and predictable way. |
| | **B** | (i) A cash flow forecast is prepared for the fiscal year and updated at least quarterly, on the basis of actual cash inflows and outflows.<br>(ii) MDAs are provided reliable information on commitment ceilings at least quarterly in advance.<br>(iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a fairly transparent way. |
| | **C** | (i) A cash flow forecast is prepared for the fiscal year, but is not (or only partially and infrequently) updated.<br>(ii) MDAs are provided reliable information for one or two months in advance.<br>(iii) Significant in-year budget adjustments are frequent, but undertaken with some transparency. |
| | **D** | (i) Cash flow planning and monitoring are not undertaken or of very poor quality.<br>(ii) MDAs are provided commitment ceilings for less than a month OR no reliable indication at all of actual resource availability for commitment.<br>(iii) Significant in-year budget adjustments are frequent and not done in a transparent manner. |
| <u>**PI 17 [M2]**</u><br>**Recording and management of cash balances, debt and guarantees**<br>(i) Quality of debt data recording and reporting | **A** | Domestic and foreign debt records are complete, updated and reconciled on a monthly basis with data considered of high integrity. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least quarterly. |
| | **B** | Domestic and foreign debt records are complete, updated and reconciled quarterly. Data considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least annually. |
| | **C** | Domestic and foreign debt records are complete, updated and reconciled at least annually. Data quality is considered fair, but some gaps and reconciliation problems are recognized. Reports on debt stocks and service are produced only occasionally or with limited content. |
| | **D** | Debt data records are incomplete and inaccurate to a significant degree. |
| <u>**PI 17 [M2]**</u><br>**Recording and management of cash balances, debt and guarantees**<br>(ii) Extent of consolidation of the government's cash balances | **A** | All cash balances are calculated daily and consolidated. |
| | **B** | Most cash balances calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement. |
| | **C** | Calculation and consolidation of most government cash balances take place at least monthly, but the system used does not allow consolidation of bank balances. |
| | **D** | Calculation of balances takes place irregularly, if at all, and the system used does not allow consolidation of bank balances. |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
|---|---|---|
| **PI 17 [M2]**<br>**Recording and management of cash balances, debt and guarantees**<br>(iii) Systems for contracting loans and issuance of guarantees. | **A** | Central government's contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets, and always approved by a single responsible government entity. |
| | **B** | Central government's contracting of loans and issuance of guarantees are made within limits for total debt and total guarantees, and always approved by a single responsible government entity. |
| | **C** | Central government's contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria or overall ceilings. |
| | **D** | Central government's contracting of loans and issuance of guarantees are approved by different government entities, without a unified overview mechanism. |
| **PI 18 [M1]**<br>**Effectiveness of payroll controls.**<br>(i) Degree of integration and reconciliation between personnel records and payroll data.<br>(ii) Timeliness of changes to personnel records and the payroll.<br>(iii) Existence of payroll audits to identify control weaknesses and/or ghost workers.<br>(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers. | **A** | (i) Personnel database and payroll are directly linked to ensure data consistency and monthly reconciliation.<br>(ii) Required changes to the personnel records and payroll are updated monthly, generally in time for the following month's payments. Retroactive adjustments are rare (if reliable data exists, it shows corrections in max. 3% of salary payments).<br>(iii) Authority to change records and payroll is restricted and results in an audit trail.<br>(iv) A strong system of annual payroll audits exists to identify control weaknesses and/or ghost workers. |
| | **B** | (i) Personnel data and payroll data are not directly linked but the payroll is supported by full documentation for all changes made to personnel records each month and checked against the previous month's payroll data.<br>(ii) Up to three months' delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally.<br>(iii) Authority and basis for changes to personnel records and the payroll are clear.<br>(iv) A payroll audit covering all central government entities has been conducted at least once in the last three years (whether in stages or as one single exercise). |
| | **C** | (i) A personnel database may not be fully maintained but reconciliation of the payroll with personnel records takes place at least every six months.<br>(ii) Up to three months delay occurs in processing changes to personnel records and payroll for a large part of changes, which leads to frequent retroactive adjustments.<br>(iii) Controls exist, but are not adequate to ensure full integrity of data.<br>(iv) Partial payroll audits or staff surveys have been undertaken within the last 3 years. |
| | **D** | (i) Integrity of the payroll is significantly undermined by lack of complete personnel records and personnel database, or by lacking reconciliation between the three lists.<br>(ii) Delays in processing changes to payroll and nominal roll are often significantly longer than three months and require |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
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| | | widespread retroactive adjustments.<br>(iii) Controls of changes to records are deficient and facilitate payment errors.<br>(iv) No payroll audits have been undertaken within the last three years. |
| **PI 19 [M2]**<br>**Competition, value for money and controls in procurement.**<br>(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases | **A** | Accurate data on the method used to award public contracts exists and shows that more than 75% of contracts above the threshold are awarded on the basis of open competition. |
| | **B** | Available data on public contract awards shows that more than 50% but less than 75% of contracts above the threshold are awarded on basis of open competition, but the data may not be accurate. |
| | **C** | Available data shows that less than 50% of contracts above the threshold are awarded on an open competitive basis, but the data may not be accurate. |
| | **D** | Insufficient data exists to assess the method used to award public contracts OR the available data indicates that use of open competition is limited. |
| **PI 19 [M2]**<br>**Competition, value for money and controls in procurement.**<br>(ii) Justification for use of less competitive procurement methods | **A** | Other less competitive methods when used are justified in accordance with clear regulatory requirements. |
| | **B** | Other less competitive methods when used are justified in accordance with regulatory requirements. |
| | **C** | Justification for use of less competitive methods is weak or missing. |
| | **D** | Regulatory requirements do not clearly establish open competition as the preferred method of procurement. |
| **PI 19 [M2]**<br>**Competition, value for money and controls in procurement.**<br>(iii) Existence and operation of a procurement complaints mechanism | **A** | A process (defined by legislation) for submission and timely resolution of procurement process complaints is operative and subject to oversight of an external body with data on resolution of complaints accessible to public scrutiny. |
| | **B** | A process (defined by legislation) for submitting and addressing procurement process complaints is operative, but lacks ability to refer resolution of the complaint to an external higher authority. |
| | **C** | A process exists for submitting and addressing procurement complaints, but it is designed poorly and does not operate in a manner that provides for timely resolution of complaints. |
| | **D** | No process is defined to enable submitting and addressing complaints regarding the implementation of the procurement process. |
| **PI 20 [M1]**<br>**Effectiveness of internal controls for non-salary expenditure.**<br>(i) Effectiveness of expenditure commitment controls.<br>(ii) Comprehensiveness, relevance and understanding of other internal control | **A** | (i) Comprehensive expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations (as revised).<br>(ii) Other internal control rules and procedures are relevant, and incorporate a comprehensive and generally cost effective set of controls, which are widely understood.<br>(iii) Compliance with rules is very high and any misuse of simplified and emergency procedures is insignificant. |
| | **B** | (i) Expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
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| rules/procedures.<br>(iii) Degree of compliance with rules for processing and recording transactions. | | budget allocations for most types of expenditure, with minor areas of exception.<br>(ii) Other internal control rules and procedures incorporate a comprehensive set of controls, which are widely understood, but may in some areas be excessive (e.g. through duplication in approvals) and lead to inefficiency in staff use and unnecessary delays.<br>(iii) Compliance with rules is fairly high, but simplified/emergency procedures are used occasionally without adequate justification. |
| | **C** | (i) Expenditure commitment control procedures exist and are partially effective, but they may not comprehensively cover all expenditures or they may occasionally be violated.<br>(ii) Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. Some rules and procedures may be excessive, while controls may be deficient in areas of minor importance.<br>(iii) Rules are complied with in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations is an important concern. |
| | **D** | (i) Commitment control systems are generally lacking OR they are routinely violated.<br>(ii) Clear, comprehensive control rules/procedures are lacking in other important areas.<br>(iii) The core set of rules are not complied with on a routine and widespread basis due to direct breach of rules or unjustified routine use of simplified/emergency procedures. |
| <u>**PI 21 [M1]**</u><br>**Effectiveness of internal audit**<br>(i) Coverage and quality of the internal audit function.<br>(ii) Frequency and distribution of reports.<br>(iii) Extent of management response to internal audit findings. | **A** | (i) Internal audit is operational for all central government entities, and generally meet professional standards. It is focused on systemic issues (at least 50% of staff time).<br>(ii) Reports adhere to a fixed schedule and are distributed to the audited entity, ministry of finance and the SAI.<br>(iii) Action by management on internal audit findings is prompt and comprehensive across central government entities. |
| | **B** | (i) Internal audit is operational for the majority of central government entities (measured by value of revenue/expenditure), and substantially meet professional standards. It is focused on systemic issues (at least 50% of staff time).<br>(ii) Reports are issued regularly for most audited entities are distributed to the audited entity, the ministry of finance and the SAI.<br>(iii) Prompt and comprehensive action is taken by many (but not all) managers. |
| | **C** | (i) The function is operational for at least the most important central government entities and undertakes some systems review (at least 20% of staff time), but may not meet recognized professional standards.<br>(ii) Reports are issued regularly for most government entities, but may not be submitted to the ministry of finance and the SAI.<br>(iii) A fair degree of action taken by many managers on major issues but often with delay |
| | **D** | (i) There is little or no internal audit focused on systems monitoring. |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
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| | | (ii) Reports are either non-existent or very irregular.<br>(iii) Internal audit recommendations are usually ignored (with few exceptions). |
| **PI 22 [M2]**<br>**Timeliness and regularity of accounts reconciliation.**<br>(i) Regularity of bank reconciliations | **A** | Bank reconciliation for all central government bank accounts take place at least monthly at aggregate and detailed levels, usually within 4 weeks of end of period. |
| | **B** | Bank reconciliation for all Treasury managed bank accounts take place at least monthly, usually within 4 weeks from end of month. |
| | **C** | Bank reconciliation for all Treasury managed bank accounts take place quarterly, usually within 8 weeks of end of quarter. |
| | **D** | Bank reconciliation for all Treasury managed bank accounts take place less frequently than quarterly OR with backlogs of several months. |
| **PI 22 [M2]**<br>**Timeliness and regularity of accounts reconciliation.**<br>(ii) Regularity of reconciliation and clearance of suspense accounts and advances | **A** | Reconciliation and clearance of suspense accounts and advances take place at least quarterly, within a month from end of period and with few balances brought forward. |
| | **B** | Reconciliation and clearance of suspense accounts and advances take place at least annually within two months of end of period. Some accounts have uncleared balances brought forward. |
| | **C** | Reconciliation and clearance of suspense accounts and advances take place annually in general, within two months of end of year, but a significant number of accounts have uncleared balances brought forward. |
| | **D** | Reconciliation and clearance of suspense accounts and advances take place either annually with more than two months' delay, OR less frequently. |
| **PI 23 [M1]**<br>**Availability of information on resources received by service delivery units.**<br>(i) Collection & processing of info to demonstrate the resources that were actually received (in cash & kind) by the most common front-line service delivery units (focus on primary schools & primary health clinics) in relation to the overall resources made available to the sector(s), irrespective of which level of government is responsible for the operation and funding those units | **A** | (i) Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by both primary schools and primary health clinics across the country. The information is compiled into reports at least annually. |
| | **B** | (i) Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by either primary schools or primary health clinics across most of the country with information compiled into reports at least annually; OR special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by both primary schools and primary health clinics across most of the country (including by representative sampling). |
| | **C** | (i) Special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by either primary schools or primary health clinics covering a significant part of the country OR by primary service delivery units at local community level in several other sectors. |
| | **D** | (i) No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last 3 years. |
| **PI 24 [M1]** | **A** | (i) Classification of data allows direct comparison to the original |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
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| **Quality and timeliness of in-year budget reports.**<br>(i) Scope of reports in terms of coverage and compatibility with budget estimates.<br>(ii) Timeliness of the issue of reports.<br>(iii) Quality of information. | | budget. Information includes all items of budget estimates. Expenditure is covered at both commitment and payment stages.<br>(ii) Reports are prepared quarterly or more frequently, and issued within 4 weeks of end of period.<br>(iii) There are no material concerns regarding data accuracy. |
| | **B** | (i) Classification allows comparison to budget but only with some aggregation. Expenditure is covered at both commitment and payment stages.<br>(ii) Reports are prepared quarterly, and issued within 6 weeks of end of quarter.<br>(iii) There are some concerns about accuracy, but data issues are generally highlighted in the reports and do not compromise overall consistency/ usefulness. |
| | **C** | (i) Comparison to budget is possible only for main administrative headings. Expenditure is captured either at commitment or at payment stage (not both).<br>(ii) Reports are prepared quarterly (possibly excluding first quarter), and issued within 8 weeks of end of quarter.<br>(iii) There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness. |
| | **D** | (i) Comparison to the budget may not be possible across all main administrative headings.<br>(ii) Quarterly reports are either not prepared or often issued with more than 8 weeks delay.<br>(iii) Data is too inaccurate to be of any real use. |
| <u>**PI 25 [M1]**</u><br>**Quality and timeliness of annual financial statements.**<br>(i) Completeness of the financial statements.<br>(ii) Timeliness of submission of the financial statements.<br>(iii) Accounting standards used. | **A** | (i) A consolidated government statement is prepared annually and includes full information on revenue, expenditure and financial assets/liabilities.<br>(ii) The statement is submitted for external audit within 6 months of the end of the fiscal year.<br>(iii) IPSAS or corresponding national standards are applied for all statements. |
| | **B** | (i) A consolidated government statement is prepared annually. They include, with few exceptions, full information on revenue, expenditure and financial assets/liabilities<br>(ii) The consolidated government statement is submitted for external audit within 10 months of the end of the fiscal year.<br>(iii) IPSAS or corresponding national standards are applied. |
| | **C** | (i) A consolidated government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete, but the omissions are not significant.<br>(ii) The statements are submitted for external audit within 15 months of the end of the fiscal year.<br>(iii) Statements are presented in consistent format over time with some disclosure of accounting standards. |
| | **D** | (i) A consolidated government statement is not prepared annually, OR essential information is missing from the financial statements OR the financial records are too poor to enable audit.<br>(ii) If annual statements are prepared, they are generally not submitted for external audit within 15 months of the end of the |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
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| | | fiscal year<br>(iii) Statements are not presented in a consistent format over time or accounting standards are not disclosed. |
| **<u>PI 26 [M1]</u>**<br>**Scope, nature and follow-up of external audit**<br>(i) Scope/nature of audit performed (incl. adherence to auditing standards)<br>(ii) Timeliness of submission of audit reports to legislature.<br>(iii) Evidence of follow up on audit recommendations. | **A** | (i) All entities of central government are audited annually covering revenue, expenditure and assets/liabilities. A full range of financial audits and some aspects of performance audit are performed and generally adhere to auditing standards, focusing on significant and systemic issues.<br>(ii) Audit reports are submitted to the legislature within 4 months of the end of the period covered and in the case of financial statements from their receipt by the audit office.<br>(iii) There is clear evidence of effective and timely follow up. |
| | **B** | (i) Central government entities representing at least 75% of total expenditures12 are audited annually, at least covering revenue and expenditure. A wide range of financial audits are performed and generally adheres to auditing standards, focusing on significant and systemic issues.<br>(ii) Audit reports are submitted to the legislature within 8 months of the end of the period covered and in the case of financial statements from their receipt by the audit office.<br>(iii) A formal response is made in a timely manner, but there is little evidence of systematic follow up. |
| | **C** | (i) Central government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only.<br>(ii) Audit reports are submitted to the legislature within 12 months of the end of the period covered (for audit of financial statements from their receipt by the auditors).<br>(iii) A formal response is made, though delayed or not very thorough, but there is little evidence of any follow up. |
| | **D** | (i) Audits cover central government entities representing less than 50% of total expenditures or audits have higher coverage but do not highlight the significant issues.<br>(ii) Audit reports are submitted to the legislature more than 12 months from the end of the period covered (for audit of financial statements from their receipt by the auditors).<br>(iii) There is little evidence of response or follow up. |
| **<u>PI 27 [M1]</u>**<br>**Legislative scrutiny of the annual budget law**<br>(i) Scope of the legislature's scrutiny.<br>(ii) Extent to which the legislature's procedures are well-established and respected.<br>(iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for | **A** | (i) The legislature's review covers fiscal policies, medium term fiscal framework and medium term priorities as well as details of expenditure and revenue.<br>(ii) The legislature's procedures for budget review are firmly established and respected. They include internal organizational arrangements, such as specialized review committees, and negotiation procedures.<br>(iii) The legislature has at least two months to review the budget proposals.<br>(iv) Clear rules exist for in-year budget amendments by the executive, set strict limits on extent and nature of amendments and are consistently respected. |
| | **B** | (i) The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue. |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
|---|---|---|
| proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined).<br>(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature. | | (ii) Simple procedures exist for the legislature's budget review and are respected.<br>(iii) The legislature has at least one month to review the budget proposals.<br>(iv) Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations. |
| | **C** | (i) The legislature's review covers details of expenditure and revenue, but only at a stage where detailed proposals have been finalized.<br>(ii) Some procedures exist for the legislature's budget review, but they are not comprehensive and only partially respected.<br>(iii) The legislature has at least one month to review the budget proposals.<br>(iv) Clear rules exist, but they may not always be respected OR they may allow extensive administrative reallocation as well as expansion of total expenditure. |
| | **D** | (i) The legislature's review is non-existent or extremely limited, OR there is no functioning legislature.<br>(ii) Procedures for the legislature's review are non-existent or not respected.<br>(iii) The time allowed for the legislature's review is clearly insufficient for a meaningful debate (significantly less than one month).<br>(iv) Rules regarding in-year budget amendments may exist but are either very rudimentary and unclear, OR they are usually not respected. |
| **<u>PI 28 [M1]</u>**<br>**Legislative scrutiny of external audit reports.**<br>(i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years).<br>(ii) Extent of hearings on key findings undertaken by the legislature.<br>(iii) Issuance of recommended actions by the legislature and implementation by the executive. | **A** | (i) Scrutiny of audit reports is usually completed by the legislature within 3 months from receipt of the reports.<br>(ii) In-depth hearings on key findings take place consistently with responsible officers from all or most audited entities, which receive a qualified or adverse audit opinion.<br>(iii) The legislature usually issues recommendations on action to be implemented by the executive, and evidence exists that they are generally implemented. |
| | **B** | (i) Scrutiny of audit reports is usually completed by the legislature within 6 months from receipt of the reports.<br>(ii) In-depth hearings on key findings take place with responsible officers from the audited entities as a routine, but may cover only some of the entities, which received a qualified or adverse audit opinion.<br>(iii) Actions are recommended to the executive, some of which are implemented, according to existing evidence. |
| | **C** | (i) Scrutiny of audit reports is usually completed by the legislature within 12 months from receipt of the reports.<br>(ii) In-depth hearings on key findings take place occasionally, cover only a few audited entities or may include with ministry of finance officials only.<br>(iii) Actions are recommended, but are rarely acted upon by the executive. |
| | **D** | (i) Examination of audit reports by the legislature does not take place |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
|---|---|---|
| | | or usually takes more than 12 months to complete.<br>(ii) No in-depth hearings are conducted by the legislature.<br>(iii) No recommendations are being issued by the legislature. |
| **D1 [M1]**<br>**Predictability of Direct Budget Support.**<br>(i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body).<br>(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates) | **A** | (i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 5%.<br>(ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years. |
| | **B** | (i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 10%.<br>(ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years. |
| | **C** | (i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 15%.<br>(ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 50% in two of the last three years. |
| | **D** | (i) In at least two of the last three years did direct budget support outturn fall short of the forecast by more than 15% OR no comprehensive and timely forecast for the year(s) was provided by the donor agencies.<br>(ii) The requirements for score C (or higher) are not met. |
| **D2 [M1]**<br>**Financial information provided by donors for budgeting and reporting on project and program aid.**<br>(i) Completeness and timeliness of budget estimates by donors for project support.<br>(ii) Frequency and coverage of reporting by donors on actual donor flows for project support. | **A** | (i) All donors (with the possible exception of a few donors providing insignificant amounts) provide budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification.<br>(ii) Donors provide quarterly reports within one month of end-of-quarter on the all disbursements made for at least 85% of the externally financed project estimates in the budget, with a break-down consistent with the government budget classification. |
| | **B** | (i) At least half of donors (including the five largest) provide complete budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification.<br>(ii) Donors provide quarterly reports within one month of end-of-quarter on the all disbursements made for at least 70% of the externally financed project estimates in the budget with a break-down consistent with the government budget classification. |
| | **C** | (i) At least half of donors (including the five largest) provide complete budget estimates for disbursement of project aid for the government's coming fiscal year, at least three months prior its start. Estimates may use donor classification and not be consistent with the government's budget classification.<br>(ii) Donors provide quarterly reports within two months of end-of-quarter on the all disbursements made for at least 50% of the externally financed project estimates in the budget. The |

| INDICATOR & DIMENSION [Scoring Method] | SCORE | MINIMUM REQUIREMENTS FOR DIMENSION SCORE |
|---|---|---|
| | | information does not necessarily provide a break-down consistent with the government budget classification. |
| | **D** | (i) Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior its start.<br>(ii) Donors do not provide quarterly reports within two month of end-of-quarter on the disbursements made for at least 50% of the externally financed project estimates in the budget. |
| **<u>D3 [M1]</u>**<br>**Proportion of aid that is managed by use of national procedures.**<br>(i) Overall proportion of aid funds to central government that are managed through national procedures. | **A** | (i) 90% or more of aid funds to central government are managed through national procedures. |
| | **B** | (i) 75% or more of aid funds to central government are managed through national procedures. |
| | **C** | (i) 50% or more of aid funds to central government are managed through national procedures. |
| | **D** | (i) Less than 50% of aid funds to central government are managed through national procedures. |

## Annex D: Calculation of Deviations by Budget Heads 2006

(Rupiah)

| Item | Budget Head | Budget APBN UU 13/2005 | Actual* LKPP 2006 | Difference | Absolute Deviation | Percent |
|---|---|---|---|---|---|---|
| 1 | Subsidies and Transfers | 114,659,300,000,000 | 134,532,400,000,000 | 19,873,100,000,000 | 19,873,100,000,000 | 17% |
| 2 | Department of National Education | 36,755,900,000,000 | 39,460,200,000,000 | 2,704,300,000,000 | 2,704,300,000,000 | 7% |
| 3 | Other Expenditure | 31,923,400,000,000 | 40,809,000,000,000 | 8,885,600,000,000 | 8,885,600,000,000 | 28% |
| 4 | Department of Land Affairs | 28,229,200,000,000 | 26,961,400,000,000 | (1,267,800,000,000) | 1,267,800,000,000 | 4% |
| 5 | Department of Public Works | 18,013,800,000,000 | 18,268,300,000,000 | 254,500,000,000 | 254,500,000,000 | 1% |
| 6 | State Police | 16,778,200,000,000 | 15,942,400,000,000 | (835,800,000,000) | 835,800,000,000 | 5% |
| 7 | Department of Health | 13,523,600,000,000 | 14,225,000,000,000 | 701,400,000,000 | 701,400,000,000 | 5% |
| 8 | Department of Religious Affairs | 9,720,900,000,000 | 10,647,100,000,000 | 926,200,000,000 | 926,200,000,000 | 10% |
| 9 | Agency for Reconstruction of Aceh and Nias | 9,617,600,000,000 | 11,464,100,000,000 | 1,846,500,000,000 | 1,846,500,000,000 | 19% |
| 10 | Department of Transportation | 8,452,300,000,000 | 8,037,400,000,000 | (414,900,000,000) | 414,900,000,000 | 5% |
| 11 | Department of Finance | 6,617,900,000,000 | 6,578,400,000,000 | (39,500,000,000) | 39,500,000,000 | 1% |
| 12 | Department of Agriculture | 6,285,100,000,000 | 6,218,100,000,000 | (67,000,000,000) | 67,000,000,000 | 1% |
| 13 | Department of Energy and Nat. Resources | 5,382,400,000,000 | 5,096,600,000,000 | (285,800,000,000) | 285,800,000,000 | 5% |
| 14 | Department of Foreign Affairs | 4,747,100,000,000 | 4,753,800,000,000 | 6,700,000,000 | 6,700,000,000 | 0% |
| 15 | Department of Legal Affairs and Human Rights | 3,376,900,000,000 | 3,397,700,000,000 | 20,800,000,000 | 20,800,000,000 | 1% |
| 16 | Department of Oceanic Affairs and Fishery | 2,646,600,000,000 | 2,664,500,000,000 | 17,900,000,000 | 17,900,000,000 | 1% |
| 17 | Department of Social Affairs | 2,255,600,000,000 | 2,301,700,000,000 | 46,100,000,000 | 46,100,000,000 | 2% |
| 18 | Department of Labour and Transmigration | 2,182,200,000,000 | 2,180,100,000,000 | (2,100,000,000) | 2,100,000,000 | 0% |
| 19 | Supreme Court | 2,163,700,000,000 | 2,207,400,000,000 | 43,700,000,000 | 43,700,000,000 | 2% |
| 20 | Department for Communication and Information | 2,061,500,000,000 | 1,967,300,000,000 | (94,200,000,000) | 94,200,000,000 | 5% |
| 21 | *Sum of Remaining Budget Heads* | *25,426,200,000,000* | *24,732,300,000,000* | *(693,900,000,000)* | *1,203,900,000,000* | *5%* |
| A | Total Gross Primary Expenditures** | 350,819,400,000,000 | 382,445,200,000,000 | 31,625,800,000,000 | 31,625,800,000,000 | 9% |
| B | Gross Composite Variance | | | | 39,537,800,000,000 | 11% |
| C | Grants | 4,232,907,854,000 | 1,834,050,785,735 | (2,398,857,068,265) | 2,398,857,068,265 | 57% |
| D | Project Loans | 25,475,300,000,000 | 25,475,300,000,000 | - | - | |
| E | Sub-Total (C+D) | 29,708,207,854,000 | 27,309,350,785,735 | (2,398,857,068,265) | 2,398,857,068,265 | 8% |
| F | Total Net Primary Expenditures (A-E) | 321,111,192,146,000 | 355,135,849,214,265 | 34,024,657,068,265 | 34,024,657,068,265 | 10.60% |
| G | Net Composite Variance | | | | 37,138,942,931,735 | 11.57% |