

SUMMARY OF INDONESIA'S PUBLIC SECTOR MANAGEMENT SECTOR ASSESSMENT

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PUBLIC SECTOR MANAGEMENT SECTOR ASSESSMENT (SUMMARY)¹

A. Sector Performance, Problems, and Opportunities

1. **General outlook for PFM.** The 2012 Public Expenditure and Financial Accountability (PEFA) point to a well-functioning PFM system in Indonesia. The PEFA 2012 repeat assessment, following the first assessment in 2007, demonstrates continuous progress in several aspects, albeit incrementally, resulting in tangible improvements in the quality of Indonesia's PFM, together with increased transparency and independent oversight of public expenditures.² However, some reforms are still identified as 'work in progress.' These include: (i) improving the results-orientation in state budget planning and development; (ii) modernizing budget and treasury management; (iii) strengthening monitoring and evaluation of public expenditure and programs; (iv) improving the public procurement systems; (v) improving government accounting and audit functions; (vi) civil service reforms to improve the quality and performance of the workforce; (vii) debt management; (viii) strengthening local government public financial management; and (xi) governance and anti-corruption.

2. **The need to increase tax revenues.** Both at the national and sub-national level, the government are mobilizing more tax revenue to meet bigger development spending, especially in infrastructure. At the national level, efforts to increase tax revenue has had limited success, largely due to the narrowness of the tax base (particularly for personal income tax), over dependence on the commodity sector, and inefficiencies in tax administration. At present, the central government tax revenue to GDP ratio is one of the lowest in the G20 and among emerging market economies (EMEs), averaging 10.9% of GDP 2010-2014. To improve this result, Ministry of Finance has introduced e-tax filling and registration aimed at broadening the personal income tax base. At the sub-national level, the devolution of local taxes has created an opportunity and also poses a new challenge for fiscal decentralization. A number of local governments, such as the Provincial Government of Jakarta and East Java, have introduced e-tax payment system for local taxes. Moving forward, the biggest challenge will be on administering the local taxes by sub-national government, which still lack competent resources. As a consequence,, collections at national and sub-national levels are not expected to increase substantially in the medium term.

3. **Budget implementation.** To improve the efficiency, transparency and accountability of Indonesia's public finances, the Government has reformed its budget controls and reporting. The budget classification system now follows IMF international standards. Further, transparency of the budget has been enhanced with the key budget documents being made available on the web. Government's score in the open budget index has increased from 51% in 2010 to 62% in 2012.³As a result, audits by the Supreme Audit Board (BPK) show an improvement in the quality of government financial statements. The number of line ministries and local governments with statements receiving "unqualified" opinion has increased, while the number of those agencies'

¹ This summary is based on ADB's Country Level Governance Risk Assessment and Risk Management Plans, Public Financial Management Sector Assessment, and Procurement Sector Assessment.

² The World Bank (2007). Public Expenditure and Financial Accountability: Public Financial Management Performance Reports and Performance Indicators [on line]. Report No. 42098 ID. Indonesia: The World Bank. The World Bank (2012). Indonesia: Repeat Public Expenditure and Financial Accountability (PEFA) Report and Performance Indicators. Jakarta: Public Financial Management Multi Donor Trust Fund for Indonesia.

³ International Budget Partnership (undated). *Indonesia, Open Budget Index 2012*.

financial statements with auditors' "disclaimer of opinion"⁴ has fallen. However, the country (both at national and sub-national levels) have yet fully implemented accrual-based accounting.

4. **Medium-term budgeting and performance-based budget.** Regulatory reforms continue at national and sub-national level. At national level, the government has introduced a medium-term expenditure framework (MTEF) and performance-based budgeting to promote more accountability and transparency. However, implementation has been difficult. Problems relate to: (i) difficulties in linking resource allocations to results; (ii) defining outputs (focus on quantitative instead of qualitative results); (iii) difficulty in defining indicators; (iv) lack of capacity; (v) lack of monitoring and evaluation feedback into policy making and resource allocation; (vi) difficulty in aligning policy planning with organizational accountability; and (vii) the need to streamline documents for planning, budgeting and monitoring and evaluation. In promoting performance-based budget, the government has introduced the "performance and accountability system for government agencies" (SAKIP) which consists of strategic plans, performance measures, and performance reports. The output of SAKIP is the government's performance accountability report (LAKIP), through which government institutions must evaluate their performance prior to the Ministry of Bureaucracy Reform grading the performance of the government institution.

5. **Budget Execution.** The slow pace of budget execution poses significant barriers to efficient public service delivery in Indonesia. At national and sub-national levels, typically, 50%–60% of capital spending is disbursed in the last quarter, and this contributes to the low level of budget execution in public investment.⁵ These constraints are largely attributed to cumbersome and complicated reallocation processes and systems as well as functional responsibility capacity constraints in spending units. To expedite budget execution at the national level, the Ministry of Finance introduced a new automated cash management system in 2015. The National Public Procurement Agency has also introduced advanced procurement. However, more reform is needed particularly to streamline systems and procedures with a greater focus on performance and flexibility for managers to deliver their budgets.

6. **PFM at subnational level.** Indonesia has effectively devolved key expenditure and revenue functions to regional governments. The first wave of reforms have targeted enhancing equalization and transparency in fiscal transfers and developing more dynamic sources of local revenue. Wider pool of resources for subnational governments has also vested them with greater responsibilities. However, weak PFM capability at all tiers of subnational administration and abuse of inter-regional transfer, such as DAU, pose a governance risk. Fiscal transfer mechanisms⁶ do not sufficiently provide incentives for PFM improvement at subnational levels, as (i) fiscal transfers are not linked to improved performance in service delivery and financial management; (ii) increases in own-source funds are offset by a decrease in fiscal transfers; and (iii) current transfer principles are not adequately needs-based. Focus on building PFM capacity is pertinent to improved governance and thus better public service delivery.⁷

⁴ A Disclaimer of Opinion is issued when a limitation on scope is imposed by the client; as a result the auditor is unable to obtain sufficient appropriate audit evidence.

⁵ 2013. *Staff Report for the 2013 Article IV Consultation*. Indonesia.

⁶ The Indonesian fiscal transfer system consists of three main types of grants: (i) General Allocation Fund (DAU), determined by the amount of spending in personnel plus the "fiscal gap" of the particular district; (ii) Special Allocation Funds (DAK), allocated to districts to focus on particular national priorities; and (iii) Shared Revenue Funds (DBH) related to the generation of revenues from natural resources and taxes in the particular regions.

⁷ Under the Law 32/2004 on regional governments (decentralization), the Ministry of Home Affairs (MoHA) is assigned to supervise and regulate financial management at the level of regional governments; while the role of the MOF is limited to transfer of budget, and setting the limit of cumulative loans and deficits, signing on-lending loans, and setting up regional finance information systems. At the strategic

7. Internal Audit. The government has also adopted COSO (Committee of Sponsoring Organizations of the Treadway Commission) as its control framework. The role of the central government internal auditors (BPKP) and state institutions to implement the government internal control system (GICS) for effective, efficient management of state funds and reliable reporting is detailed in government regulation (PP) 60/2008.⁸ To improve internal audits, the Government is currently designing a Management Information System for Accountability (SIMA) with the aim to monitor performance and compliance. Notwithstanding, coordination on the GCIS among regional agencies is weak, and no uniform audit planning framework is in place. Auditors' capacity requires further enhancing through formal education and a professional certification program. The quality of audit by inspectors general in line ministries and local government inspectorates remains substandard, with little focus on risk-based audit.

8. Public procurement. Progress has been made in Indonesia's public procurement since 2003. The key accomplishments are the roll-out of a national e-procurement system which is aimed at increasing transparency and efficiency in the procurement actions, and the establishment of procurement service units (ULP's) with accredited personnel at all levels of government. Today, around 33 provincial governments and 681 regional governments and government institutions have introduced e-procurement.⁹ The introduction of e-procurement has reduced delays in the completion of public works projects¹⁰ and strengthened competition among bidders with more and more winning bidders come from outside the region where the work takes place. However, despite such progress, the key legislation for public procurement still has no clear mechanism for handling disputes and no clear sanctions for violation of the procurement procedures. Further, it does not contain provisions authorizing the monitoring of procurement by civil society. While bidders and government staff are required to sign an "integrity pact", its force is limited to a "vow."¹¹ The presidential regulation does not have a sufficiently high legal status to truly standardize the public procurement system throughout Indonesia, and a more detailed procurement law which consolidates numerous presidential decrees is still required.

B. Government's Sector Strategy

9. The National Development Plan 2015-2019 outlines the guiding principles of decentralization and its linkages to service delivery, which is focused on minimum-service standards and increased public participation in decision-making. These are further refined in the Grand Design for Fiscal Decentralization and the second National Action Plan for Fiscal Decentralization (NAPFD). The latter is also linked to the strategic plans of the Ministries of Finance (MOF) and Home Affairs (MOHA). The NAPFD outlines the main components of future decentralization efforts. The core of the regulatory framework for the system of intergovernmental fiscal relations in Indonesia is contained in Laws 23/2014, on administrative aspects of decentralization and 33/2004, which defines the financial framework for sub-national levels of government. A review of Law 33/2014 for 2016 consideration is being prepared.

level, there must be greater cooperation and coordination between the MOF and the MoHA. The laws which define the roles of both ministries are currently under review.

⁸ Under the regulation, four types of institutions share the responsibility for conducting the government's internal audit function: the BPKP, inspectorates general, provincial inspectorates, and district/city inspectorates. Each of these is assigned different roles.

⁹ Source: INAPROC-Smart Report LKPP (<http://report-lpse.lkpp.go.id/v2/public/index>).

¹⁰ 2014. NBER Working Paper Series. *Can Electronic Procurement improve infrastructure provision? Evidence from Public Works in India and Indonesia*. Sean Lewis-Faupel, Yusuf Neggars, Benjamin A. Olken and Rohini Oande. Working Paper 20344. Cambridge, USA.

¹¹ *Ibid.*, Article 1(13).

Appendix 1. Problem Tree for Public Sector Management

