Additional Annex 11: Anti-Corruption Strategy
INDONESIA: Third Kecamatan Development Project

Projects in Indonesia operate in a high-risk environment when it comes to issues of leakage and corruption. Project preparation for KDP3 updated the 2002 financial management assessment and disbursement action program for KDP-2, which provides the compliance framework for fiduciary management. Nevertheless, highly dispersed community projects such as KDP operate in somewhat different institutional environments than standard projects do which must be addressed by their anti-corruption strategies. A well-implemented strategy that makes greater use of social controls and transparency can ensure levels of confidence demonstrably higher than traditional project designs that operate in these very same villages.

This annex summarizes the general anti-corruption strategy for KDP-3. It draws heavily on the general OSU Indonesia anti-corruption framework and the recently issued World Bank guide for fiduciary management in CDD projects, but it also builds on field experiences over the past three years of KDP implementation.

Identifying Corruption in Indonesian Community Projects – Traditional community development projects have a relatively limited number of well-known points of leakage. A non-exhaustive list would include:

a. Transfers – Financial transfers to communities usually come earmarked or in kind. The Local Level Institutions (ESW) study found that less than 50% of the nominal Rps. 20 million cash grant per village got there at all, and less than 15% of that amount actually came as a cash grant. IDT (Inpres desa tertinggal), a $200 million nationwide poverty program, also suffered badly from delivery of goods in kind (usually of an inferior kind).

b. Poor contractor management – Contractor management for communities is normally handled by district technical offices, not by villages. Contract awards are often “directed” to favored companies, regardless of qualifications or experience. Anecdotal interviews by WB staff have found endemic problems of substitution of inferior materials, unfinished works, and off the top payments for contract awards. There are no sanctions for inferior work.

c. Poor pricing practices – Because contractor markets are not competitive, both over billing and overdesign are endemic.

d. False taxes and charges – Government charging for “services” is so common that officials will even issue receipts for blatantly illegal practices, such as a standard 5% charge on all funds going through a village head. Virtually every financial transaction in a development project has a charge on it to get the proper form signed and the funds released.

e. Standard financial control systems often work against rather than in favor of sound financial management – villagers everywhere report recurrent charges being levied by auditors and inspectors to not find fault with financial reporting, often on formats that either have never been given to villagers or else contradict the ones already in use.

The corruption problems with technical assistance for community projects are also well known and, while they are not very different from Indonesian development projects in general, stand out in the case of community programs because communities often have few alternative suppliers and nobody from whom they can seek redress:

i. Improper billing practices by consultant firms – in KDP-1, students from one company called the WB to complain about how they and all other candidates (more than 100) were given
instructions on how to falsify their c.v’s to meet the project’s TOR. Another (fired) company claimed that it was forced to swallow a merger with the second-ranked company, including a Rp. 300 million cash payment and the absorption of 20 entirely unqualified staff.

ii. Cuts in salaries and travel allowances – often QCBS “winners” can beat the competition because apparently competitive overhead costs are “subsidized” by later cuts from staff salaries and travel allowances.

iii. Price fixing between TA staff and local government (including village heads) is also common, aided by a general lack of public information about prices.

KDP’s anti-corruption strategy has three main themes: (i) eliminate complexity; (ii) shine bright lights on every financial transaction; (iii) respond quickly to complaints. The guiding principle underlying the anti-corruption program is that KDP procedures must encourage oversight and action by multiple stakeholders, not just the World Bank or the government.

**Eliminate complexity** – In many traditional community-oriented projects, money disappears due to the welter of transfer levels, intermediaries, and processing requirements involved in turning World Bank project funds into bridges, roads, and water supply system in distant villages. KDP simplifies every aspect of this system. Because money goes straight from the national level to the village accounts, there are almost none of the delays or leakages normal to designs that step funds down through inter-governmental transfers. The project’s handover of budgets to the villagers also supports simplified management: when agencies start listing the many forms and procedural requirements needed to get started, the villagers almost always take their business elsewhere.

KDP has also simplified all of the steps involved in financial management and disbursement so that many kinds of stakeholders can easily understand and use them. There are no “hidden” charges allowed other than those listed on the forms, and MoF ratification included notes to auditors that no other financial reporting or license documents were to be used other than those negotiated with the project. All of the basic formats attached to the appraisal report are the same as those used in the field.

**Shine a bright light** – Transparency lies at the core of KDP’s anti-corruption work, and it takes place in three main arenas. First, there are a broad range of materials and procedures to ensure that all financial information is both public and publicly displayed within the villages. For example, local shopping price quotations for materials must be read out loud in public meetings to be valid; signboards posted around the villages state material and labor unit costs; and all bookkeeping is managed by an elected “implementation committee.” Unlike standard practice, there isn’t a single format in KDP that would allow a lone official to withdraw or transfer funds: all require at least three signatures, including gone from an elected villager and a second from the project facilitator.

Second, as noted in the PCD text, KDP involves a broad range of entirely independent groups whose job is to inspect KDP sites for signs of irregularity. These groups have full access to KDP documents. The provincial NGOs also have monthly meetings with the consultant and government management teams to list the problems they encounter and review proposed corrective actions.

Third, the government management group has also taken many steps to ensure national level transparency. KDP is the first World Bank project in Indonesia to send its audit summaries to civil society oversight groups. Contract provisions and follow-up letters for the NGO monitors provide them with full discretion to share all findings, and the independent journalist contracts specify that there is no prior review. For Year 3 of KDP, PMD is publishing an expanded version of the problems database summarized below in commonly read provincial newspapers so that independent organizations can check
for themselves whether problems have been reported and fixed.

**Respond to complaints** – The last major element in the strategy is to follow-up on reported cases of corruption – and to be seen to be following up on corruption by the villagers and other stakeholders. KDP has several channels for villagers to complain, including a well-used national “complaints box” whose address is printed on all village graphical materials. However, by far the most common source for complaints are those relayed by or through the technical consultants. 77% of all complaints received by the oversight team came from the field consultants themselves; an additional 7% were reported by Home Affairs and 2% were sent through the mass media.

Table 1 summarizes the reporting and follow-up from KDP’s first three years. This is a national level database, updated weekly, which is routinely shared with civil society watchdog groups, including the press. At the provincial level, reports by field staff, villagers, and the monitors are logged in, reported to local government and the national team, and then pursued every two weeks until resolved. In several districts and provinces, increasingly active project coordination teams also pursue corruption problems. In some extreme cases they have removed abusive village heads and camats (e.g. North Sumatra, South Kalimantan) and succeeded in getting missing funds restored. More common than restoring funds is fixing bad quality infrastructure, and project files document several cases where corrective action plans were proposed and implemented. Approximately 5% of the TA staff have also been replaced because of corruption or letting corruption happen without reporting it. (By way of providing some perspective, the database refers to a total of 55,000 village subprojects.)

<table>
<thead>
<tr>
<th>Type of Complaints</th>
<th>Total received</th>
<th>Requiring clarification</th>
<th>Solved</th>
<th>Further investigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>KDP processes and procedures</td>
<td>987</td>
<td>5</td>
<td>451</td>
<td>488</td>
</tr>
<tr>
<td>KDP funds</td>
<td>724</td>
<td>37</td>
<td>267</td>
<td>420</td>
</tr>
<tr>
<td>Inappropriate intervention by government and consultants</td>
<td>75</td>
<td>24</td>
<td>47</td>
<td>41</td>
</tr>
<tr>
<td>Totals</td>
<td>1,909</td>
<td>91</td>
<td>838</td>
<td>980</td>
</tr>
</tbody>
</table>

*defined as restored original program (i.e. money returned, works finished, etc.)*

KDP-1 also enforced a vigorous financial management improvement campaign for the national level contracts. This included:

- letters from PMD and the companies to all field staff informing them of their salaries and entitlements;
- spot on-site inventory reviews of equipment and paycheck stubs;
- retroactive payment corrections as conditions for contract extensions (esp. for travel);
- semi-annual meetings with all companies to review their performance;
- spot ex post reviews of staff qualifications.
- replacement of recurrent offending companies.

**KDP design and corruption** – KDP’s anti corruption action program consists of three major sets of actions. First, the project design uses a variety of procedures to minimize leakage during national level procurement, contract management, and financial transfers, as discussed in the relevant parts of this PAD. Second, prior to appraising KDP-2 in 2000, the project carried out an anti-corruption diagnostic that supplemented project specific fiduciary requirements with an incentive map of opportunities for corruption within the village planning process (Table 2). The village-level action plan used that map to
identify opportunities for minimizing corruption risks, although it should be noted that this is an ongoing process.

<table>
<thead>
<tr>
<th>STAGE</th>
<th>OPPORTUNITIES FOR CORRUPTION</th>
</tr>
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</table>
| (1) Dissemination of information & selection of consultants | Low  
  - But risk of nepotism in choosing consultants 
  & elite capture for later kickbacks |
| (2) Socialization: villagers learn how the project works and what their rights are | Low  
  - But risk of elite capture |
| (3) Villages prepare proposals | High  
  - Kickbacks with selection of TA; collusion; budget-mark-ups; false groups formed to get micro-credit |
| (4) Technical teams look at the proposals to see if they are feasible | Low  
  - But incentive to try to influence results of assessment in village's favor |
| (5) Villages choose proposals that will be funded | Low  
  - But incentive to simply split funds among villages: leads to bad projects |
| (6) Preparations for implementation: funds are released | High  
  - Main threat is collusion among three signatories of bank withdrawal to take a cut of funds before transferring to village |
| (7) Implementation:  
  - Materials are bought  
  - Village labor is mobilized  
  - Roads & bridges are built | Extremely high  
  - Most common source of corruption in KDP (apart from operational funds & consultants' payments) is with procurement of materials. Implementation teams buy cheaper materials than those specified and pocket the difference. |
| (8) Post-implementation:  
  - Loans repaid; revolving funds set up  
  - Maintenance of infrastructure | Medium  
  - Loan repayments managed badly; risk of corruption with user fees for maintenance. |

KDP's design allows for graduated sanctions because funds cannot be released to the field unless the facilitators are present to sign off on transfers. Removing the facilitators from the field location is relatively easy to carry out and has become a sanction preferred by MoHa as a response to supervision findings. Conversely, once restitution has been made, the facilitator can be returned to the field and the project continue.

Although initially reluctant to use this sanction, the Ministry of Home Affairs has become increasingly confident that it produces rapid results. In a number of cases, MoHa will temporarily suspend an entire kecamatan until corruption problems reported by individual villages have been rectified. This is an effective remedy because it introduces peer pressure rather than making corruption entirely a matter of enforcement by the center.

Overall performance – There are three major sources of evidence which suggest that there is less corruption in KDP than most other community projects. First, KDP produces an average of 20-25% more output for the same input (ongoing studies will provide a more quantified report of this early finding). Technical reviews also conclude that output quality is the same or better. Second, interviews with field staff and companies by Bank missions and reporters suggest a strong downwards trend in
diversions. A growing number of newspaper reports and village self-reporting point to spillover effects: villagers reject demands for kickbacks and in several cases have run people asking for bribes out of town. Finally, independent reviews by professionally qualified auditors (i.e. SGS) also report generally low corruption levels in KDP subprojects.

So much for the good news. The bad news is that (i) there is still corruption in KDP; (ii) not all remedies work; and (iii) there has been little progress in improving the overarching fiduciary environment within which the project must work. Local level collusion, often with district and village governments, remains the single biggest source of problems. Of special difficulty has been the endemic tendency to avoid sharing information, or limiting its access only to officials and elites. Another recurrent problem has been the harassment and the physical intimidation of staff who report corruption. Fear of reprisals inhibits facilitator’s willingness to report corruption, although reports from the facilitators still remain the best source of information about diversions and leakage. Overall, the reporting of problems and their disposition needs to be improved and better protection provided for the whistleblowers who are threatened.

Sanctions and remedies -- Three of the project’s consulting firms (of 19) were not extended in the project’s second year because of concerns over delays or cuts in payments to field staff. Not surprisingly, the poorest and most isolated provinces have suffered most from corruption. A very informal group discussion with government counterparts suggested that aggregate corruption in KDP accounts to 10% (project audits estimated that only 5% of funds could not be accounted for) but all such numbers must be treated as working assumptions, at best.

By and large official complaint channels have proved to be of little use and complaints to authorities have not provided an effective corruption sanction. Nevertheless, there has been progress over time. In KDP-I’s final year, at least 15 legal cases were successfully brought against village and subdistrict officials by communities working with NGOs and justice officers. When pursuit of official corruption happens, sanctions are nearly always the outcome of villager and consultant appeals to higher-level officials, like bupatis, or the outcome of WB supervision follow-up, and are not due to a functioning, accessible system of legal redress.

Central government response to the corruption problem has been relatively encouraging. The project management secretariat has expanded the program of legal assistance to KDP villages. They have also initiated monthly meetings with the independent journalists and with the NGO monitors to review progress on their findings. A particularly relevant indicator of growing government interest in the anti-corruption work has been the suspension of two provinces because of failure to act on corruption reports. In one case the suspension was lifted when the offending parties were removed and the funds returned, while in the other the main district where the problems were happening was dropped from the project entirely.

KDP-3’s anti-corruption strategy

KDP-3 extends the basic principles of the strategy outlined above, but it also adds some additional elements. The most important new decision facing KDP-3’s anti-corruption strategy will be how to deal with decentralization. Decentralization in principle offers new opportunities to promote government accountability. In practice, at least during the transition to a decentralized administration, the opportunities for rent-seeking are more likely to rise than to fall. Nevertheless, just as center-district relationships are being entirely re-worked, executive-legislative relationships are also a site of struggle. KDP’s anti-corruption strategy will chart a course through this broken landscape in the following ways:
a. Technical assistance procurement will remain centralized (a pilot program under VIP-2 to
decentralize contracting to the provinces failed), although all field staff will be from their
province;
b. Increasingly deep involvement of DPRDs, including routine provision of audit reports and
the joint implementation monitoring teams;
c. Carrying out spot audits from the center by the national management consultant company;
d. Using prior year performance as the basis for increasing each district’s KDP-2 allocations;
e. Preparation of an on-site auditing manual that will be issued by MoF and distributed to all
KDP participants with a MoF cover letter saying that no other auditing formats are allowed;
f. No projects will be allowed to enter a new project year until problems in the master MIS
complaints database have been satisfactorily resolved;
g. Distribution and public posting in each district of a unit cost price table based on real
expenditures;
h. More sharing of information with civil society watchdog groups.

In the past, government commitment to pursuing corruption problems was at times lackadaisical
in part because of the conflict of interest created by the unified civil service. That is, the district level
civil servants involved in unauthorized diversions were often outposted members of the same central
agencies. Sanctions by past or future colleagues were minimal, and usually taken only in response to
strong Bank (and a times, community) pressure.

Decentralization changes this configuration somewhat. All of KDP’s local implementing
agencies are now part of local government, not Jakarta line agencies and ministries. At least in theory,
the built-in conflict between regulation and implementation is eliminated. Part of KDP3’s anti-corruption
strategy, therefore, consists of encouraging the Jakarta group to exert their regulatory role more
forcefully. Evidence that there is some willingness to move this way is already appearing within the
current KDP:

- Strong PMD support for the idea of legal advocacy by using university-based lawyers to help
  bring legal cases against corruption in KDP;
- Suspending entire provinces and kabupaten in South Sulawesi and North Sumatra because of
  local corruption.
- Strong involvement in DPRD alliance-building;
- Good, critical audits by BPKP.

The World Bank and Corruption in KDP -- The Bank’s program for KDP oversight involves a number
of managerial innovations. OSU involvement in capacity assessment and prior reviews is extended much
further. OSU staff routinely join field supervision, and they also organize hands-on short courses for task
teams and senior counterpart staff. Hands-on involvement in KDP’s anti-corruption work provides a close
link between the general institutional reform strategy for fighting corruption being coordinated through
OSU, and day-to-day practical actions in a large Bank-funded operation.

In addition to KDP’s collaboration with the WB OSU group, three additional activities promote
anti-corruption work in the project. First, because KDP is managed through the resident mission, it is
feasible to adopt a supervision strategy that involves constant rather than periodic oversight. Supervision
missions visit field sites every month.

Second, the Bank plays a very active role in pursuing corruption cases. Project supervision is not
done randomly: the project's MIS is used to select cases where corruption or other anomalies have been reported. The government and Bank pursue verified cases until restitution has been made or the subproject suspended.

Third, the Bank's ESW program on governance and anti-corruption includes several KDP-based activities, such as the work on mapping corruption in CDD projects, a AAA activity on how poor communities can access the legal system, or a recently started program to conduct research on the effectiveness of incentive and sanction regimes in community programs. While results from such programs benefit the Bank's overall governance reform strategy, they also provide immediate benefits to KDP implementation.

Bank oversight for KDP-3 work can be strengthened in a number of ways. First, project appraisal and first year supervision will pay special attention to the quality of the mechanisms for receiving and responding to complaints from the field. The Bank team will provide monthly reviews of this system for the first six months of operation. Second, the Bank's new disclosure policy allows for a more in-depth involvement by civil society organizations, particularly those concerned with transparency and governance reform in Indonesia. Third, the pilot program to outsource auditing to private firms will be extended to KDP-3. Last, during appraisal, the Bank and government will agree on an appropriate regime of sanctions for cases where corruption is discovered.