

SECTOR ASSESSMENT (SUMMARY): PUBLIC SECTOR MANAGEMENT¹

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. Indonesia achieved good economic growth and steady poverty reduction during 2009-2019. However, the end of the commodity boom in 2010 slowed progress on poverty reduction and contributed to a rise in inequality, which poses a challenge for economic development. There is also a wide gap in poverty rates between urban (6.7%) and rural areas (12.3%). From 2014 to 2019, the Gini coefficient fell from 0.41 to 0.38.² On progress toward achieving the Sustainable Development Goals (SDGs), Indonesia ranked 102 out of 162 countries in 2019.³ With an overall SDG's index score of 64.2, Indonesia's performance on SDG achievement is slightly lower than the regional average score of 65.7 in 2019. In general, Indonesia was either making moderate progress or progress was stagnating in economic growth and poverty reduction, primarily because of weaknesses in the country's public financial management (PFM) system as noted by the 2017 Public Expenditure and Financial Accountability (PEFA) Assessment Report.⁴ The lack of accountability in government institutions has a significant influence in many cases of inefficiency, budget inconsistency, and fraud in Indonesia.

2. The 2017 PEFA assessment report further noted this “underscores the importance of the overall public financial management (PFM) reform agenda to ensure that the delivery of public services continues to function effectively.”⁵ The PEFA assessment report concluded that Indonesia has a strong legal and regulatory framework for PFM, but the effectiveness of PFM systems and the monitoring of performance can be improved. The average PEFA performance score was slightly below B, above the basic level of performance broadly consistent with international good practices. The weakest areas (scores of D or D+) were in revenue outturn, public investment management, and legislative scrutiny of audit reports. Under the public finance spending and accountability pillar, Indonesia was still weak (a score of C) on the criterion of monitoring of budgeting realization and very weak (a score of D) on the criteria of asset management and external audit.

3. Furthermore, the assessment report found that while the internal control function is adequately defined in the legal regulatory framework, its financial management information system (FMIS) is not sufficiently integrated with other PFM systems. In addition, internal audit plans and reports are implemented, but findings are not followed up in a consistent and effective

¹ This summary (i) updates the previous summary conducted as part of Asian Development Bank (ADB). 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the State Accountability Revitalization Project*. Manila; and (ii) summarizes the prior analyses related to public expenditure and fiscal management for ADB. 2018. *Report and Recommendation of the President to the Board of Directors: Proposed Program Cluster and Loan for Subprogram 2 to the Republic of Indonesia for the Fiscal and Public Expenditure Management Program*. Manila.

² Asian Development Bank (ADB). (2019). *Asian Development Outlook Update 2019*. Manila.

³ Sustainable Development Report. 2019. <https://dashboards.sdgindex.org/#/>

⁴ World Bank. 2018. *Indonesia Public Expenditure and Financial Accountability (PEFA) Assessment Report 2017*. Washington, DC. PEFA is a methodology for assessing PFM performance. It identifies 94 characteristics (dimensions) across 31 key components (indicators) of PFM in seven broad areas of activity (pillars). PEFA is a program managed by eight international development partners, including the International Monetary Fund and the World Bank. The 2017 PEFA assessment for Indonesia covered three completed years (2014, 2015, and 2016) with a cutoff date of August 2017.

⁵ World Bank. 2018. *Indonesia Public Expenditure and Financial Accountability (PEFA) Assessment Report 2017*. Washington, DC. p. 1.

manner. The report highlighted areas for improvement, including conforming with standards outlined in the Institute of Internal Auditors' international professional practices framework. It also stressed a need to (i) address strategic issues relating to governance, risk management, and control processes in cross-sector and government-wide programs; and (ii) build auditors' capabilities and certification efforts in the areas of risk awareness and governance, as well as in information systems. The additional financing responds to these recommendations and, in doing so, supports institutional strengthening and contributes to improved sustainability of PFM in Indonesia.

4. Transparency International's Corruption Perceptions Index (CPI) 2018 showed a significant increase in Indonesia's ranking (89th out of 180 countries assessed) compared to other high-population countries such as Argentina, Brazil, Nigeria, and the People's Republic of China, Thailand, and Viet Nam. Despite the increase, Indonesia's CPI was still well below the average CPI.⁶

5. **Internal audit function needs to be strengthened.** Internal audits are currently not making the contribution they should to improving PFM in Indonesia. According to the 2017 PEFA assessment, internal audit is a weak area with a score of C+, because of ratings of C for the dimensions of nature of audits and standards applied, and the extent of response to internal audit findings. The other two dimensions (coverage, and implementation and reporting) were considered strong, both with scores of A. Although not a focus of the State Accountability Revitalization Project, external audit is also a weak area (also scoring C+) while one of the weakest areas of all is a lack of scrutiny of audit reports by the legislature (para. 3). A prior PEFA assessment was carried out in 2011, but a direct comparison of indicators and scores is not possible as the framework and methodology changed twice in the intervening period. However, the 2017 PEFA assessment report concluded that the "needle has moved in the right direction."⁷ On the internal audit function, the report identified that capacity building on risk and performance management is still needed to increase the effectiveness of internal audit, while follow-up on audit recommendations needs to be improved. Although the government requires all government institutions, including local governments, to implement the Government Internal Control System through Government Regulation No. 60/2008, capacity in the public audit institutions (especially at the local level), coordination among these institutions, and a uniform auditing and planning framework were identified as the primary causes of weaknesses in the internal audit function.

6. Weakness in the internal audit function has caused weak accountability in government institutions, and such weakness is believed to have a high degree of influence in many cases of inefficiencies, budget inconsistencies, and fraud and corruption. As one part of the supervision system, strengthening the internal audit function within the government is seen as a necessary requirement for better PFM.

7. **Budget realization needs to be improved.** The planning and implementation of budget preparation are timely and participatory, and are carried out in accordance with clearly defined, applicable regulations. However, budget realization is hampered by budget reliability (forecasts are not accurate, necessitating numerous requests for revisions to the budget, which take up an inordinate amount of time that could better used elsewhere); implementation of a medium-term expenditure framework that is inconsistent with the annual budgeting process; and the absence of performance information consolidated from each sector in the overall budget. Repeated

⁶ Transparency International. [Corruption Perceptions Index 2018](#).

⁷ World Bank. 2018. *Indonesia Public Expenditure and Financial Accountability (PEFA) Assessment Report 2017*. Washington, DC. p. 151.

deviations between the original planned budget and actual utilization reflect the lack of political consensus on projected income and expenditure. The process of formulating a routine budget is undermined by a systematic revised budget in the current budget year, which impacts on the alignment between strategic planning and the ability to estimate funding, which ultimately affects the quality of spending. Based on 2017 Ministry of Finance data, working units in all government institutions (at the central and local levels) were not able to plan the budget properly. In 2017 alone, there were 52,400 budget indicative revisions submitted by 26,000 working units throughout Indonesia. This may have been primarily because of inadequate detailed information to support the budget requests, which caused delays in budget execution, and affected overall government budget performance.

8. Financial management information systems lack interoperability. While government internal auditor and finance officer skills need improving to enhance the quality of PFM, FMISs also need improving to enhance processing efficiency, and the accuracy and timeliness of report submission. A particular problem is the use of multiple systems by local governments and their inability to “talk to each other” in many cases. There are currently more than 30 different FMISs being used by 542 local governments to manage budget planning, execution, accounting, reporting, and other functions. As of 2018, according to mapping done by the Central Government Internal Auditor, out of these more than 30 FMISs, the following three main FMIS solutions were developed and maintained: the regional financial management information system (FMIS) developed by the Central Government Internal Auditor (BPKP), the regional FMIS developed by the Ministry of Home Affairs, and the regional FMIS developed by the Agency for the Research and Application of Technology (BPPT). However, these FMISs (and other lesser-used ones) are not compatible with online data transfer. Therefore, district-level, province-level, and national-level consolidation and monitoring of both financial and nonfinancial data rely on the manual transfer of data with all the attendant risks such manual transfers may entail. Furthermore, problems may arise as each local government is free to define its own coding structure and, as a result, data structure and data definitions may vary.⁸ For consolidation at the national level of local government financial reports and fiscal policy analysis, the Ministry of Finance’s Directorate General of Fiscal Balance developed a Regional Financial Information System (SIKD); however, this is only a repository for collecting data from all 542 local government FMIS platforms using web services or application program interfaces, so the data still requires manual transfer. Also, systems need to operate on the basis of a standard chart of accounts, data structure, and coding; and use the same business process to allow seamless transmission of data. Moving to a cloud-based system with a standard chart of accounts will also help achieve data integration.

2. Government’s Sector Strategy

9. The government’s National Medium-Term Development Plan (RPJMN), 2015–2019 focuses on improving PFM; improving public service delivery; and expanding spending on education, infrastructure, health, and social protection, which are recognized as key to achieving the ambitious growth and poverty reduction objectives. The RPJMN, 2015–2019 also seeks to promote good governance, transparency, and accountability of government institutions through, among other things, strengthening the government’s internal supervision institutions.⁹ Strengthened capacity of internal auditors and finance officers is a key priority, with a target of 100% of the Supreme Audit Board’s audit opinions being “unqualified” and full implementation of the Government Internal Control System across all levels of government by 2019.

⁸ A 2016 Ministry of Home Affairs regulation provides a coding system standard; however, this standard is outdated and is not followed.

⁹ Government of Indonesia, National Development Planning Agency. 2014. *RPJMN, 2015–2019*. Jakarta.

10. As the RPJMN, 2020–2024 completes the National Long-Term Development Plan, 2005–2024, there will be increased pressure to meet remaining targets.¹⁰ The goal is that, by 2024, Indonesia has the infrastructure and other development indicators of an upper-middle-income country. The RPJMN, 2020–2024 will focus on infrastructure and human capital quality development including strengthening public service. The RPJMN, 2020–2024 further emphasizes good governance as one of the mainstream policies or drivers of change, which requires accountability, reliable and effective supervision, and integrity of the government institutions and officials. The government’s strategies to improve accountability are (i) improvement of the quality of state apparatus; (ii) improvement of good governance of government institutions through the introduction of an e-government system through the promulgation of Presidential Regulation No. 95/2018 on e-government; (iii) improvement of the performance accountability of government institutions through the implementation of a risk-based approach to performance management; (iv) improvement of public service quality; (v) updating of information on the public service information system; and (vi) integration of public services of the central and local governments.

11. The government is undertaking several reforms related to strengthening PFM at the local government level. Key elements of the reforms include: (i) revision of relevant regulations; (ii) standardization of budget classification and chart of accounts; and (iii) integration of different FMISs.

3. Asian Development Bank Sector Experience and Assistance Program

12. Since 2002, the Asian Development Bank (ADB) has been supporting the government in public sector management improvement, covering legal and regulatory reform, institutional strengthening, and the building of government staff’s PFM capacity through the Local Government Finance and Governance Reform Sector Development Program,¹¹ the Sustainable Capacity Building for Decentralization Project,¹² the State Audit Reform Sector Development Program,¹³ the State Accountability Revitalization Project,¹⁴ Strengthening National Public Procurement Processes,¹⁵ and the Fiscal and Public Expenditure Management Program.¹⁶ ADB support has contributed to overall improvement of PFM through regulatory reform, strengthening of the audit function, and support to fiscal reform under a decentralized government.

13. Under the country partnership strategy for Indonesia, 2016–2019, ADB supports the government’s efforts to foster good governance by improving financial accountability, with a focus on local governments. The forthcoming country partnership strategy, 2020–2024 is expected to

¹⁰ Government of Indonesia, National Development Planning Agency. Forthcoming. *National Medium-Term Development Plan, 2020–2024*. Jakarta.

¹¹ ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Loans and Technical Assistance Grant to the Republic of Indonesia for the Local Government Finance and Governance Sector Development Program*. Manila.

¹² ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to the Republic of Indonesia for the Sustainable Capacity Building for Decentralization Project*. Manila.

¹³ 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Republic of Indonesia for the State Audit Reform Sector Development Program*. Manila.

¹⁴ 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the State Accountability Revitalization Project*. Manila.

¹⁵ ADB. 2010. *Technical Assistance to the Republic of Indonesia for Strengthening National Public Procurement Processes*. Manila.

¹⁶ ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1 to the Republic of Indonesia for the Fiscal and Public Expenditure Management Program*. Manila.

retain the relevant governance-related issue. The overall project will contribute to the achievement of SDG 16 (peace, justice, and strong institutions); is line with ADB's Strategy 2030 operational plan for priority 6 (strengthening governance and institutional capacity); and supports the implementation of the Second Governance and Anticorruption Action Plan (improving governance, and institutional and corruption risks).¹⁷ Toward the goal of improving financial accountability, ADB will continue to assist the government in building capacity, especially at the local government level, in audit functions to strengthen PFM, reduce corruption, enhance sector governance, and improve the timeliness and impact of ADB assistance. The specific objectives of ADB support are to assist the government to achieve (i) stronger audit institutions with clearly defined mandates, (ii) improved audit practices, (iii) increased transparency in audit results, (iv) reduced corruption risks in core ADB-supported line ministries, and (v) improved ADB portfolio management.

¹⁷ ADB. 2006. *Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.



