

Financial Management Assessment

Government of Indonesia – Ministry of Marine Affairs and Fisheries (MMAF)

Proposed Loan 46421–INO: Coral Reef Rehabilitation and Management Program—
Coral Triangle Initiative Project

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Financial Management Assessment

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Proposed Loan 46421–INO: Coral Reef Rehabilitation and Management Program—Coral Triangle Initiative Project (COREMAP—CTI)

I. INTRODUCTION

1. This Financial Management Assessment (FMA) has been prepared in accordance with ADB's Guidelines for the *Financial Management and Analysis of Projects*¹ (the Guidelines) and the publication *Financial Due Diligence: A Methodology Note*.² This FMA incorporates the Financial Management Internal Control and Risk Management Assessment required by the Guidelines. Annex 1 presents the completed FMA Questionnaires.

2. Preparation activities for this FMA report included reviewing documents, interviewing the staff of the Government agencies, consultants, private sector, targeted project beneficiaries and other stakeholders. Mitigating actions were identified together with the stakeholders. This assessment was initially drafted during a consultation mission from 27 May to 7 June 2013; and completed during pre-fact-finding mission on 26 July 2013.

II. EXECUTIVE SUMMARY OF FINDINGS AND CONCLUSIONS

A. Project Description

3. **Impact, Outcome and Inputs:** The Project impact will be sustainable management of coral reef ecosystems. The Project outcome will be enhanced capacity to manage coral reef ecosystems inside the targeted marine protection areas (MPAs). The project has four outputs:

- (i) Output 1: coral reef management and institutions strengthened, focused on strengthening and institutionalizing capacities developed under COREMAP II.
- (ii) Output 2: ecosystem based resources management developed, focussed on strengthening MPA management capacity. The biodiversity conservation of threatened and endangered species under this output will be financed through the Global Environment Facility (GEF) cofinancing.
- (iii) Output 3: sustainable marine-based livelihoods (economy) improved, promoting sustainable livelihoods and developing small infrastructure.
- (iv) Output 4: efficient project management.

4. The Project will be implemented in the existing COREMAP Phase II areas of 7 districts having at least 57 existing project coastal villages in 3 provinces in Sumatra (North Sumatra, West Sumatra, and Riau Kepulauan). The new project activities will include improving MPA management effectiveness at three existing national MPAs: Anambas (in Anambas District in Riau islands province), Pulau Pieh (in Pariaman District in West Sumatra province), and Gili Matra (in North Lombok District of West Nusa Tenggara province).

¹ ADB. *Financial Management and Analysis of Projects*. 2005. Refer page 14 of Knowledge Management Addendum for more information on the Financial Management Assessment.

² ADB. *Financial Due Diligence A Methodology Note*. 2009. Refer page 3 for more information on the Financial Management Assessment.

B. Risk Assessment

5. The main anticipated risk is the complexity of the project. Because of issues that emerged during the previous two phases, the project will further explore a number of investment activities that may not be financially viable or organizationally sustainable. All participating districts need to be well-equipped to carry out activities from the planning process through operation and maintenance of the investments.

6. Attention is required for the three national MPAs that will largely be implemented by the project implementation unit (PIU) Pekanbaru. The institutional history of the PIU Pekanbaru is very short, and its capacity to manage the national MPAs is regarded as weak. The PIU Pekanbaru needs to create a clear institutional arrangement to implement field activities since it will involve multi-stakeholder management. For example, Kepulauan Pieh, one of the three MPAs, administratively belongs to West Sumatra province involving three districts: Padang city, Pariaman city, and Padang Pariaman districts. Each of these districts has its own MPA. PIU Pekanbaru will need to coordinate and work effectively with these three districts. Furthermore, the islands under this national MPA, especially the no-take zones, traditionally belong to several households/ethnic groups. The time taken to process the agreement between the PIU Pekanbaru, the three districts and the landowners may create significant delays in investment activities. The agreements may include potential land acquisition and compensation. Similar agreements will also be required by other district and national MPAs.

C. Implementation Requirements

7. **Project organization structure.** In line with the overarching Government decentralization policy (to empower capacities of local governments at the provincial, district and village levels), the project will support the decentralized approach adopted by COREMAP-II. Following the implementation structure developed under COREMAP II, the Directorate General of Marine, Coasts and Small Islands (DGMCSI)³ of the Ministry of Marine Affairs and Fisheries (MMAF) will be the Executing Agency. It will maintain a project management office (PMO) to coordinate COREMAP—CTI activities. The PMO will be responsible for managing two projects in parallel: one funded by ADB and one by World Bank.⁴ The PMO will be responsible to DG, DGMCSI who in turn will be responsible to the Minister, MMAF.

D. Conclusion

8. DGMCSI acted as executing agency for COREMAP II and the Marine Coastal Resources Management Project (MCRMP), and therefore has substantial and highly relevant experience in implementing externally-financed subprojects and in managing ADB loan disbursements. Based on the FMA, DGMCSI is considered to be a capable executing agency for COREMAP—CTI.

³ Locally known as KKP3K.

⁴ ADB will finance COREMAP—CTI activities mostly in the western parts of Indonesia, while the World Bank will fund project activities in eastern parts of the country.

III. DETAILED FINDINGS

A. Country Issues and Progress

1. Public Financial Management Environment

9. Significant data is available on the Indonesia country public financial management (PFM) arrangements that have been assessed using the Public Expenditure Financial Accountability (PEFA) on Performance Measurement Framework.⁴ As presented in Indonesia's PEFA⁵, in recent years, the country 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, MOF) 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 Badan Pemeriksa Keuangan (BPK), the Indonesian Supreme Audit Institution, as the external audit institution. Its 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.

10. 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 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. In almost all areas of PFM a sound regulatory framework is now in place. Likewise the major reorganization of the MOF, 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.

2. Management and Skills Capacity

11. The results of two previous COREMAP phases have been positive in terms of: (i) community ownership of the notion that protecting reefs will generate benefits in the future and enhance community welfare; and (ii) improvement in the condition of some coral reefs since the start of the program, linked to a reduction in destructive fishing and better overall protection. COREMAP II also played a key role in establishing the Coral Triangle Initiative on Coral Reefs, Fisheries and Food Security (CTI-CFF). CTI-CFF was developed with five neighbouring countries in 2009 and set a 10-year plan of action to address the urgent threats facing the coastal and marine resources of one of the most biologically diverse and ecologically rich regions on Earth.

12. As a part of conservation commitment, the Government has pledged placing 20 million hectares of marine space under Marine Protected Area (MPA) management by 2020 to meet its

⁴ Under the PEFA framework, performance is assessed in relation to seven dimensions of public financial management: credibility of the budget; comprehensiveness and transparency; degree to which the budget is prepared with due regard to government policy; predictability and control in budget execution; accounting, recording and reporting; external scrutiny and audit operations; appropriateness of development partner practices in country; and intergovernmental fiscal relationships.

⁵ Prepared by the World Bank, 31 October 2007.

obligations under various international agreements. So far, 15.7 million hectares have been demarcated and 5.5 million hectares have been brought under management plans. Now CTI provides a framework of coral conservation in Indonesia, and COREMAP constitutes the main source of support to implement Indonesia's National Plan of Action under CTI.

13. A decade since the inception of COREMAP, however, major challenges remain, in terms of: (a) the sheer extent of reef area under threat relative to the area under improved management (there are some 10,000 coastal villages in Indonesia); (b) obstinate and widespread poverty among coastal communities; (c) controlling a wider practice of illegal, destructive fishing by fishers based outside the project areas, including major cities; and (d) insufficient governance frameworks to regulate artisanal fishing and control illegal fishing.

14. In addition, there are new issues and opportunities emerging, including: (e) rapid depletion of fish stocks; (f) the onset of climate change-related impacts from rising concentrations of CO₂ in the atmosphere and in the ocean on the one hand; and (g) the government's introduction of a policy framework to use marine spatial planning (MSP) as a tool for sustainable marine-based natural resources management and economic development; (h) the transfer of a number of MPAs to the MMAF from the Directorate General of Forest Protection and Nature Conservation (PHKA); and (i) the relative autonomy of local government in interpreting and implementing fisheries governance frameworks.

3. ADB Country Portfolio

15. The proposed COREMAP—CTI is closely aligned with the current (2012-2014⁶) Indonesia Country Program Strategy (CPS) priorities. It will address several of the CPS' institutional, economic and social development pillars, namely, strengthening government institutions and systems; private sector development; community development and social protection; and environmental sustainability and disaster mitigation. COREMAP—CTI's focus on strengthening governance and decentralized, effective and accountable institutions at provincial, district and village levels is strongly aligned with the CPS.

B. Risk Analysis

16. The following risk assessments are based on existing circumstances, staffing and procedures, and include recommendations for risk mitigation measures.

Risk type	Risk Assessment ^a	Risk Description	Mitigation Measures
Country-Specific Risks	N	The Government has not properly monitored implementation of the accounting and financial management manual to guide all government agencies.	Efforts will be made to properly monitor fund flow management

⁶ ADB. 2012. *Country Partnership Strategy: Indonesia-2012-2014*. Manila.

Risk type	Risk Assessment^a	Risk Description	Mitigation Measures
Entity-Specific Risks	L	Project's national budget preparation is not accurate resulting in need for budget revisions delaying project implementation	Competent financial management specialists with good experience in Government budget preparation are selected and planning for budget process begins ahead of time so inaccuracies can be minimized
Management	S	Unclear authorities among national, provincial and district levels in managing national MPAs	Memorandums of agreement will be formulated among all parties involved in managing national MPAs
Project complexity	M	Significant investment activities with multi-stakeholder management	Three core subprojects will be developed as viable models that will be replicated by other subprojects
Reporting and Monitoring	M	Incomplete and late submission of quarterly financial progress reports	Recruit a financial management specialist to help PMO consolidate reports from all PIUs
Funds Flow - Internal Audit	M	Lack of internal control for fund flow from MOF to end users	Coordinate with BPKP ^b to improve internal control system
Remote and dispersed project locations	L	Dispersed and remote locations resulting in delayed liquidation submissions to executing agency may result in inadequate cash flow impeding project implementation	District performance be assessed based on timely submission to executing agency for liquidation paperwork and strong executing agency team for monitoring and evaluation
Inadequate capacity in procurement In National Technical Units and Districts	M	Need for strengthened capacity of procurement staff in district/National Technical Implementation office	Regular procurement training at district/UPT level by PMO and close coordination between them, mentoring of district/National Technical Implementation Office procurement staff with national procurement staff
Overall Risk	M		

^a score for assessment: H = high, S = substantial, M = moderate, N = Negligible or low.

^b BPKP = *badan pengawas keuangan pembangunan* = internal control institution.

Sources: Government of Indonesia and Asian Development Bank.

C. Risk Mitigation

1. Need for Capacity Building

17. The completed Financial Management Assessment Questionnaire identifies that technical assistance could be provided in the following areas: (i) capacity building in the area of PFM and ADB's financial management and reporting requirements, especially for empowering the MPAs in each district; and clear coordination between district MPAs and national MPAs; (ii) development of an accounting and financial management manual to empower MPAs as viable institutions; (iii) development of an improved accounting system; (iv) strengthening the internal audit function; and (v) putting in place systems to ensure data is safeguarded for MPA related development.

2. Risk mitigation actions

18. This section summarizes the actions identified throughout the Assessment for managing the risks to the project from a PFM perspective. The following are the proposed actions:

- (i) Develop a proper organizational structure of the MPAs and explore their relationship with the district authorities and other stakeholders;
- (ii) Develop work plans with nominated core activities for all MPA personnel and how they will be funded during and after project completion.
- (iii) Develop a comprehensive accounting and financial management manual for MPA sustainability.
- (iv) Provide training in ADB Financial Management and Disbursement Procedures to focus mainly on empowering MPAs;
- (v) Train accounting staff in the preparation of the annual project financial statements and the underlying supporting documents;
- (vi) Recruit a financial management specialist (national consultant) to help the project (i) prepare quarterly and annual progress reports separately for the project financial statements for all project components financed by ADB, GEF and the Government, and to be audited by an independent auditor.
- (vii) monitor the compliance with financial covenants, including submission of audited annual project financial statements.
- (viii) back-up regularly all accounting systems and ensure appropriate security measures over backed-up data to be put in place.

19. With the experiences gained during COREMAP II, the Project will not require intensive support for safeguards and procurement plans. However, new activities, especially for the establishment of MPAs may cause delays in the preparation of activities. The following risks will require constant attention from both the government and ADB:

- **Limited Capacity of LKKPN Pekanbaru National MPAs:** The improvement in institutional capacity of the LKKPN Pekanbaru of the national MPA will be provided adequate attention. The areas to be covered from the Pekanbaru office are huge, and distances to travel to other MPAs are large. By using monitoring and evaluation tool kit, project activities will be systematic, but limited experience and human resources in the office may cause delay in implementation. MMAF has a plan to quickly expand the number of National MPA technical implementation unit (UPT) officers. Although all incoming staff will be given training prior to the assignment, such rapid expansion may be a source of confusion. In addition, the lack of experience in promoting co-management of

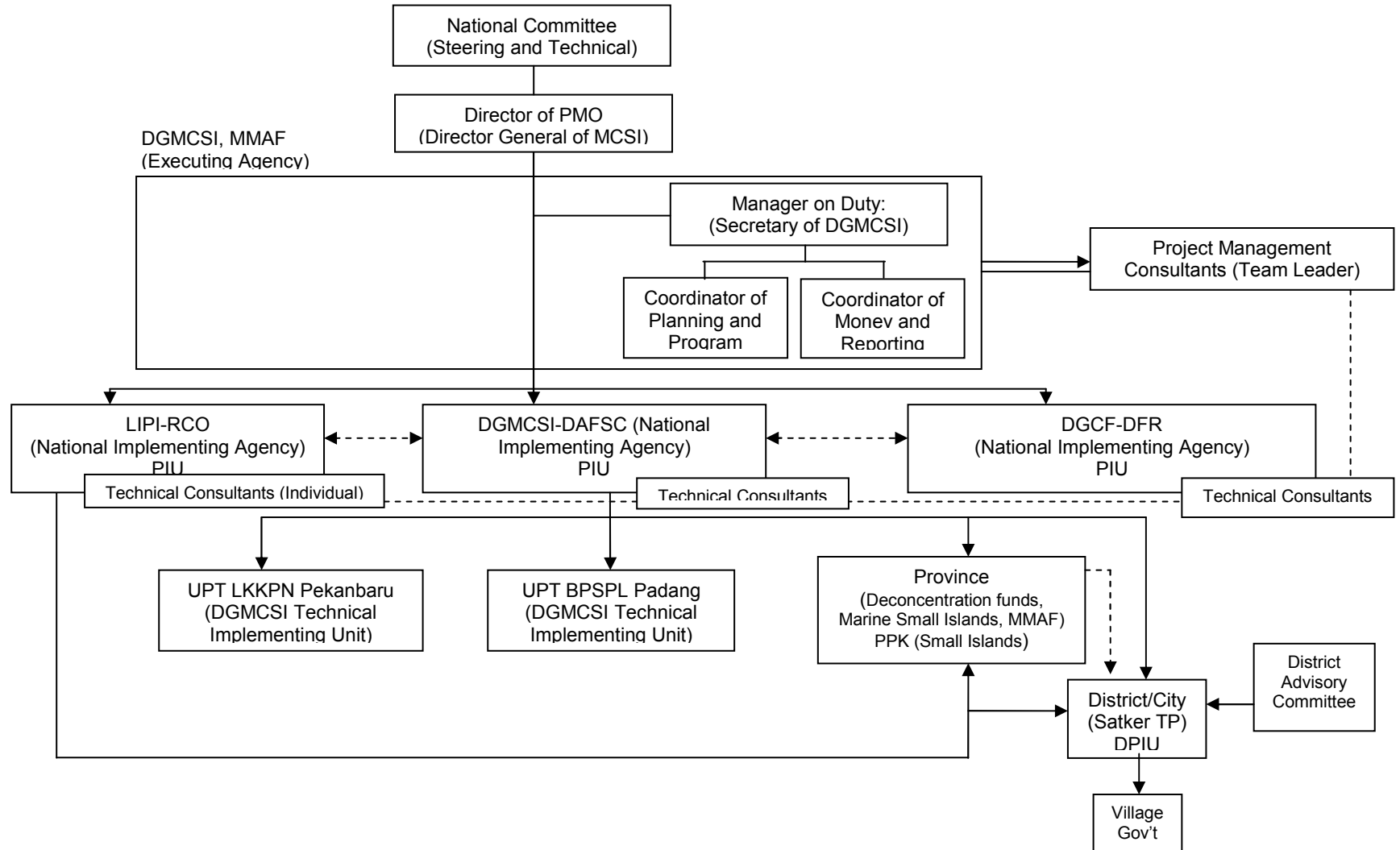
MPAs through coordinating work between UPT officers and district officers may cause delays, and therefore activities need to be strengthened to achieve the target numbers. Because of MMAF's short history of managing MPAs, it is essential that networking and sharing of experience are promoted between staffs. Furthermore, it is fundamental to provide technically qualified MPA management consultants to UPT for National MPA's.

- **Partnership Formation with Private Sector:** Promoting partnerships with private sector companies both in the country and abroad is necessary. However, the target districts and some villages are remote and thus private sector companies may regard it as risky. In order to mitigate such risks, the project will adopt a gradual approach by carrying out extensive study at the onset of the project in order to identify best matches between private sector companies and villages.
- **Fiduciary:** MMAF has established procedures for funding decentralized activities, but procurement and FM capacity might not be adequate to handle the additional types of project activities. To mitigate these risks, the PMO will include a Procurement Officer, a Procurement Assistant, a Financial Officer, and an Accountant. Also, ADB and the Government will ensure that project readiness requirements are met, including preparing the procurement plan and establishing a financial accounting system satisfactory to ADB.
- **Monitoring and Evaluation.** A simple but comprehensive MIS to monitor project performance has been initiated under COREMAP II. This will provide the backbone of project performance management system (PPMS). Technical assistance is proposed for PPMS design and for surveys and impact assessments. Monitoring quality of project activities will be assured through improving capacity of the PMO at the district level.

IV. EXECUTING AND IMPLEMENTING AGENCIES

20. DGMCSI of the MMAF will serve as the executing agency. The Directorate of Area and Fish Species Conservation (DAFSC) of DGMCSI, Indonesian Institute of Science (LIPI), Directorate, General of Capture Fisheries (DGCF), the Technical Implementation Unit (UPT) of the National Marine Conservation Areas (LKKPN) of Pekanbaru and the Technical Unit of Coastal and Marine Management (UPT BPSPL) in Padang, will be the national implementing units. The Provincial Government will take a facilitation role, and the district government will implement the Project through its marine and fisheries office. At the village level, the activities will be carried out by Community Coral Reef Management Board (LPSTK) and community groups (pokmas). A consulting firm and several individual consultants will be recruited to support project implementation. Chart 1 below provides a simplified conceptual diagram of the Project organizational structure.

Chart 1: Project Organizational Structure



AMRC = Directorate of Aquatic and Marine Resource Conservation, COREMAP = coral reef rehabilitation and management program, CTI = Coral Triangle Initiative, DGMCISI = Directorate General of Marine, Coasts and Small Islands, LKKPN = National Marine Conservations, NPIU = national project implementation unit, PIU = project implementation unit, PMO = project management office, UPT = technical implementing unit.

21. **DG Capture Fishery:** DGCF will be responsible for implementing Ecosystem Approaches to Managing Small-Scale Fisheries, stock and coral reef fish assessment and development of fisheries management plans based on eco-system-based approaches.

22. Indonesia Institute of Sciences (LIPI) -**Research Centre for Oceanography:** LIPI will continue to be responsible for implementing robust ecological and socioeconomic monitoring. It will be responsible for developing a certified coral reef and fisheries monitoring protocol and training curriculum in collaboration with technical specialists. LIPI will be the certifier of coral reef and fisheries monitoring protocols and provide training to partners to carry out monitoring and data gathering. It will also update the data of CRMIS and make necessary modifications of the system.

23. The technical implementing unit of the National Marine Conservations Areas (LKKPN) of Pekanbaru will cover the national parks of Pieh islands, Anambas, and Gilimatra. The LKKPN Pekanbaru will be responsible mainly in implementing activities of Component 2: Ecosystem-Based Resource Management. In order to support the LKKPN, the project will form a small team within the LKKPN supervised by PMO Component 2 manager. A small sub-team will also be established in the selected districts close to Pieh, Anambas and Gilimatra.

24. District Level Responsibilities: Under the overall guidance of the PMO and PIUs at the national level, detailed program planning, implementation, and evaluation will be executed by a district project implementation unit (DPIU), comprising of key local institutions, their staff members and consultants. Each DPIU will be responsible for district level project implementation such as strengthening and embedding the COREMAP—CTI approach within the local government structure under Component 1 and promoting and monitoring the sustainable enterprises and their alliances. The DPIUs will be located within the Department of Marine and Fisheries office (DMFO) within each district and its head of DMFO will serve as the director of DPIU under the overall supervision of the district mayor (Bupati). Each DPIU will have at least two extension agents: one assigned by MMAF and the other from DMFO to carryout field activities. In addition, the PMO will assign one SEA development and support officer, and M&E officer.

25. The PMO will be responsible for preparing annual budgets and work plans consolidated from all the project implementation units (PIUs). It will monitor and evaluate the implementation progress and outcomes of the project components, as well as the Project expenses by components and the allocation of loan and grand proceeds. The project design and monitoring framework (DMF, attached to the RRP) will serve as the basis for project monitoring and evaluation (M&E). The progress will be monitored and its data will be stored in the project management information system (MIS) for the project management and evaluation. The project will conduct a baseline survey at the onset of project implementation and an impact assessment toward the end of the project period to determine the project achievements against the RRP and its linked documents.

A. Staffing

26. The PMO will employ two National Consultants to undertake the roles of Financial Management Specialist and Accountant/Finance Clerk. A full time M&E officer will be recruited to carry out project M&E at the PMO, while the project will recruit one M&E officer at each district PIU to update the MIS data. The M&E officer at the PMO will be responsible in overseeing the data collection by the district M&E officers and identifying issues to apply

corrective measures. The M&E officer at the PMO will prepare quarterly progress reports for submission to the NSC and the ADB through the EA.

27. In addition to the quarterly reports, the PMO would prepare relevant monitoring of the environmental and social safeguards implementation reports related to their areas of responsibility. These reports would contain: progress in implementation of the overall safeguard requirements such as in relation to: (i) land appropriation; (ii) other social mitigation measures (including income restoration activities as needed); (iii) update on project-affected persons; (iv) monitoring of contractor performance; (v) identification of emerging social and environmental issues; and (vi) updated plan for social and environmental safeguards as well as on overall positive environmental and social outcomes of the project.

B. Accounting Policies and Procedures

28. **Accounting Policies:** In accordance with Minister of Finance Decree 171/ 2007 (on the Government accounting system and financial reporting⁷), DGMCSI have an accounting system that allows for the proper recording of subproject financial transactions, including the allocation of expenditures in accordance with the respective components, disbursement categories, and sources of funds. Controls are in place concerning the preparation and approval of transactions, ensuring that all transactions are correctly made and adequately explained. The chart of accounts is adequate to properly account for and report on subproject activities and disbursement categories. Cost allocations to funding sources are made accurately and in accordance with established agreements. The General Ledger and subsidiary ledgers are reconciled and in balance. All accounting and supporting documents are retained on a permanent basis in a defined system that allows authorized users easy access. Access is possible by authorized personnel, but the documents are not stored in a centralized computerized database.

29. The following functional responsibilities are performed by different units or persons: (i) authorization to execute a transaction; (ii) recording of the transaction; and (iii) custody of assets involved in the transaction; (iv) functions of ordering, receiving, accounting for, and paying for goods and services are appropriately segregated; and (v) bank reconciliations are prepared by someone other than those who make or approve payments.

30. **Budgeting System:** Budgets include physical and financial targets. The budgets are prepared for all significant activities in sufficient detail to provide a meaningful tool with which to monitor subsequent performance. The actual expenditures are compared to the budget with reasonable frequency, and explanations required for significant variations from the budget. Approvals for variations from the budget are required in advance. Budgets are prepared by the planning official, approved by the Head of DGMCSI, and submitted to MMAF for final approval by the Indonesian Parliament. Procedures are in place to plan subproject activities, collect information from the units in charge of the different components, and prepare the budgets. The subproject plans and budgets of subproject activities are realistic, based on valid assumptions, and developed by knowledgeable individuals. They are prepared by PPTA Consultant in consultation with DGMCSI and regional government.

31. **Payments:** Invoice-processing procedures provide: (i) copies of purchase orders and receiving reports to be obtained directly from issuing departments (ii) comparison of invoice

⁷ the government system is in line with the International Financial Reporting Standards will be applied for project reporting (as required by ADB's Guidelines for the Financial Management and Analysis of Projects) ,

quantities, prices and terms, with those indicated on the purchase order and with records of goods actually received; (iii) Comparison of invoice quantities with those indicated on the receiving reports; and (iv) checking the accuracy of calculations. All invoices are stamped PAID, dated, reviewed and approved, and marked for account code assignment. Controls exist for the preparation of the payroll and changes to the payroll are properly authorized.

32. **Policies and Procedures:** the basis of accounting is cash and manuals are distributed to appropriate personnel. Subprojects have an adequate policies and procedures manual to guide activities and ensure staff accountability. The accounting policy and procedure manuals are updated for subproject activities. Procedures exist to ensure that only authorized persons can alter or establish a new accounting principle, policy or procedure to be used by DGMCSI. The software is available, provided by the Ministry of Finance. There are written policies and procedures covering all routine financial management and related administrative activities. The policies and procedures define conflict of interest and related party transactions (real and apparent) and provide safeguards to protect the organization from fraud and corruption. Therefore, the managerial independence and authority of the DGMCSI requires strengthening (technical assistance provided through the Project).

33. **Cash and Bank:** The Ministry of Finance will determine names and positions of authorized signatories for the bank. The organization maintains an adequate, up-to-date cashbook, recording receipts and payments. Controls exist for the collection, timely deposit and recording of receipts at each collection location. Bank and cash are reconciled on a monthly basis. All unusual items on the bank reconciliation are reviewed and approved by a responsible official. all receipts deposited on a timely basis.

34. **Safeguard over Assets.** There is a system of adequate safeguards to protect assets from fraud, waste and abuse. The Ministry of Finance provides a Management and Accounting Information System for State-Owned Assets (SIMAK-BMN) for use by the accounting unit. The management of state-owned assets is regulated by Government Regulation 6/2006. Subsidiary records of fixed assets and stocks are kept up to date and reconciled with control accounts. There are periodic physical inventories of fixed assets and stocks. However, the assets are sufficiently covered by insurance policies.

35. **Other Offices and Implementing Entities.** There are various implementing agencies at regional level (*Unit Pelaksanaan Teknis* or UPT), at least three national MPAs managed by UPT-Pekanbaru, and other seven district-based MPAs, as subprojects. Each subproject will establish controls and procedures for flow of funds, financial information, accountability, and audits in relation to the other offices or entities. The project will ensure that information among the different offices and implementing agencies flows in an accurate and timely fashion. Periodic reconciliation at least on quarterly basis will be performed among the different offices and implementing agencies. Each of the subprojects will advise employees, beneficiaries and other recipients to whom to report if they suspect fraud, waste or misuse of subproject resources or property.

a. Internal Audit

36. The internal audit will be conducted by the Inspectorate from MMAF and the national government institution for the internal audit (*badan pengawas keuangan pembangunan*, (BPKP). The Inspectorate reports to the Minister of MMAF, while BPKP reports to the President of Indonesia. The Mission has not been able to collect adequate information on the qualifications and experience of audit department staff. The PMO will ensure that the

Inspectorate and BPKP will include the Project in its work program. Previous projects indicate that audit reports on the annual project financial statements (APFS)s were rated highly satisfactory. BPKP prepared the audited APFS on time and no significant anomalies or discrepancies were noted. Transactions were adequately supported by relevant transaction documents. ADB has a project with BPKP for strengthening the internal audit functions from national to regional levels.

b. Reporting, Monitoring and Information Systems

37. The financial statements prepared for DGMCSI will be in accordance with local accounting standards, with due concern for ADB reporting requirements. It will be prepared by PPK on monthly, quarterly and annual basis. The PPK will prepare the financial statements for the PMO and each PIU. Internal financial statements are required to be prepared monthly, quarterly and annually. In addition, an external audit will be conducted annually. The current reporting system needs to be adapted to report on the subproject components.

38. DGMCSI has established an integrated project monitoring and reporting system that was used during COREMAP II. The system monitors physical and financial progress for each project activity area based on work plan as well as physical completion and disbursement targets. This system will be made more effective during COREMAP—CTI implementation and will help reduce financial management related risks.

39. The Project will establish financial management reporting responsibilities that specify what reports are to be prepared, what they are to contain, and how they are to be used. The financial management reports will be used by management to compare actual expenditures with budgeted and programmed allocations. The financial reports will be prepared directly by the automated accounting system provided by MOF.

V. FUNDS FLOW

40. The chart below presents the fund flow arrangement of the Project. The Project will establish two imprest accounts (one for ADB loan and one for GEF grant), in US Dollars, in the name of MOF at the central bank, Bank Indonesia (BI) that is acceptable to ADB. In parallel, MOF will open a conduit account for the conversion of US Dollars into Rupiah (Indonesian Drawing Rights, IDR). ADB will channel the loan and grant funds to these imprest accounts. COREMAP CTI will have three budget holders: DGMCSI, DGCF and LIPI. Each budget holder will establish a working unit for COREMAP CTI implementation, which is headed by a commitment officer (*pejabat pembuat komitmen*, PPK).

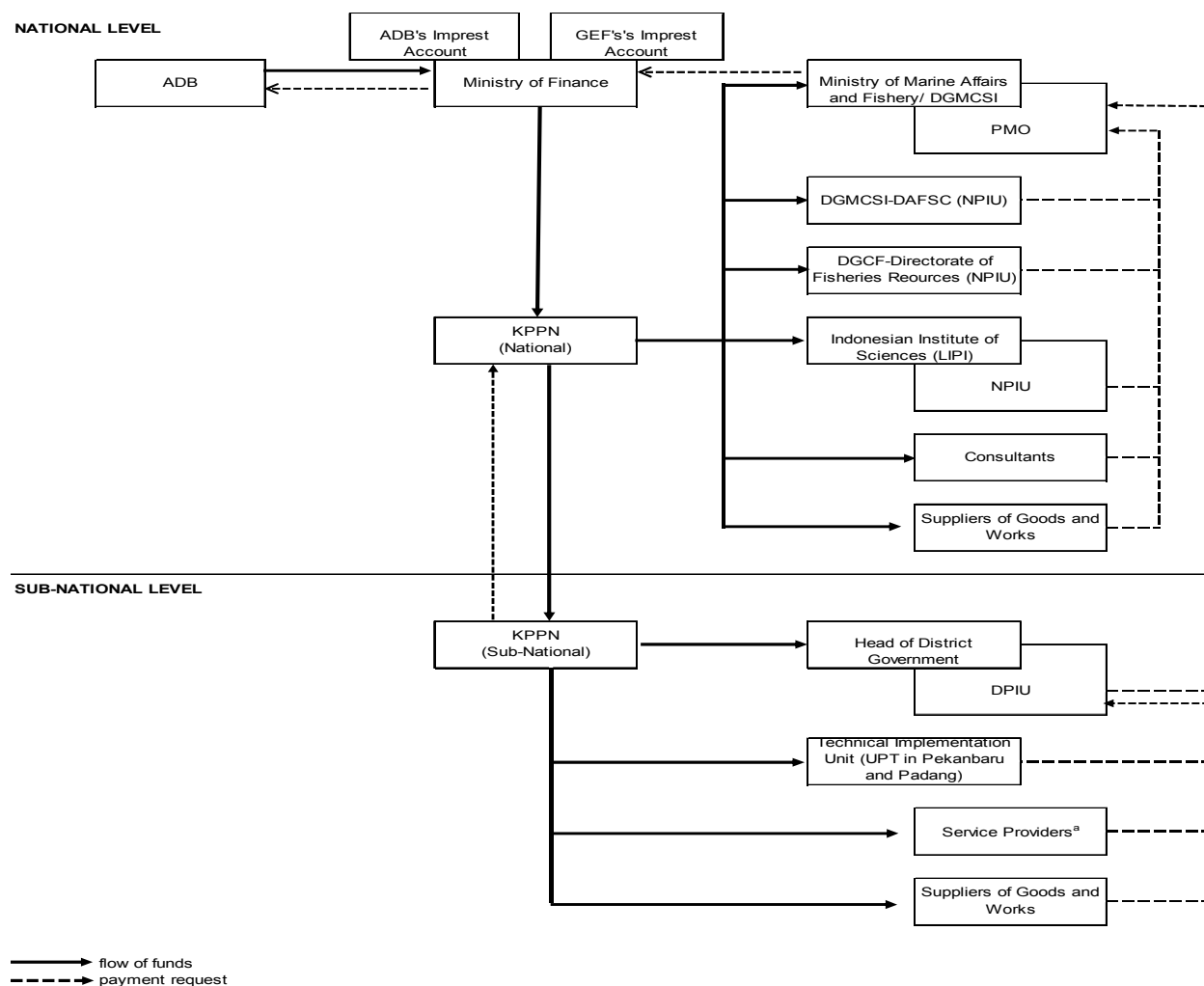
41. The PPK is responsible for monitoring procurements and managing the payments for procured works, goods or services. The payments are made by the treasury (*Kantor Pembendaharaan dan Kas Negara*, KPN) at the request of PPK and following the approval by the budget holders. The funds will be transferred to DGMCSI and PIUs through the regular government budgets. The Government prefers all payments to be made through the imprest accounts since the “Direct Payment” method was deemed time-consuming. Payments through these accounts indeed will be faster than direct payments. The Project will improve the control systems to ensure that the funds will be properly used as intended.

42. All fund proceeds will be disbursed in accordance with ADB’s *Loan Disbursement Handbook* (July 2012, as amended from time to time) and detailed arrangements agreed upon between the Government and ADB. As mentioned above, the project will use the imprest

account procedure. The ceiling of total advances to the imprest accounts will initially not exceed 10% of the grant amount that will be allocated for the specific account. The requests for the initial and additional advance(s) should be based on the 6 months' estimated expenditures. The statement of expenditure (SOE) procedures will be used for reimbursement of eligible expenditures for the loan and GEF grant and to liquidate advances provided into the imprest accounts.

43. Any individual payment to be reimbursed or liquidated under the SOE procedure shall not exceed \$100,000, and for payment and for transactions in excess of \$100,000 equivalent, supporting documents (e.g., contracts) will need to be submitted to ADB for these activities for imprest account replenishment. Payments for project-related travel and per-diem for counterpart staff will be based on standard government rates/cost norms acceptable to ADB if they are funded by ADB loan.

Chart 2: Fund Flow Arrangement



ADB = Asian Development Bank, DAFSC = Directorate of Area and Fish Species Conservation, DGCF = Directorate General of Captured Fisheries, DGMCSI = Directorate General of Marine, Coasts and Small Islands, DPIU = District Project Implementation Unit, GEF = Global Environment Facility, KPPN = *Kantor Pelayanan Perbendaharaan Negara* (State Treasury Office), LIPI = *Lembaga Ilmu Pengetahuan Indonesia* (Indonesian Institute of Sciences), NPIU = National Project Implementation Unit, PMO = Project Management Office.

^a GOI regulations no longer give NGOs or academic institutions preferential access to government-financed contracts (including contracts finance from government loans or grants).

From Imprest Accounts, the funds will from national to district and provinces through regular government budget systems - no sub-accounts are established.

VI. EXTERNAL AUDIT

44. The EA will engage the Badan Pengawas Keuangan (BPK), the Indonesian Supreme Audit Institution (SAI), to audit the consolidated project financial statements annually. The EA/IA will submit to ADB certified copies of audited annual project financial statements as well as the auditor's report and the management letter within 6 months of each financial year-end during implementation. The terms of reference (TOR) of auditors have been discussed with BPK and BPK committed to standardize the TOR for all ADB funded projects. It also committed to harmonize the TOR with other donors and other ASEAN countries.

Annex 1

Responses to FMA Questionnaire - by DGMCSI

Topic	Response
1. Implementing Agency	
1.1 What is DGMCSI's legal status / registration?	Directorate-General in central government ministry
1.2 Has DGMCSI implemented an externally-financed subproject in the past (if so, please provide details)?	Yes, COREMAP II and the Marine Coastal Resources Management Project (MCRMP).
1.3 What are the statutory reporting requirements for DGMCSI?	Cf. official requirements for central government entities in GOI.
1.4 Is the governing body for the subproject independent?	No, integral part of the central government.
1.5 Is the organizational structure appropriate for the needs of the subproject?	For implementation of COREMAP-CTI, DGMCSI intends to use the organizational structure used for COREMAP II, which was deemed appropriate.
2. Funds Flow Arrangements	
2.1 Describe (proposed) subproject funds flow arrangements, including a chart and explanation of the flow of funds from ADB, government and other financiers.	COREMAP-CTI will have two budget holders: DGMCSI and LIPI. Each budget holder will establish a working unit for COREMAP-CTI implementation, which is headed by a commitment officer (PPK ⁸). The PPK is responsible for procurement, and payment for procured works, goods or services are made by the treasury (KPPN ⁹) at the request of PPK and following approval by the budget holder.
2.2 Are the proposed arrangements to transfer loan proceeds (from Ministry of Finance) to DGMCSI satisfactory?	Yes, the fund will transferred to DGMCSI and PIUs through the regular government budgets.
2.3 What have been the major problems in the past in receipt of funds by DGMCSI?	Payment using the "Direct Payment" method was deemed time-consuming, and for this reason an Imprest Account (held by MOF) was set up. Payment through this account was indeed fast but control was lacking.
2.4 In which bank will the Imprest account be opened?	Bank of Indonesia, the central bank
2.5 Does DGMCSI have experience in the management of disbursements from ADB?	Yes, several projects
2.6 Does DGMCSI have/need a capacity to manage foreign exchange risks?	Not relevant (ADB funds on-granted to DGMCSI in the currency of use (mainly Rupiah, except for foreign consultant contracts, which are denominated and paid in US Dollar). Foreign exchange risk is fully managed by MOF.
2.7 How are the counterpart funds accessed?	Counterpart funds for COREMAP-CTI will be allocated in annual budgets, based on annual work plans.
2.8 How are payments made from the counterpart funds?	Against invoices from firms or individual consultants, following established the Government procedures.
2.9 If part of the subproject is implemented by communities or NGOs, does DGMCSI have the necessary reporting and monitoring features built into its systems to track the use of subproject proceeds by such agencies?	Yes, experience from the previous projects funded by ADB and the World Bank.

⁸ PPK = pejabat pembuat komitmen = commitment officer

⁹ KPPN =

Responses to FMA Questionnaire - by DGMCSI

Topic	Response
2.10 Are the beneficiaries required to contribute to subproject costs? If beneficiaries have an option to contribute in kind (in the form of labor), are proper guidelines formulated to record and value the labor contribution?	Yes. DGMSCI established a mechanism under COREMAP II to record in-kind contributions. In kind contribution is not reported in regular quarterly reports.
3. Staffing	
3.1 What is the (proposed) organizational structure of the accounting department? Attach an organization chart.	See Table S14-2.
3.2 Identify the (proposed) accounts staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions and CVs of key accounting staff.	The accounts staff should be a bachelor degree in economics (with a major in accounting), and at least five years of professional experience (and preferably be familiar with government accounting standards and procedures). The responsibilities of the accounts staff include: (i) process source documents to produce financial statements, including the report on budget realization, balance sheet and notes to the financial report, (ii) submit the report on budget realization and balance sheet together with the computer data archive to the accounting division of MMAF for consolidation every month, (iii) prepare a reconciliation report with KPPN every month, and (iv) prepare mid-term and annual financial statements accompanied by notes to the financial report.
3.3 Is the subproject finance and accounting function staffed adequately?	Sufficient, but training for specifically this loan project is required.
3.4 Is the finance and accounts staff adequately qualified and experienced?	
3.5 Is the subproject accounts and finance staff trained in ADB procedures?	Yes, DGMSCI recognizes that further training is required to update their skills and knowledge.
3.6 What is the duration of the contract with the finance and accounts staff?	Permanent employees of DGMSCI.
3.7 Indicate key positions not contracted yet, and the estimated date of appointment.	To be determined.
3.10 Does the subproject have written position descriptions that clearly define duties, responsibilities, lines of supervision, and limits of authority for all of the officers, managers, and staff?	No (position descriptions for COREMAP-CTI will be based on available descriptions for COREMAP II).
3.11 At what frequency are personnel transferred?	Once every one to three years, depending on their tasks and their performance.
3.12 What is training policy for finance and accounting staff?	There is a routine training agenda provided by MMAF every year.
4. Accounting Policies and Procedures	
4.1 Does DGMCSI have an accounting system that allows for the proper recording of subproject financial transactions, including the allocation of expenditures in accordance with the respective components, disbursement categories, and sources of funds? Will the subproject use DGMCSI accounting system?	Yes, in accordance with Minister of Finance Decree 171/ 2007 (on the Government accounting system and financial reporting).

Responses to FMA Questionnaire - by DGMCSI

Topic	Response
4.2 Are controls in place concerning the preparation and approval of transactions, ensuring that all transactions are correctly made and adequately explained?	Yes.
4.3 Is the chart of accounts adequate to properly account for and report on subproject activities and disbursement categories?	Yes.
4.4 Are cost allocations to funding sources made accurately and in accordance with established agreements?	Yes.
4.5 Are the General Ledger and subsidiary ledgers reconciled and in balance?	Yes.
4.6 Are all accounting and supporting documents retained on a permanent basis in a defined system that allows authorized users easy access?	Yes. Access is possible by authorized personnel, but the documents are not stored in a centralized computerized database.
a. Segregation of Duties	
4.7 Are the following functional responsibilities performed by different units or persons: (i) authorization to execute a transaction; (ii) recording of the transaction; and (iii) custody of assets involved in the transaction?	Yes.
4.8 Are functions of ordering, receiving, accounting for, and paying for goods and services appropriately segregated?	Yes.
4.9 Are bank reconciliations prepared by someone other than those who make or approve payments?	Yes.
b. Budgeting System	
4.10 Do budgets include physical and financial targets?	Yes.
4.11 Are budgets prepared for all significant activities in sufficient detail to provide a meaningful tool with which to monitor subsequent performance?	Yes.
4.12 Are actual expenditures compared to the budget with reasonable frequency, and explanations required for significant variations from the budget?	Yes.
4.13 Are approvals for variations from the budget required in advance or after the fact?	Approval must be given in advance.
4.14 Who is responsible for budget preparation and approval?	Prepared by the planning official, approved by the Head of DGMCSI, and submitted to MMAF for final approval by the parliament (DPR).
4.15 Are procedures in place to plan subproject activities, collect information from the units in charge of the different components, and prepare the budgets?	Yes.
4.16 Are the subproject plans and budgets of subproject activities realistic, based on valid assumptions, and developed by knowledgeable individuals?	Yes, prepared by PPTA Consultant in consultation with DGMCSI and regional government.

Responses to FMA Questionnaire - by DGMCSI

Topic	Response
Payments	
4.17 Do invoice-processing procedures provide for: (i) Copies of purchase orders and receiving reports to be obtained directly from issuing departments? (ii) Comparison of invoice quantities, prices and terms, with those indicated on the purchase order and with records of goods actually received? (iii) Comparison of invoice quantities with those indicated on the receiving reports? (iv) Checking the accuracy of calculations?	Yes.
4.18 Are all invoices stamped PAID, dated, reviewed and approved, and marked for account code assignment?	Yes.
4.19 Do controls exist for the preparation of the payroll and are changes to the payroll properly authorized?	Yes.
Policies And Procedures	
4.20 What is the basis of accounting (e.g., cash, accrual)?	Cash
4.21 What accounting standards are followed?	See 7.1.
4.22 Does the subproject have an adequate policies and procedures manual to guide activities and ensure staff accountability?	Yes.
4.23 Is the accounting policy and procedure manual updated for the subproject activities?	Yes.
4.24 Do procedures exist to ensure that only authorized persons can alter or establish a new accounting principle, policy or procedure to be used by DGMCSI?	Yes, the software is available provided by the Ministry of Finance.
4.25 Are there written policies and procedures covering all routine financial management and related administrative activities?	Yes.
4.26 Do policies and procedures clearly define conflict of interest and related party transactions (real and apparent) and provide safeguards to protect the organization from?	No, the managerial independence and authority of the DGMCSI requires strengthening (technical assistance provided through the Project).
4.27 Are manuals distributed to appropriate personnel?	Yes.
Cash and Bank	
4.28 Indicate names and positions of authorized signatories in the bank accounts.	To be determined by the Ministry of Finance.
4.29 Does the organization maintain an adequate, up-to-date cashbook, recording receipts and payments?	Yes.
4.30 Do controls exist for the collection, timely deposit and recording of receipts at each collection location?	Yes.
4.31 Are bank and cash reconciled on a monthly basis?	Yes.
4.32 Are all unusual items on the bank reconciliation reviewed and approved by a responsible official?	Yes.
4.33 Are all receipts deposited on a timely basis?	Yes
Safeguard over Assets	
4.34 Is there a system of adequate safeguards to protect assets from fraud, waste and abuse?	Yes, the Ministry of Finance provides a Management and Accounting Information System for State-Owned Assets (SIMAK-BMN) for use by the accounting unit. The management of state-owned assets is regulated by Government Regulation 6/2006.

Responses to FMA Questionnaire - by DGMCSI

Topic	Response
4.35 Are subsidiary records of fixed assets and stocks kept up to date and reconciled with control accounts?	Yes.
4.36 Are there periodic physical inventories of fixed assets and stocks?	Yes.
4.37 Are assets sufficiently covered by insurance policies?	No.
Other Offices and Implementing Entities	
4.38 Are there any other regional offices or executing entities participating in implementation?	Yes, there are various implementing agencies at regional level (<i>Unit Pelaksanaan Teknis</i> or UPT).
4.39 Has the subproject established controls and procedures for flow of funds, financial information, accountability, and audits in relation to the other offices or entities?	Yes.
4.40 Does information among the different offices/ implementing agencies flow in an accurate and timely fashion?	Yes.
4.41 Are periodic reconciliations performed among the different offices/implementing agencies?	Yes.
Other	
4.42 Has the subproject advised employees, beneficiaries and other recipients to whom to report if they suspect fraud, waste or misuse of subproject resources or property?	Yes.
5. Internal Audit	
5.1 Is there an internal audit department in DGMCSI?	Yes, the Inspectorate from MMAF and BPKP.
5.2 What are the qualifications and experience of audit department staff?	NA.
5.3 To whom does the internal auditor report?	To MMAF and president
5.4 Will the internal audit department include the subproject in its work program?	Yes.
5.5 Are actions taken on the internal audit findings?	Yes.
6. External Audit	
6.1 Is DGMCSI financial statement audited regularly by an independent auditor? Who is the auditor?	Yes, annually by BPK, as part of reports prepared by the Directorate General of Treasury (refer to Minister of Finance decree 171/2007 on the Government accounting system and financial reporting).
6.2 Are there any delays in audit of DGMCSI? When are the audit reports issued?	BPK usually issues its financial report for a financial year in July of the next year. The working unit will receive the report (specifically for its part) about two months after the audit.
6.3 Is the audit of DGMCSI conducted according to the International Standards on Auditing?	In accordance with prevailing GOI regulations (which are largely but not fully compatible with IAS), and with due concern for ADB reporting requirements.
6.4 Were there any major accountability issues brought out in the audit report of the past three years?	No.
6.5 Will DGMCSI auditor audit the subproject accounts or will another auditor be appointed to audit the accounts?	No, BPK.
6.6 Are there any recommendations made by the auditors in prior audit reports or management letters that have not yet been implemented?	No.

Responses to FMA Questionnaire - by DGMCSI

Topic	Response
6.7 Is the subproject subject to any kind of audit from an independent governmental entity (e.g., the supreme audit institution) in addition to the external audit?	Yes
6.8 Has the subproject prepared acceptable terms of reference for an annual subproject audit?	Being discussed with BPK
7. Reporting and Monitoring	
7.1 Are financial statements prepared for DGMCSI? In accordance with which accounting standards?	In accordance with local accounting standards, with due concern for ADB reporting requirements.
7.2 Are financial statements prepared for the implementing unit?	Yes, prepared by the PPK.
7.3 What is the frequency of preparation of financial statements? Are the reports prepared in a timely fashion so as to be useful to management for decision making?	Internal financial statements are required to be prepared monthly, quarterly and annually. In addition, an external audit will be conducted annually.
7.4 Does the reporting system need to be adapted to report on the subproject components?	Yes, in accordance with COREMAP– CTI loan agreement (technical assistance provided through the Project).
7.5 Does the reporting system have the capacity to link the financial information with the subproject's physical progress? If separate systems are used to gather and compile physical data, what controls are in place to reduce the risk that the physical data may not synchronize with the financial data?	DGMCSI established an integrated reporting system for use by COREMAP II. This system needs to be updated so that it can also be used for COREMAP CTI (no need for new software).
7.6 Does the subproject have established financial management reporting responsibilities that specify what reports are to be prepared, what they are to contain, and how they are to be used?	To be determined.
7.7 Are financial management reports used by management?	Yes.
7.8 Do the financial reports compare actual expenditures with budgeted and programmed allocations?	Yes (conform budgets in existing DGMCSI budgets).
7.9 Are financial reports prepared directly by the automated accounting system or are they prepared by spreadsheets or some other means?	By an automated accounting system, provided by MoF.
8. Information Systems	
8.1 Is the financial management system computerized?	MMAF does not operate a computerized financial management system. For COREMAP–CTI implementation, DGMCSI intends to use ADB's system.
8.2 Can the system produce the necessary subproject financial reports?	Yes.
8.3 Is the staff adequately trained to maintain the system?	Yes, but training is always required since staff is periodically replaced.
8.4 Does the management organization and processing system safeguard the confidentiality, integrity and availability of the data?	Yes.