Annex 16: Anti-Corruption Strategy

Indonesia: National Program for Community Empowerment (PNPM-KDP)

Projects in Indonesia operate in a high-risk overall environment when it comes to issues of leakage and corruption. GOI’s National Steering Committee has repeatedly placed anti-corruption at the top of its priorities for the national program, and PNPM’s anti-corruption action plan will enter the government’s own project readiness filter. This annex summarizes the general anti-corruption strategy for PNPM-KDP. 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 eight years of KDP implementation.

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

- **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 provided by district governments got there at all and less than 15% of that amount actually came as a cash grant. Field reports continue to report that significant percentages of village transfers disappear en route or get provided in kind.

- **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. Few sanctions are available for remediying inferior work.

- **Poor pricing practices.** Because contractor markets are not competitive, both over billing and over design are endemic.

- **False taxes and charges.** Government charging for “services” is still common. Officials will even issue receipts for illegal practices, such as a standard 5% charge on all funds going through a Village Head. (Semi-legal practices by local governments such as “special” tariffs and mandatory purchasing agreements also recur).

- **Poor quality or dishonest technical support** -- 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, they stand out in the case of community programs because communities often have few alternative suppliers and nobody from whom they can seek redress:

- **Improper billing practices by consultant firms.** Often QCBS “winners” can beat the competition because apparently competitive overhead costs are “subsidized” by later cuts from staff salaries and travel allowances.

- **Price fixing between TA staff and local government** (including village heads) is also common, aided by a general lack of public information about prices.
**Overview: Patterns and trends in KDP corruption.** KDP’s master database records information received from all sources (complaints, audits, NGOs, journalists, and WB supervision). Table 1 summarizes the corruption status of KDP in 2006. In 2006, KDP disbursed $168.9 million, so the $0.65 million of missing funds amounts to a recorded corruption rate of 0.38%.

<table>
<thead>
<tr>
<th>Year Reported</th>
<th>Classification</th>
<th>Total cases</th>
<th>Misuse of funds</th>
<th>Funds returned</th>
<th>Outstanding</th>
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</thead>
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<tr>
<td>Residual from 2005</td>
<td>&gt;4,500</td>
<td>86</td>
<td>1,100,000</td>
<td>250,000</td>
<td>850,000</td>
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<td>520,000</td>
<td>190,000</td>
<td>330,000</td>
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<tr>
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<td>649,400</td>
<td>180,000</td>
<td>469,400</td>
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<tr>
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<td>280,000</td>
<td>101,000</td>
<td>179,000</td>
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<tr>
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<td></td>
<td>976</td>
<td>2,549,400</td>
<td>721,000</td>
<td>1,828,400</td>
</tr>
</tbody>
</table>

Source: Ministry of Home Affairs, 2007. All figures were converted into US dollars and rounded.

Certain trends and patterns can be seen in KDP’s data. First, the overall tendency is for the number of cases to go down over time but for the amounts being stolen to increase. This is due to the increasing sophistication of fraud. In each of the three largest cases, Bank Rakyat Indonesia (BRI) officials colluded to forge release documents (the aim was to borrow funds to invest in high-profit lending but these cases were caught because communities complained that their funds were delayed). Second, as discussed below, whereas in earlier years more of the cases involved government officials, in recent years officials account for only some 15% of the total cases. By contrast, consultants and members of the subdistrict financial management units, who have the most direct access to funds now, account for some 30%. Finally, on the positive side, the amount of money being recovered continues to rise; many of the 2006 cases are still in the courts or under community adjudication.

PNPM-KDP’s anti-corruption strategy has four main themes: (i) Reduce opportunity through tailored designs; (ii) Strengthen formal systems; (iii) Strengthen social controls; and (iv) Improve redress. 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.

KDP’s overall anti-corruption strategy has been reviewed several times in other appraisal documents. This PAD will briefly describe the main features of the plan, but it will primarily emphasize lessons learned and the improvements being proposed under PNPM.

**Improving designs.** 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 simplified every aspect of this system by:

- **Reducing discretion** – Community proposals can be accepted or rejected but not modified;
- **Reducing transactions** – Through direct transfers to community bank accounts;
- **Promoting competition** – There are always more proposals than there are funds;
- **Lowering costs of acquiring information** – KDP promotes public disclosure of all key fiduciary information through signboards, public meetings, and even, in Aceh and Nias, 

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1 Measuring corruption is very imprecise. The figures reported here should be treated as indicative only. Furthermore, they do not count or estimate unreported losses, particularly for cases of under delivery of materials which is where most KDP corruption happens.
information facilitators. The WB OSU team has played a key role in simplifying fiduciary formats so that they are useful for villagers;

- **Promoting social controls** – KDP has structured participation whose purpose is to monitor contract deliverables, witness all financial transactions, and sign-off on activities. 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 one from an elected villager and a second from the project facilitator.

- **Engaging independent monitors** – KDP pioneered the use of NGO monitors and independent journalists in Indonesian development projects.

KDP’s primary sanction for offenders is to stop disbursements to an offending subdistrict or to the level above it. Its design allows for effective, simple 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 the Ministry of Home Affairs as a response to supervision findings. Conversely, once restitution has been made, the facilitator can be returned to the field and the project continues. Furthermore, because of the project’s modular design, suspending one village or subdistrict does not affect progress in other locations.

KDP introduced a system of graduated sanctions. Sanctions are applied to the level above the level where the infraction was committed, particularly when local government officials were involved. Thus, village infractions would result in the suspension of the subdistrict until restitution was made; in two cases, subdistrict-wide infractions were sanctioned by suspending the district, one of which was let back in and the other permanently dropped from the project. In one cases, province-wide infractions in consultant selection and management resulted in the temporary suspension of the province.

Although initially reluctant to use this sanction, the Ministry of Home Affairs has become increasingly confident that it produces results. It is an effective remedy because it introduces a measure of peer pressure rather than making corruption entirely a matter of enforcement by the center. In at least five districts, local governments used their own budgets to complete works left incomplete by corrupt practices.

**Issues for PNPM.** While the core design for PNPM is not significantly different from that of KDP, the project’s risk mapping requires updating. Risks faced by KDP such as government intervention in village decision-making have diminished, whereas risks posed by more complex transfers (i.e. local government contributions) have increased. The overall risk assessment will be updated during appraisal. However, on a provisional basis the main new corruption risks that PNPM will face are caused by:

- The much larger coverage;
- Increases in block grant amount that change the risk/incentive ratio;
- Increased contributions from local governments, with their own weak budgeting and control systems;
- Pilot programs to reduce TA ratios by increasing local government oversight.

PNPM also faces a challenge to streamline the project’s operating manual, which over the years has become more complex and less accessible to villagers. Ongoing technical assistance to the Indonesian audit board (BPKP) that is managed by the Bank’s OSU unit is preparing proposals for review at appraisal.
**Strengthening Formal Systems.** KDP uses two types of formal control mechanisms: internal controls and external audits. Each will be strengthened under PNPM:

- **Internal controls** – The primary means of internal control is through the project’s management and monitoring systems. Backing this system up is complaints handling unit, which is part of the overall monitoring program that is described in Annex 2. The unit maintains a master database for recording all corruption allegations against KDP and for tracking their disposition. Until 2007, KDP also maintained a central financial management unit; however, under the additional financing loan the central unit was disbanded in favor of adding one complaints specialist and one financial management specialist to each provincial team.

- **Audits** – KDP traditionally has been monitored by the Indonesian national project audit board agency (“BPKP”). Parallel audits of KDP by international audit firms showed no discrepancy in their findings, which suggests that BPKP audits met an international standard.

Both systems will be strengthened considerably under PNPM. Diagnostics carried out during project preparation recommended the following improvements:

- **Strengthening internal controls** – Proposals for strengthening internal controls are discussed elsewhere in this report, particularly the importance of updating the MIS system to accommodate the expanded project scope. Other recommendations to be agreed during appraisal include:
  - Switching into a web-based MIS;
  - Monitoring response times to complaints;
  - Improvements to enforcing village procurement procedures;
  - Restoring the central financial management oversight unit so that there is overall oversight and tracking;
  - Revising the fiduciary formats, which have gotten more complicated over time.

- **Strengthening government audit systems** – OSU conducted an in-depth review of KDP audit procedures as part of preparation for PNPM. PNPM’s audit procedures will be more complicated than KDP because of the substantial contribution of funds from local governments, which must be audited by the district government audit board (“bawasda”). PNPM will update the existing KDP audit manual to stress still further the risk-based control framework, particularly the role of public understanding of fiduciary objectives. Recommendations for strengthening GOI audits include:
  - Requiring the national audit agency (“BPK”) to certify a national financial report.
  - Strengthening bawasda training, compliance mechanisms, and quality control;
  - Requiring bawasda to report their findings to the central fiduciary unit;
  - Promoting easy public access to audit reports;
  - Increasing audit samples from approx. 2.5% to 7.5% (20% of total subdistricts);
  - Increasing facilitator budgets for fiduciary training;
  - Increasing audit monitoring by the national program.

- **Using the judicial system** – Projects in Indonesia traditionally rely on project-specific mechanisms for controlling leakage. This differs from many other countries, where engaging the legal system provides a crucial mechanism for adjudicating disputes. However, some
progress can be noted and built upon. In 2006, 176 cases of misuse of KDP funds were sent to law enforcement agencies. While only 11 cases obtained a court decision (most are being prepared for trial), the general trend of court decisions is increasingly favorable to village complaints, and 2006 saw the stiffest fine ever handed out for the abuse of village funds in a case brought by villagers: 15.5 years in prison plus the return of all funds to the community. In-depth research conducted in thirteen KDP corruption cases in 2004 showed that all five that made it to court resulted in prison sentences and fines for the perpetrators. PNPM will introduce closer monitoring the corruption and embezzlement cases by initiating semi-annual meetings at the district and provincial law enforcement agencies to assess progress on case handling.

A linked, Bank-financed project, the Support for Poor and Disadvantaged Areas Project (SPADA) already includes a component to work with the local courts and legal aid NGOs to provide legal aid and basic legal literacy training to communities as part of its anti-corruption program for Aceh. The $1.2 million Mediation and Community Legal Empowerment component will establish 34 community legal aid posts covering 300 villages and 6 districts in Aceh and Maluku. The posts will provide an avenue of complaint for corruption and other legal issues, ad they will link communities and PNPM facilitators to legal assistance to help resolve the more serious cases through the courts. The component will provide training to communities and government officials on how to identify and resolve corruption. A second pilot program provided legal education and assistance through a JSDF program of support to female-headed households. This program, which worked with district government and law enforcement officials, was again extremely successful (all documents are in PNPM project files) and has now been taken up by local governments in West and Central Java. The program focuses specifically on helping poor women to both understand and to enforce their economic rights – property rights, marriage, and identity (i.e. birth and marriage certificates).

PNPM will also expand its work with the legal system through project activities. The Bank’s community development program is complemented by a GOI-UNDP-WB partnership called “Justice for the Poor”, which is preparing a national access to justice strategy. At GOI’s request, the Justice for the Poor program will partner with PNPM, where it will provide capacity assessments of local law enforcement mechanisms and training for local court officers; legal education and legal aid; and training in legal literacy and social mobilization for communities. The following changes will be supported directly through PNPM:

- PNPM planning funds can be used for transportation to testify at court cases or witness proceedings (case reviews show that communities require financial assistance to travel to district offices to give evidence, and that having groups of villagers appear during case hearings is critical for pushing trials through to final adjudication.)
- PNPM training will include materials on villager rights and how to pursue cases through the court system;
- PNPM negotiations will propose that MOF confirm that all embezzled village funds retrieved through criminal prosecution by the State be returned to villagers (at present they return to the budget).

- **Strengthening Social Controls** – KDP used two types of social controls: controls over financial flows by villagers themselves, and controls through civil society. Both have been useful learning experiences.
- **Village-level social controls** – Traditionally social controls are associated with greater access to information and higher levels of participation. However, detailed quantitative and qualitative studies of KDP suggest that a third element is equally important. Communities require an organizational means to act on financial malpractice. PNPM will reinforce existing mechanisms by:
  
  - Streamlining and simplifying reporting formats;
  - Budgeting an enhanced information disclosure package and monitoring its dissemination;
  - Financing villager participatory cross-audits (see below);
  - Improving monitoring of procurement procedures, which require that all supplier bids be opened in public meetings;
  - Extending the mandate of the women’s groups that count materials delivered to communities.
  - Expanding the pilot programs of paralegal training and assistance;

Reviews showed that a recurring problem for villages is not lack of knowledge about corruption but lack of mechanisms for filing complaints and fear of reprisals for doing so. PNPM’s national coordination secretariat has developed a media campaign that includes television and radio programs informing villagers of their rights and how to file complaints. The “Justice for the Poor” program will be tracking whether reprisals and other forms of intimidation affect reporting.

- **Civil Society oversight** – The KDP program as monitored by both provincial NGOs and independent journalists. This system will be changed for PNPM. With Indonesia’s now free press there is no need for special arrangements to involve journalists, and by mutual agreement this arrangement will be discontinued. However, it is expected that journalists will be even more interested in PNPM since it is a national poverty program.

The NGO monitoring program is also being revamped. In 2006, KDP’s excellent NGO monitor in Aceh proposed to pilot their program for community based participatory monitoring in neighboring provinces. Results from the pilot showed that:

  - Community members reported more problems to monitoring groups from other villages than they did to NGOs;
  - Knowing that there would be cross-audits by peers produced improvements in village administration; and
  - Community members felt that their complaints were more likely to be acted upon.

Based on these findings, PNPM will scale up the community based participatory monitoring program to cover all PNPM provinces. NGO TOR will be modified to reflect the change. PNPM’s procurement plan also provides for an apex NGO to provide training and administration to provincial NGOs in the new procedures. Additional training will also be provided to regional government officials and to NGOs on how to handle and resolve corruption cases once complaints have been received. OSU’s pilot discussions with the Muhammadiyah anti-corruption program will be explored further during appraisal.

**Overall performance.** There are three major sources of evidence which suggest that there is less corruption in KDP than most other community projects. First and most importantly, KDP gets more bang for the buck than other village level development programs do. KDP’s infrastructure is found to be on average 55% less expensive than comparable government-executed infrastructure. (These cost savings do
not yet include community voluntary contributions which nationally in KDP average 17% of project costs). Technical reviews also conclude that output quality is the same or, in most cases, better. A 2004 infrastructure independent evaluation found that out of the 108 infrastructure projects reviewed, 94% of the projects were found to be of very good or good technical quality. In short, KDP’s anti-corruption action strategy is delivering high quality services to Indonesia’s government and citizenry at low cost.

The World Bank and Corruption in PNPM. The Bank's program for PNPM oversight involves a number of managerial innovations. OSU involvement in capacity assessment and prior reviews is extended much further. OSU staff routinely joins field supervision, and they also organize hands-on short courses for task teams and senior counterpart staff.

In addition to PNPM's collaboration with the WB OSU group, three additional activities promote anti-corruption work in the project:

- 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 almost every month.

- The Bank plays an active role in helping the government pursue corruption cases. PNPM’s Multidonor trust fund includes a window dedicated to strengthening government agencies’ ability to monitor and oversee PNPM. A strong program of technical assistance on the national access to justice strategy; on strengthening the PNPM audit agencies; and on promoting civil society linkages will be proposed to the MDTF Steering Committee once PNPM is launched.

- The Bank's ESW program on governance and anti-corruption includes several PNPM-based activities, such as longitudinal reviews of what makes for effective corruption reduction; randomized evaluations (in partnership with the national anti-corruption board) on petty corruption in government programs, and work with parliament on Indonesia’s proposed Right to Information act. While results from such programs benefit the Bank's overall governance reform strategy, they also benefit PNPM implementation.

Bank oversight for PNPM 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. Second, OSU technical assistance to the national audit agencies will include the audit agencies monitoring PNPM. Third, the Bank will continue to monitor progress on implementation of the anti-corruption program and the efficacy of the measures developed through it. Last, during appraisal, the Bank and government will agree on an appropriate regime of sanctions for cases where corruption is discovered.