

PROGRAM FIDUCIARY SYSTEMS ASSESSMENT

1. The Sustainable Energy Access in Eastern Indonesia—Electricity Grid Development Program 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]), 2017–2026. The program covers four *wilayah* (regional office) service areas in Eastern Indonesia: (i) South, Southeast, and West Sulawesi (“Sulselrabar”); (ii) North and Central Sulawesi, and Gorontalo (“Suluttenggo”); (iii) West Nusa Tenggara (*Nusa Tenggara Barat*); and (iv) East Nusa Tenggara (*Nusa Tenggara Timur*). The program will be implemented with Asian Development Bank (ADB) financing using ADB’s results-based lending (RBL) modality and PLN’s financial management, procurement, and anticorruption systems.

A. Information System

2. The assessment was undertaken from May to August 2016 and included a review of PLN’s financial management and procurement systems, and anticorruption mechanisms. The primary focus is on PLN as the executing agency for the 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.¹ The procurement system assessment is based on ADB’s 2015 PLN procurement assessment report, which focuses on the performance, practices, and status of procurement systems.² The procurement assessment also benefited from the availability of counterpart staff at PLN overseeing procurement, as well as a desk review of their procurement data and statistics. The anticorruption assessment relating to the implementation of good corporate governance (GCG) is a follow-up to the 2002 decree of the minister of state-owned enterprises (SOEs), subsequently amended in 2011 to regulate the implementation of GCG in SOEs.

B. 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. Related procedures have generally been well implemented, and PLN has satisfactorily employed the 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 2016.³ This showed that performance had improved in many areas, including the comprehensiveness and transparency of the budget, policy-based budgeting, predictability and control in budget execution, accounting, recording and reporting, and external scrutiny and audit. However, it also showed that some specific areas

¹ 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.

² ADB. 2015. *Indonesia Country Procurement Assessment Report 2015*. Manila.

³ ADB. 2016. *Public Financial Management Assessment for INO 48134—Stepping up Investments for Growth Acceleration Program—Subprogram 2*. Manila.

remained very weak, including the extent of unreported government operations, transparency of intergovernmental fiscal relations, multiyear budgeting, the implementation of internal controls for payroll and non-salary expenditure, the internal audit function, the quality and timeliness of in-year budget reports, and the legislature's scrutiny of external audit reports. 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 fully government-owned, implying financial accountability and a relationship vis-à-vis the government budget, as significant subsidies are allocated via the budget and Parliament approves subsidiary loan agreement as separate budget lines. SOEs are required to submit quarterly financial statements to the Ministry of State-Owned Enterprises and to produce audited financial statements as part of their annual reports. They must also undertake regular financial assessments. SOEs generally comply with reporting requirements, and the Ministry of Finance encourages compliance by following up on their preparation of fiscal risk statements.

6. **Fund flow arrangements.** ADB will, based on a government guarantee, sign a loan agreement directly with PLN. PLN will prepare withdrawal applications for submission to ADB, and disbursements will accordingly be made directly to PLN. PLN will merge the ADB loan funds with other resources; it will not be required to identify transactions or payments related to any specific funding source. The management of funds will be based on PLN's ordinary system for budget preparation, funds release, execution, and accountability. Given PLN's financial management systems, this arrangement is 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. The shareholders approve PLN's annual work plan and budget at the general meeting of shareholders represented by the Ministry of State-Owned Enterprises. Parliament 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 introduces a revised budget, the dollar-rupiah exchange rate or Indonesian crude price for oil fluctuates, or external policy developments affect the macroeconomic assumptions underlying the work plan and budget. Budget amendments occur once a year and require approval. PLN's planning and budget function is deemed acceptable.

8. **Accounting and internal control.** PLN applies the Indonesian Financial Accounting Standards, which are gradually being merged with the International Financial Reporting Standards and the Interpretation of Financial Accounting Standards. Indonesia is working to minimize significant differences between the standards, including their interpretation. According to the external auditor, PLN had, as of the end of 2013, adopted all new and revised financial accounting standards and interpretations relevant to its operations and effective for accounting. PLN regularly updates its manuals to reflect the Indonesian Financial Accounting Standards, and maintains internal rules and regulations on financial management and accounting.

9. PLN's accounting system is computerized and incorporated in a SAP-based enterprise resource planning (ERP) system. As not all of PLN's subsidiaries use the same SAP-based ERP system, consolidated financial statements are presently being generated manually using a spreadsheet, and checks and balance are in place to mitigate the risk of human error. For example, all adjustments to entries 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. PLN is working to transition to full computerization

in the near future by integrating its Budget Planning and Control Information System with the ERP. Once integration is complete, PLN's subsidiaries will produce financial data in specific templates using the Budget Planning and Control Information System for uploading information into the ERP, which will facilitate the creation of system-generated, consolidated financial statements.

10. Accounting and finance staff are trained to apply the ERP system and understand it well. 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 in line 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 a new asset management system containing detailed records of fixed assets that are reconciled with the control account. A physical inventory check is conducted annually and checked by the external auditor. However, no guidelines or procedures are in place to ensure that assets are recorded immediately after acquisition, and the external auditor has noted frequent delays in recognizing and recording the transfer of fixed assets from construction-in-progress accounts.

12. **Financial reporting.** The ERP system used for financial reporting generally functions well but, among other challenges, cannot automatically compare budgets and actual expenditures at the end of the year, and does not produce lender-specific reports, which must be prepared manually. PLN does not ordinarily prepare separate financial reports for each funding source, but does prepare separate reports on program transactions to development partners on a quarterly basis using interim financial reports. PLN's reports do not include physical targets. In 2014, PLN began implementing the pilot project, Internal Control over Financial Reporting, which indicates potential spending-related risks.

13. **Internal audit.** PLN's internal audit is governed by a charter and carried out by its Internal Supervisory Unit, which reports directly to PLN's president director and works closely with the Audit Committee of the board of commissioners. The Internal Supervisory Unit has offices in all 13 PLN regions with 184 personnel (although an external quality assurance review recommended a total of 220 auditors). Most auditors are qualified internal auditors. Internal audits utilize risk-based annual work program monitoring, which generally includes development partner-supported programs and projects. PLN's management usually takes prompt follow-up 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 issued by the Indonesian Institute of Public Accountants. The external audit is to obtain reasonable assurance about the quality of the financial statement and determine if it matches the books of accounts. No significant accountability issues have been identified in recent audit reports, and the audit opinions for 2012–2016 have been unqualified. There are no outstanding audit reports under existing ADB operations. The State Audit Agency audits only PLN's subsidy calculations.

15. **Human resource capacity.** PLN's Finance Department has five main divisions; this appears to be 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, particularly senior staff members, holding relevant degrees and having extensive experience in business accounting, program accounting, and financial management.

Some accounting and finance staff have participated in training and have experience with ADB loan disbursement procedures. PLN has formulated a human resource strategic plan and road map, which are being implemented up to 2016.

16. **Program financial reporting and external audit arrangements.** Program accounting and reporting procedures and responsibilities 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.⁴ The external auditor will prepare a separate program disclosure to certify the actual program expenditure⁵ and the procurement eligibility computation.⁶ PLN will submit the annual audited financial statements and program disclosure to ADB within 1 month of approval by the relevant authority. 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

Risk Description	Risk Rating^a	Mitigation Measures
Inherent Risk^b		
Country-level risks: Overall weak country financial management system, especially with regard to budget execution, accounting and reporting, and budget credibility.	Moderate	Continuation of PFM reforms in line with the Government Financial Management and Revenue Administration Project, RPJMN, and ministry and agency plans; and supported where relevant by the PFM multidonor trust fund.
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.
Overall Inherent Risk	Moderate	
Control Risk^c		
Implementing entity	Low	PLN has implemented several ADB- and World Bank-financed projects over the last few decades. It has a sufficient financial management system in place to ensure proper program implementation.
Funds flow	Moderate	The government is providing guarantee of tariff subsidies and equity injections to enable PLN to finance its capital expansion program while meeting its financial covenants. ADB and other development partners are supporting tariff reform through a coordinated policy-based loan.
Staffing	Low	Several of the accounting and finance staff have participated in training on and have experience with ADB loan disbursement procedures. The Human Resources Department has organized various in-house training programs in accounting and finance. Staff members also attend external training programs conducted by universities and consulting firms.

⁴ 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.

⁵ The amount of program expenditures for the previous year(s), for the current year, and cumulatively.

⁶ The net procurement from ADB member countries is at least equal to the value of ADB disbursements.

Risk Description	Risk Rating^a	Mitigation Measures
Accounting policies and procedures: Delay in the recognition of fixed assets and transfer from construction-in-progress accounts, resulting in the understatement of depreciation.	Moderate	The Accounting Division is updating the outdated internal regulations on the handover of projects to fixed assets to ensure that fixed assets are recognized on a timely basis. The proposed internal regulation is now undergoing a final review by senior management.
Accounting policies and procedures: PLN's consolidated financial statements are prepared manually using spreadsheets, which implies the risk of human error.	Moderate	Present controls include the requirement that all adjustments to entries must be cleared by a supervisor and logged. PLN is integrating its Budget Planning and Control Information System with the ERP system; once this is complete, the PLN subsidiaries will produce financial data in specific templates for uploading to the system, which will facilitate the creation of system-generated consolidated financial statements.
Internal audit	Low	PLN's Internal Supervisory Unit reports directly to the president director, and works closely with the Audit Committee of the board of commissioners. Most of its internal auditors are qualified, and generally have extensive experience in accounting and finance.
External audit	Low	PLN's financial statements are subject to external audit by Price Waterhouse Cooper. 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: The ERP system cannot automatically produce budget tables and compare these with actual year-end expenditures.	Low	PLN is currently in the process of integrating the Budget Planning and Control Information System with the ERP system to compare the budget with actual expenditures.
Information systems	Low	PLN's accounting system is computerized and incorporated in a SAP-based ERP system, which is fully rolled out throughout PLN. PLN's Budget Planning and Control Information System is in the process of being integrated with the ERP system.
Overall Control Risk	Low	
Overall Risk	Moderate	

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

^a 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.

^b 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).

^c 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, which will be regularly reviewed for progress and updated when required.

19. Conclusion. The financial management assessment indicates moderate fiduciary risk. While some financial management weaknesses and shortcomings have been identified for PLN,

these are relatively minor and are being addressed through the proposed mitigation measures and actions in the earlier RBL. Based on these being fully and properly implemented, the financial management arrangements are considered adequate.

Table 2: Financial Management Action Plan

Risk Description	Risk^a	Action Item	Period	Responsibility
Accounting policies and procedures: Delay in the recognition of fixed assets and transfer from construction-in-progress accounts, resulting in the understatement of depreciation.	Moderate	Update the outdated internal regulations on the handover of projects to fixed assets to ensure that fixed assets are recognized on a timely basis.	Jan 2018	Accounting Division
Financial reporting: The ERP system cannot automatically produce budget tables and compare these with actual year-end expenditures.	Moderate	Fully integrate the Budget Planning and Control System with the ERP system to allow system-generated comparisons of the budget with actual expenditures.	Jan 2018	Information Systems Division
PLN's consolidated financial statements are prepared manually using spreadsheets, which implies the risk of human error.	Moderate	Fully integrate the Budget Planning and Control Information System with the ERP system so that PLN subsidiaries can input data in templates and upload the data to the system, facilitating the creation of system-generated, consolidated financial statements.	Jan 2018	Information Systems Division

ERP = enterprise resource planning, PFM = public financing management, PLN = State Electricity Corporation (*Perusahaan Listrik Negara*).

^a 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.

C. Procurement System

20. This procurement assessment of PLN was guided by the 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. This procurement assessment updates the "Procurement Assessment of Indonesia's State Electricity Corporation (PLN) for a Possible RBL Operation" on PLN capacity, which was previously conducted for the Electricity Grid Strengthening—Sumatra Program in June 2015.⁷ This assessment also utilizes the Indonesia Country Procurement and Sector Assessment Report, interviews with PLN staff using the questionnaires mentioned in para. 3, and a desk study performed on PLN's procurement system, including a review of procurement data provided by PLN.

21. Lessons learned from the implementation of the Electricity Grid Strengthening—Sumatra Program are as follows:

⁷ 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).

- a. **The State Electricity Corporation (*Perusahaan Listrik Negara*) has no standard procurement and contract monitoring report.** Monitoring procurement performance is crucial to ensure the quality, timeliness, and efficiency of procurement processes and results. However, there is no adequate and easily available procurement and contract monitoring tool at PLN. Thus, under the program action plan (PAP), PLN has developed a contract monitoring application (*Aplikasi Monitoring Kontrak* [AMK]), which is capable of interfacing with various procurement data throughout the PLN business process, and integrating them into a necessary tool for monitoring procurement performance. However, inputs to the system are entered manually; they are not stored and linked automatically from the procurement planning and implementation data. This AMK application is being applied on a pilot basis for the program, and procurement reporting documents are still being developed. Currently the Directorate of Sulawesi and Nusa Tenggara (SNT) lacks any procurement monitoring and reporting standards. Attachments 1–3 of this procurement assessment provide examples of the tools used by the various PLN *wilayahs* to confirm this finding.⁸ Accordingly, the AMK is expected to be improved and rolled over to be applicable in SNT using the same procurement monitoring framework applied in the program.
- b. **It is important to enhance value for money in procurement by using framework contracts for specific procurements.** 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. This is partly triggered by the PAP, and not only helps expedite the procurement and works, but also makes PLN more efficient. Most PLN *wilayahs* have only recently introduced the use of framework contracts for civil works. The PLN *wilayahs* are expected to use framework contracts for civil and other smaller works for the proposed RBL program.
- c. **Although PLN has introduced joint procurement of important, high-value commodities for *wilayahs*, some delays still occur.** PLN Supply Chain Management has developed an integrated software application that serves as a procurement dispatching system, enabling *wilayahs* and *areas* (*wilayah units*) to make procurement orders online and transparently, and track them. Once PLN Supply Chain Management has signed the framework contracts with particular vendors, the *wilayahs* can easily place orders online by issuing purchase orders. This helps reduce procurement delays and identifies the source of any delays. This application is expected to be improved and expanded for use in the Directorate of SNT under this RBL program.
- d. **It is important to track the quality of contractors and vendors, as well as the quality of procurement conducted by PLN *wilayahs*.** Various significant additional works have been imposed on PLN in responding to the government's ambitious program to develop the country's capacity to produce 35,000 megawatts of electricity. This has raised the issue of the capacity of PLN and local contractors and vendors to deliver good quality outputs. Furthermore, some local contractors and vendors lack the capacity and efforts to meet the more complicated qualification requirements imposed by PLN and the Ministry of Energy and Mineral Resources. Thus, it is important to perform a sample procurement audit to ensure

⁸ Accessible from the list of linked documents in Appendix 2.

that quality results are enforced. The World Bank also imposes this requirement in its P4R program (similar to the ADB RBL modality) for Sumatra.

22. The procurement process for the program will include the engineering, procurement, and construction (EPC) of the pilot smart grid system, supervisory control, data acquisition, and the acquisition of equipment for distribution networks, as well as civil works and installation services. 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 the pilot smart grid system, and procurement of works, goods, and services under contracts with an estimated value that does not exceed specified monetary amounts (high-value contracts).⁹

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 around the world. The framework provides overall principles, a strategy, and detailed procedures for procurement. The strategy's overall objective is to increase value for money for the organization, which is identified as the correct balance of the six "Rights": quality, quantity, location, time, socioeconomic impact, and price. The right price is only considered once the other 5 Rights have been complied with. 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 key 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 spend, and classifies its procurements 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 conditions when deciding to use the RBL modality, because the RBL policy clearly states that implementation must rely on country systems, not ADB's Procurement Guidelines. 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. It should be noted that 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,

⁹ According to the RBL Staff Guidance, 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.

open-book contracting brings other benefits, such as secure supplies and (according to PLN) value for money. Overall, only 6%–6.5% of the funds spent to procure distribution equipment anticipated 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) **Procurement and market capacity.** As investment in distribution and transmission will increase significantly during implementation, it may strain the capacity of PLN, as well as that of the supply markets. ADB is processing a RBL program, other development partners will likely support the distribution and transmission program, and PLN is investing heavily to meet the ambitious goals of the power subsector development program. Thus, it is necessary to monitor carefully both the absorptive capacity of PLN and, perhaps more importantly, the capacity of the private sector to deliver. Increased investment in distribution may result in (a) a lack of qualified contractors to carry out installation and works contracts; and (b) supply risks for certain categories of equipment, especially those with limited suppliers. 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) **Anticorruption measures.** All large-scale procurements must include suitable safeguards against fraud and corruption. Over the last 3–4 years, PLN has taken a number of important initiatives 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. Each quarter, PLN will submit to the board and/or Value for Money Committee, and to ADB a report on the procurement monitoring framework indicators and provide the updated spend 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 introduce a procurement monitoring system, including an expenditure analysis. This would enable both PLN and ADB to manage procurement risks adequately and take corrective action if and when necessary.

Table 3: Risk Profile and Mitigation Measures

Risk Description	Risk Assessment	Mitigation Measures
Market capacity and supply risk issues cause price fluctuations.	Moderate	ADB and PLN will develop a procurement monitoring and spending profile, to identify any lack of competition or above-normal contract prices due to market failure.
Procurement may be delayed.	Low	Roll out the existing procurement monitoring framework, which has been developed and made operational under the predecessor RBL program for the Electricity Grid Strengthening—Sumatra Program (Loan 3339-INO and Loan 8297-INO), to be applicable in this program.

Risk Description	Risk Assessment	Mitigation Measures
Large investments in the sector stretch existing institutional capacity to undertake innovation particularly at the regional level.	Low	PLN will strengthen the mandate of its regional directorates to undertake pilot projects and develop staff capacity through its training programs.
PLN struggles with initiatives to strengthen internal controls.	Substantial	The procurement monitoring system will be used to detect red flags and suspicious patterns in contract awards. PLN will submit quarterly reports to its board of directors, its value for money committee, and to ADB on the indicators in the procurement monitoring framework; and will provide the updated spending profile. In addition, procurement audits will be carried out covering 10% of the contracts under the program. Any issues identified will be discussed with PLN's management team, and relevant government authorities as appropriate.

ADB = Asian Development Bank, PLN = State Electricity Corporation (*Perusahaan Listrik Negara*), RBL = results-based lending, *wilayah* = regional office.

^a 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.

D. Anticorruption System

27. Since the program is part of PLN's overarching generation expansion program, it will be implemented in accordance with the legal framework and through institutions designed to protect PLN from corruption risks, while aiming to become a continuously growing and competitive SOE. PLN has developed a structure and system of GCG by adhering to its principles in accordance with relevant rules and regulations, as well as best practice. In 2011, the minister of SOEs amended the 2002 decree to include the "Implementation of Good Corporate Governance in SOEs" regulation, which states that "[each] SOE shall carry out its operations by adhering to GCG principles of transparency, accountability, responsibility, independence, and fairness."

28. PLN has included GCG in its daily operations to achieve its goal of becoming a company that continues to grow and improve with quality services and working processes, and a strong code of conduct. GCG's 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 the interests of all parties are fulfilled; (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 were granted, in accordance with the Agreement Establishing the Asian Development Bank. 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. The Guidelines to Prevent or Mitigate Fraud, Corruption, and Other Prohibited Activities in Results-Based Lending for Programs were explained to and discussed with PLN.