

## PROGRAM FIDUCIARY SYSTEMS ASSESSMENT

1. The Sustainable Energy Access in Eastern Indonesia—Electricity Grid Development Program Phase results-based loan will contribute to the power development plans for Eastern Indonesia of the State Electricity Corporation (Perusahaan Listrik Negara [PLN]) as identified in the Electricity Power Supply Business Plan (*Rencana Usaha Penyediaan Tenaga Listrik* [RUPTL]), 2019–2028.<sup>1</sup> The program covers nine administrative regional service areas in Eastern Indonesia: (i) North, South, East, Central and West Kalimantan; (ii) Maluku and North Maluku; and (iii) Papua and West Papua. The program will be partially financed by the Asian Development Bank (ADB) using ADB's results-based lending (RBL) modality and implemented using PLN's financial management, procurement, and anticorruption systems.

### I. Information System

2. The assessment was undertaken from November 2018 to June 2020 and included a review of PLN's financial management systems, procurement systems, and anticorruption mechanisms. The primary focus was on PLN as the executing agency for the proposed RBL program. The assessment is based on existing diagnostics, document reviews, and interviews with counterparts and development partner representatives. The assessment was conducted with reference to relevant ADB guidance on financial management and, as required by ADB's RBL staff guidance, it focuses on accountability and transparency, and covers critical financial management aspects, including funds flow, accounting, internal controls, financial reporting, and independent audit.<sup>2</sup> The procurement system assessment is based on ADB's 2019 PLN procurement assessment report, which focuses on the performance, practices, and status of procurement systems.<sup>3</sup> The procurement assessment also benefited from the availability of counterpart staff at PLN overseeing procurement, as well as a desk top review of their procurement data and statistics. The anticorruption assessment was a review of the 2002 decree by the minister of state-owned enterprises (SOEs) on good corporate governance (GCG),<sup>4</sup> subsequently amended in 2011 to extend the decree of GCG to SOEs.<sup>5</sup>

### II. Financial Management System

3. The program will use PLN's existing financial management system and procedures, which ADB considers adequate and will allow PLN to implement the program effectively. PLN has significant experience in implementing projects and programs financed by development partners, including ADB, other international organizations, and commercial banks. Procedures have generally been implemented well, and PLN has satisfactorily employed acceptable funds flow and disbursement arrangements for ADB-funded programs.

4. Indonesia has a relatively well-functioning public financial management (PFM) system, as evidenced by the PFM assessment performed in 2018.<sup>6</sup> This assessment determined adequate systems and processes in key areas, including a well-defined performance-based budgeting

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<sup>1</sup> PLN. 2019. *Electricity Power Supply Business Plan, 2019–2028*. Jakarta.

<sup>2</sup> ADB. 2005. *Guidelines for the Financial Management and Analysis of Projects*. Manila; ADB. 2009. *Financial Due Diligence: A Methodology Note*. Manila; ADB. 2013. *Staff Guidance for Piloting Results-Based Lending for Programs*. Manila.

<sup>3</sup> Procurement Assessment (accessible from the list of linked documents in Appendix 2 of the report and recommendation of the President).

<sup>4</sup> Badan Usaha Milik Negara. 2002. [Penerapan Praktek Good Corporate Governance](#). Jakarta.

<sup>5</sup> Badan Usaha Milik Negara. 2011. [Penerapan Praktek Good Corporate Governance](#). Jakarta.

<sup>6</sup> ADB. 2018. *Public Financial Management Assessment*. Manila.

process and classification system aligned with international standards, segregation of duties, and external scrutiny and audit. However, there is a need for improvement with regard to timely budget execution, the government's ability to manage contingent obligations, the lengthy and time-consuming project approval process, the accuracy and reliability of forecasts for ministries, the implementation of risk-based audits, and the full adoption of international best-practice accounting standards. The Government of Indonesia has been carrying out PFM reforms with development partner support for several years.

5. Indonesia's SOEs are not part of the PFM system, as they are governed by boards and follow private sector legislation and regulations. However, PLN and other large SOEs are wholly government-owned entities, implying financial accountability and strong links with the government budget, as significant subsidies are appropriated from the budget, and Parliament approves subsidiary loan agreements as separate budget lines. SOEs are required to submit quarterly financial statements to the Ministry of State-Owned Enterprises and to publish annual audited financial statements. They must also undertake regular government audits.

6. **Fund flow arrangements.** Supported by a government guarantee, ADB will sign a loan agreement directly with PLN. PLN will prepare withdrawal applications for submission to ADB, and disbursements will be made directly to PLN. ADB's loan proceeds will be pooled with other sources of capital, and PLN will not be required to identify transactions or payments related to any specific funding source. The management of funds will use PLN's systems and procedures for budget preparation, funds release, execution, and accountability. This arrangement is deemed adequate and acceptable to ADB.

7. **Planning and budgeting.** PLN has clearly defined budgeting procedures. PLN's head office determines the annual budget based on proposals submitted by the units, which also formulate multiyear investment programs. Shareholding ministries approve PLN's annual work plan and budget at the general meeting of shareholders chaired by the Ministry of State-Owned Enterprises. Parliament then approves PLN's investment program, funded through the subsidiary loan agreement as a separate line in the government's annual budget. The budget composition may be amended if the government subsequently revises the budget, there is significant foreign exchange or commodity price volatility, or external policy developments affect the macroeconomic assumptions underlying the work plan. Budget amendments occur once per year and require approval. PLN's planning and budget function is assessed as acceptable.

8. **Accounting and internal control.** PLN applies Generally Accepted Accounting Principles (GAAP), which covers Indonesian Financial Accounting Standards (PSAK), Indonesian Syariah Accounting Standards and Capital Market Regulations as Stated by Financial Service Authority (OJK). In 2015 Indonesia significantly reduced the differences between the national and the international reporting standards, and adopted all international accounting standards relevant to its operation. PLN regularly updates its accounting manuals to reflect the PSAK, and maintains internal rules and regulations on financial management and accounting standards.

9. PLN's financial reporting system is computerized and applies a systems, applications, products in data processing (SAP)-based enterprise resource planning (ERP) system. PLN's subsidiaries upload their trial balance to IBM's MAXICO system. MAXICO is integrated with PLN Holding's SAP ERP. Consolidated financial statements are generated automatically by MAXICO. All accounting adjustments require clearance from a supervisor and must be logged. Furthermore, PLN's external auditors carry out the consolidation independently, and are thus able to identify any errors during the annual audit.

10. Accounting and finance staff are trained to understand and apply the ERP system. The system has safeguards in place to maintain the confidentiality and integrity of the accounting and financial data, including the segregation of duties, authorization levels aligned with duties and functions, and dedicated user passwords to restrict unauthorized access. PLN has an effective cash management system, and the Finance Department is authorized to investigate reconciliation deviations, if detected.

11. The majority of PLN's units and divisions use an asset management system containing detailed records of fixed assets that are reconciled with the internal control. A physical inventory check is conducted annually and checked by the external auditor. The procedures in recognizing and recording the transfer of fixed assets from construction-in-progress accounts refer to BOD Regulation No 033.P/DIR/2017 (along with No 0088.P/DIR/2017), subject "Tata Cara Serah Terima Proyek Selesai Atau Bagian Proyek Selesai Dari PT PLN (Persero) Unit Induk Pembangunan Kepada PT PLN (Persero) Unit Pengusahaan", and BOD Regulation No 0039.P/DIR/2018, subject "Internal Control Over Financial Reporting".

12. **Financial reporting.** The ERP system used for financial reporting functions well and has enhanced features to automatically compare the budget to actual expenditures. Lender-specific reports are also required to be prepared manually but PLN is not required to prepare separate financial reports for each funding source under the RBL modality. However, PLN does prepare separate quarterly program transaction reports for development partners using interim financial reports. PLN's reports do not include physical targets.

13. **Internal audit.** PLN's internal audit is governed by a charter and carried out by its Internal Supervisory Unit (SPI). SPI reports directly to PLN's President Director and works closely with the Board of Commissioner's audit committee. SPI has offices in PLN's regions, and most staff are qualified internal auditors. Internal audits use risk-based annual work program monitoring, which generally includes development partner-supported programs and projects. PLN's management usually follows up promptly action on internal audit issues. PLN's internal audit function is deemed acceptable.

14. **External audit.** PLN's financial statements are subject to external audit by a private firm, which is rotated as part of PLN's audit policy. External audits are based on the national audit standards establish by the Indonesian Institute of Public Accountants. The external audit is to obtain reasonable assurance about the quality of the financial statements and determine if the financial statements are presented fairly, in all material respects. No significant accountability issues have been identified in recent audit reports, and the audit opinions for 2012–2019 have been unqualified. The State Audit Agency only audits PLN's subsidy calculations.

15. **Human resource capacity.** PLN's Finance Department has an appropriate structure, the functional lines of responsibility are suitable, and the divisions are adequately staffed. The accounting and finance staff are generally well-qualified, with most officers, and particularly senior staff members, holding relevant degrees and having extensive experience in business accounting, program accounting, and financial management. Accounting and finance staff have participated in ADB training and have experience with ADB's loan disbursement procedures.

16. **Program financial reporting and external audit arrangements.** Program accounting and reporting procedures will follow PLN's ordinary approach for program implementation. A private firm will audit PLN's annual consolidated financial statements in accordance with the

Standards on Auditing established by the Indonesian Institute of Certified Public Accountants.<sup>7</sup> The external auditor will prepare a separate program disclosure to certify the actual program expenditure<sup>8</sup> and the procurement eligibility computation<sup>9</sup>. PLN will submit the annual program audited financial statements and program disclosure to ADB within 6 months of the financial year end. PLN publishes its consolidated financial statements and the independent auditor's report in its annual report.

17. Financial management risks and mitigation measures are outlined in Table 1.

**Table 1: Financial Management Risks**

<b>Risk Description</b>	<b>Risk Rating<sup>a</sup></b>	<b>Mitigation Measures</b>
<b>Inherent Risk<sup>b</sup></b>		
Country-level risks: Overall weak country financial management system, especially with regard to budget execution, accounting and reporting, and budget credibility.	Moderate	ADB, the World Bank and other development partners will continue to support ongoing efforts to strengthen PFM arrangements, through technical assistance.
Entity-specific risks: Some of PLN's procedures for accounting and financial reporting have weaknesses.	Low	A financial management action plan has been designed and is currently being implemented to address identified weaknesses and risks.
<b>Overall Inherent Risk</b>	<b>Moderate</b>	
<b>Control Risk<sup>c</sup></b>		
Implementing entity	Low	PLN has a history of successfully implementing multiple ADB, World Bank and other development partner-sponsored projects. It also has capable and proven financial management systems to implement this program.
Funds flow	Low	PLN is knowledgeable with regard to ADB's procedures for disbursements and funds flow. All withdrawal applications are supported with the required documentation and approvals.
Staffing	Low	The accounting and finance staff have participated in ADB financial management training, and have experience in implementing multiple ADB loans. The Human Resource Department provides various in-house training programs in accounting and finance. Staff members also attend external training programs conducted by universities and consulting firms.
Accounting policies and procedures: Delays in the recognition of fixed assets and transfer from construction-in-progress accounts, resulting in the understatement of depreciation.	Low	The Accounting Division has recently updated and implemented the outdated internal regulations on the handover of projects to fixed assets.
Accounting policies and procedures: PLN's consolidated financial statements are prepared manually using spreadsheets, which carries the risk of human error.	Moderate	Accounting controls require all journal adjustments to be approved by a supervisor and logged. PLN subsidiaries are still required to manually produce financial data in specific templates for uploading to the accounting system, which can introduce additional operational risk.
Internal audit	Low	PLN's SPI reports directly to the president director and works closely with the Board of Commissioner's Audit Committee. Most of its internal auditors are qualified, and generally have extensive experience in accounting and finance.

<sup>7</sup> ADB and PLN will agree on the detailed financial reporting and external audit requirements for the program during loan negotiations; these will be documented in the program implementation document.

<sup>8</sup> The amount of program expenditures for the previous year(s), for the current year, and cumulatively.

<sup>9</sup> The net procurement from ADB member countries is at least equal to the value of ADB disbursements.

Risk Description	Risk Rating <sup>a</sup>	Mitigation Measures
External audit	Low	PLN's financial statements are subject to an annual external audit. PLN has a policy of auditor rotation, and external audits are conducted based on the national audit standards issued by the Indonesian Institute of Public Accountants.
Reporting and monitoring;	Low	Comprehensive monthly and quarterly financial management reporting systems are in place, with automated variance analysis against the budget.
Information systems	Low	PLN's accounting system is computerized and incorporated in a SAP-based ERP system. PLN's Budget Planning and Control Information System (E-budget) is integrated with the ERP system.
<b>Overall Control Risk</b>	<b>Low</b>	
<b>Overall Risk</b>	<b>Moderate</b>	

ADB = Asian Development Bank, ERP = enterprise resource planning, PFM = public financing management, PLN = Perusahaan Listrik Negara (State Electricity Corporation), RPJMN = Rencana Pembangunan Jangka Menengah Nasional (National Medium-Term Development Plan), SAP = Systems, Applications and Products in Data Processing.

<sup>a</sup> Risk factors are assessed against two dimensions: (i) the likelihood that the risk will occur, and (ii) the impact of the risk on the outcome. Rating scale: low = low likelihood and low impact; moderate = substantial to high likelihood, but low to moderate impact; substantial = low to moderate likelihood, but substantial to high impact; high = high likelihood and high impact.

<sup>b</sup> Inherent risk is the susceptibility of the program financial management system to factors arising from the environment in which it operates, such as country rules and regulations, and the agency's working environment (assuming the absence of any counterchecks or internal controls).

<sup>c</sup> Control risk is the risk that the program's accounting and internal control framework is inadequate to ensure that funds are used economically, efficiently, and as intended, and that the use of funds is properly reported.

Source: ADB.

18. **Financial management action plan.** Actions are recommended to address the identified financial management challenges and related fiduciary risks (Table 2). ADB and PLN have agreed on a rolling financial management action plan; progress will be regularly reviewed and the plan updated when required.

19. **Conclusion.** The financial management assessment indicates moderate fiduciary risk. The identified financial management weaknesses and shortcomings are considered minor and are being addressed through the proposed mitigation measures and actions in the earlier RBL. Based on the implementation of these mitigation measures, the financial management arrangements are considered adequate.

**Table 2: Financial Management Action Plan**

Risk Description	Risk <sup>a</sup>	Action Items	Period	Responsibility
Financial reporting: PLN's consolidated financial statements for subsidiaries are prepared manually using spreadsheets, introducing operational risk.	Moderate	Consolidated quarterly financial statements produced automatically by IBM MAXICO.  E-Budget implemented in the program target regions.  Staff in relevant divisions trained in the use of MAXICO and E-Budget systems.	2020	Accounting and Information Technology departments

E-Budget = Budget Planning and Control Information System, PLN = Perusahaan Listrik Negara (State Electricity Corporation).

<sup>a</sup> Risk factors are assessed against two dimensions: (i) the likelihood that the risk will occur, and (ii) the impact of the risk on the outcome. Rating scale: low = low likelihood and low impact; moderate = substantial to high likelihood, but low to moderate impact; substantial = low to moderate likelihood, but substantial to high impact; high = high likelihood and high impact.

Source: Asian Development Bank.

### III. Procurement System

20. This procurement assessment of PLN was guided by Supplementary Appendix No. 5 of the RBL Guidelines, which provides indicative questions for assessing RBL program fiduciary systems to ensure that the procurement system is adequate to support a principle-based program.<sup>10</sup> This procurement assessment updates the “Procurement Assessment of Indonesia’s State Electricity Corporation (PLN)” on PLN’s procurement capacity to implement an RBL program, which was conducted for the Electricity Grid Strengthening—Sumatra Program in June 2015.<sup>11</sup> This assessment also uses the interviews with PLN staff using questionnaires (para. 3); and a desk study performed on PLN’s procurement system, including a review of procurement data provided by PLN. A 2017 assessment was performed of PLN’s procurement capacity to implement a second RBL program (Sustainable Energy Access in Eastern Indonesia – Electricity Grid Development Program), with a cost of \$600 million; that program sought to support development of electricity distribution networks to connect businesses and households and enhance quality of life in Eastern Indonesia, particularly Sulawesi and Nusa Tenggara, through sustainable electricity use as a key driver of increased economic activity.<sup>12</sup>

21. The following lessons are drawn from the implementation of these RBL programs:

- (i) **The Aplikasi Monitoring Kontrak (contract monitoring application) has been fully implemented but has low levels of utilization.** Monitoring procurement performance is crucial to ensure the quality, timeliness, and efficiency of procurement processes and results. PLN developed a contract monitoring application that is capable of interfacing with various procurement systems throughout the PLN business process, facilitating the monitoring of procurement performance. However, inputs to the system are entered manually and are not linked automatically from the procurement planning and implementation data. ADB and PLN will explore the possibility of replacing the application with a new system capable of interfacing with the e-procurement system and SAP.
- (ii) **The introduction of framework contracting has enabled the State Electricity Corporation to aggregate the works or procurement of commodities into annual contracts.** The procurement of certain commodities or works are frequently small in value but large if aggregated. In the past, this type of procurement was conducted through direct contracting; however, the introduction of framework contracting has enabled PLN to aggregate the works or procurement of such commodities into annual contracts. The UIWs are expected to use framework contracts for civil and other smaller works for the proposed RBL program.
- (iii) **The State Electricity Corporation has introduced joint procurement of important, high-value commodities for UIWs but delays persist.** PLN Supply Chain Management has developed an integrated software application that serves as a procurement dispatching system, enabling customer service units and their implementation units to make procurement orders transparently online, with the ability to track orders. Once PLN Supply Chain Management has signed the framework contracts with particular vendors, the UIWs can easily place orders online by issuing purchase orders. This reduces procurement delays and identifies the source of any delays. This application is expected to be improved and

<sup>10</sup> ADB. 2013. *Staff Guidance for Piloting Results-Based Lending for Programs*. Manila.

<sup>11</sup> ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Results-Based Loan to Perusahaan Listrik Negara for the Electricity Grid Strengthening—Sumatra Program*. Manila (RRP INO 49080).

<sup>12</sup> ADB 2017. *Report and Recommendation of the President to the Board of Directors: Sustainable Energy Access in Eastern Indonesia – Electricity Grid Development Program*. Manila (RRP INO 50016)

expanded for use in the Directorate of Kalimantan, Maluku and Papua under this RBL program.

- (iv) **It is important to track the quality of contractors and vendors, as well as the quality of procurement conducted by State Electricity Corporation UIWs.** Significant additional works have been imposed on PLN to support the government's development target of 35,000 megawatts of increased electricity capacity, raising the issue of the capacity of PLN and local contractors to deliver the required levels of quality outputs. Furthermore, some local contractors and vendors lack the capacity to meet the more complicated qualification requirements imposed by PLN and the Ministry of Energy and Mineral Resources, making it important to perform a sample procurement audit to ensure that quality results are enforced. In Sulawesi and Nusa Tenggara PLN has been applying a sample procurement audit; the World Bank imposes this requirement in its Program-for-Results (P4R) program (which is similar to the ADB RBL modality) for Indonesia.

22. The procurement process for the program will include engineering, procurement, and construction (EPC) to increase reliable electricity services, as well as civil works and installation services to strengthen and expand electricity distribution networks. PLN will use a variety of procurement methods, including open competitive bidding, framework contracts, and direct open-book contracting. Based on the indicative expenditure framework currently available, all activities are expected to involve the EPC of community-scale clean energy generation, and procurement of works, goods, and services under contracts whose estimated value does not exceed the amount specified for high-value contracts (footnote 10).<sup>13</sup>

23. This assessment found that the procurement framework expressed in PLN's board of directors Decree No. 0620.K/DIR/2013 on PLN (Persero) General Guidelines for Procurement is appropriate and follows good practices used by utility companies globally. The framework provides overall principles, a strategy, and detailed procurement procedures. The strategy's overall objective is to increase value for money for the organization, which is identified as the correct balance of quality, quantity, location, time, socioeconomic impact, and price. Price is considered once after the other factors have been reviewed. Socioeconomic goals may include social, environmental, or other strategic objectives, and can also include building national capacity to supply PLN with domestic products, suppliers, and contractors. In implementing their procurement strategy, it is essential for PLN to conduct extensive market research and identify appropriate sourcing strategies depending on the supply market, overall expenditure for different spending categories, and the importance of those goods and services to PLN operations. As an analytical framework to develop the appropriate sourcing strategy, PLN uses the Kraljic Portfolio Purchasing Model to categorize spending, and classifies its procurement as strategic, bottleneck, leverage, or routine. For equipment, PLN has implemented a number of framework contracts to improve efficiency, secure supply, and achieve better value for money by fostering economies of scale. For works and EPC contracts, open competitive bidding is the default procurement method. To ensure the quality of supply and contractors, PLN has created a list of pre-approved vendors that meet PLN's financial and technical requirements.

24. ADB must consider two key issues in implementing an RBL using PLN's procurement system: local content requirements and direct open-book contracting. These are integral parts of PLN's procurement system. It is recommended that ADB accept these procedures when deciding

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<sup>13</sup> According to the RBL Staff Guidance (footnote 10), high-value contracts are defined as those below \$50 million for works, turnkey and supply, and installation contracts; \$30 million for goods; \$20 million for information technology systems and non-consulting services; and \$15 million for consulting services.

to use the RBL modality, because the program will follow the principles embodied in ADB Procurement Policy (2017, as amended from time to time), and Procurement Regulations for ADB Borrowers (2017, as amended from time to time) but not their rules, processes, and procedures. These are defined more specifically as follows:

- (i) **Local content requirements.** The local content requirement for equipment means that only suppliers with manufacturing facilities in Indonesia are eligible to bid for and receive contracts; several multinational firms do have manufacturing facilities in Indonesia, and PLN is actively encouraging foreign firms either to open new facilities or to expand the line of equipment that they manufacture in Indonesia.
- (ii) **Direct open-book contracting.** For direct contracting, only suppliers pre-selected by PLN are eligible to supply goods and services. Although competition is sacrificed, open-book contracting brings other benefits, such as secure supplies and (according to PLN) value for money. Overall, it is anticipated that only 6.0%–6.5% of the funds used to procure distribution equipment under the program will be disbursed through the open-book system.

25. While its overall procurement framework is appropriate, PLN will face a number of risks managing procurement under this program. ADB's procurement assessment has identified the following risks:

- (i) **Transactional approach and lack of spending analysis.** The use of strategic procurement and spending analyses was not evident during interviews with supply chain management personnel and customer service units. Current practice focuses on completing procurement transactions, due to the volume of requirements and highly departmentalized structure. This transaction-based approach inhibits full use of data generated from all transactions, which could highlight deficiencies in PLN's policies and procedures, identify gaps in the system, and analyze trends in the market. PLN should actively use a procurement monitoring and spending pattern system to identify capacity issues (both internal and external) and develop mitigating measures and action plans if capacity issues arise.
- (ii) **Use of e-procurement.** Increased awareness, familiarity and capacity building in the use of an online e-procurement system is expected to improve the overall efficiency of the system. Some PLN Regional Administrative units (UIW) have yet to implement e-procurement but once complete this will facilitate improvements in procurement data collection, enable increased oversight by headquarters and PLN-wide spending analysis, and allow improved reporting with a centralized data repository.
- (iii) **Capacity building.** The accreditation of procurement officers is a noteworthy undertaking that leads to increased professionalization, but capacity should also be developed in contract management and monitoring, contract evaluation, and overall procurement assessment. PLN's headquarters should have a dedicated team to conduct procurement assessments of both UIW and its headquarters procurement processes, with regular assessments that include a feedback loop to continuously improve subsequent procurement rounds.
- (iv) **Lack of standard document.** A recurring observation is the lack of standardized bidding documents and contracts. Although information on bidding requirements, including pre-qualifications of bidders, is available, the documents and contracts used by the suppliers differ from one transaction to another. The lack of standardized documents could lead to confusion, miscommunication, and potentially to excessive use of discretion. PLN is planning to standardize these documents.
- (v) **Lack of standard procurement timeline.** The procurement process could be improved by providing a standard timeline for each process to guide users. Efficiency



can be measured if there is a standard duration for each procurement process. This same should also be developed for the contract management processes, with all parties aware of the timeline involved for each step or process.

- (vi) **Lack of system integration.** PLN has several systems currently in operation: Budget Planning and Control Information System (e-budget), e-procurement, and SAP for purchase orders. Due to the number of systems in operation, the procurement and contract management process is cumbersome. As a result, monitoring and reporting requires manual intervention which introduces operational risk.
- (vii) **Monitoring and evaluation.** Utilization of the current contract monitoring system is low, because of the need to manually encode and transmit the information. UIWs view the process as tedious and do not submit the required information on a timely basis. PLN is seeking to replace the contract monitoring system, enabling the automation of data collection and improving analysis by integrating the system with e-procurement and SAP.
- (viii) **Anticorruption measures.** All large-scale procurements must include suitable safeguards against fraud and corruption. PLN has taken a number of important initiatives in recent years to curb corruption within the organization and has significantly strengthened internal controls. To further strengthen PLN's oversight and detection mechanism, the PAP includes a procurement monitoring framework and program spending pattern. PLN will submit quarterly reports to ADB, and the PLN Board of Directors and/or Value for Money Committee on the procurement monitoring framework indicators and provide an updated spending profile. PLN will also carry out procurement audits covering 10% of all contracts.

26. To manage procurement risk in this and subsequent RBL programs with PLN, it is crucial to monitor all procurement at the corporate level. PLN's procurement guidelines require PLN to use a procurement monitoring system, including expenditure analysis. This supports adequate management of procurement risks by both PLN and ADB and enables corrective action to be taken where needed.

**Table 3: Risk Profile and Mitigation Measures**

Risk Description	Risk Assessment	Mitigation Measures
Limited competition due to low market capacity to absorb additional supply needs results in uneconomical procurement	Moderate	The procurement monitoring and spending profile should be actively used to assess the market.  PLN should determine which items have few participating suppliers and undertake in-depth analysis to improve the supplier base for these items.
Sub-optimal procurement procedure applied by PLN results in inefficient procurement	Moderate	The e-procurement system is fully utilized by the Supply Chain Management Division, which will implement major procurements for MDU items.  Two regional offices to be covered by the proposed RBL already use the e-procurement system, and PLN headquarters plans to assist Kalimantan in its use.
Institutional capacity	Moderate	PLN should undertake regular procurement assessments within the procurement directorate. Although periodic audits are performed, an assessment from the standpoint of procurement would have a greater focus on systems, processes, contract management, and stakeholder feedback.
Fraud and Corruption	Substantial	Audit findings provide important information external to procurement and should be considered along with procurement and contract management assessments. A spending analysis of PLN could identify problem areas.

ADB = Asian Development Bank, PLN = Perusahaan Listrik Negara (State Electricity Corporation), MDU = main distribution material, RBL = results-based lending.

<sup>a</sup> Risk factors are assessed against two dimensions: (i) the likelihood that the risk will occur, and (ii) the impact of the risk on the outcome. Rating scale: low = low likelihood and low impact; moderate = substantial to high likelihood, but low to moderate impact; substantial = low to moderate likelihood, but substantial to high impact; high = high likelihood and high impact.

Source: Asian Development Bank.

#### IV. **Anticorruption System**

27. This program will be implemented in accordance with PLN's legal framework, regulations, and procedures designed to mitigate PLN's exposure to corruption risk. In 2011, the minister of SOEs amended the 2002 decree to include a regulation regarding implementation of GCG in SOEs, which requires that SOE carry out its operations by adhering to GCG principles of transparency, accountability, responsibility, independence, and fairness. In response to this decree, PLN improved its internal controls and systems by adopting the GCG principles and regulations.

28. PLN has implemented GCG in its daily operations, and is continuously striving to improve on the services it provides with a strong code of conduct. GCG's stated objectives are to (i) control and direct the relationship between the company structures, employees, customers, business partners, the community, and the environment to ensure that stakeholder interests are aligned; (ii) encourage and support the development of PLN; (iii) manage resources with strong fiduciary oversight; (iv) improve risk management; (v) enhance accountability to stakeholders; (vi) prevent any deviations in the management of PLN; (vii) improve the working culture of PLN; and (viii) improve PLN's image.

29. ADB has a fiduciary responsibility to ensure that its loans and other forms of financing are used only for the purposes for which they are granted, in accordance with the Agreement Establishing the Asian Development Bank.<sup>14</sup> To uphold that obligation, ADB developed guidelines to prevent or mitigate fraud, corruption, and other prohibited activities in RBL operations financed in whole or in part by ADB. PLN is aware of and understands ADB's Guidelines to Prevent or Mitigate Fraud, Corruption, and Other Prohibited Activities in Results-Based Lending Programs.<sup>15</sup>

<sup>14</sup> ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila

<sup>15</sup> ADB. 2013. *Staff Guidance for Piloting Results-Based Lending for Programs*. Manila. (Appendix 7).