

**Indonesia: Report on the Observance of Standards and Codes—  
Fiscal Transparency Module—Update**

This update to the Report on the Observance of Standards and Codes on the Fiscal Transparency Module for Indonesia was prepared by a staff team from the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on November 15, 2010. The views expressed in this document, as well as in the full assessment report, are those of the staff team and do not necessarily reflect the views of the government of Indonesia or the Executive Board of the IMF.

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INDONESIA

**Report on the Observance of Standards and Codes (ROSC)  
Fiscal Transparency Module—Update**

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November 15, 2010

**I. INTRODUCTION**

1. This document updates the original fiscal ROSC for Indonesia, which was issued in September 2006.<sup>1</sup> That document reported that significant progress had been made in recent years to establish a sound legal and administrative system for central government fiscal management and to improve transparency.<sup>2</sup> However, it was also noted that a substantial reform agenda remains to (1) consolidate central government reforms as well as to (2) extend them to the rest of the general government. The report thus concluded that further work was required to broaden and deepen the level of fiscal transparency and provided a number of specific recommendations for improvement.

2. The IMF staff reviewed key developments in the areas pertaining to Indonesia's observance of the fiscal transparency practices assessed in 2006,<sup>3</sup> with a view to updating, where relevant, changes in current practices or describing the implementation of the earlier ROSC's recommendations. *Unless indicated differently below, the recommendations made in the 2006 ROSC remain relevant.*

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<sup>1</sup> The original Indonesia fiscal ROSC is available as country report number 06/330 at <http://www.imf.org/external/pubs/ft/scr/2006/cr06330.pdf>.

<sup>2</sup> These include the adoption of financial legislation that greatly clarified the budget process, established a budget classification broadly consistent with international standards, and prescribed clear rules governing the management of transactions, assets, and debts at all levels of government.

<sup>3</sup> This update also builds on findings reported in the Selected Issues paper issued in the context of the 2008 Article IV discussion on Progress in Building Fiscal Institutions, available at <http://www.imf.org/external/pubs/cat/longres.cfm?sk=22353.0>.

## II. DESCRIPTION OF PROGRESS

3. **Progress has been made in building a stronger technical base for fiscal policy management at the central government level.** The Fiscal Policy Office<sup>4</sup> (FPO) is now a fully functioning and well established office within the Ministry of Finance (MoF) with a mandate for macro-fiscal projections and analysis. This includes analyzing major fiscal risks that could affect the central government budget: starting in 2008, the FPO prepares a fiscal risk statement<sup>5</sup> that is included in the annual budget documents—making Indonesia one of the pioneers in fiscal risk analysis among emerging market economies. Operational management of debt-related risks is undertaken by the Directorate General (DG) for Debt Management, which is responsible for both domestic and external debt management.

4. **Some progress has been achieved in improving the role of the legislature and parliament’s technical capacity for fiscal policy analysis.** Parliament’s (DPR) budget committee still plays an important role in budget approval processes. In addition, specialized parliamentary commissions with technical support staff (e.g., the economic commission) also play an increasing role in technical budgetary discussions. Progress has been achieved in increasing qualified staff at the DPR to provide analytical and technical support to members of parliament, though the DPR’s effectiveness in budget scrutiny and oversight is still inadequate. Intense involvement of the DPR at the pre-budget presentation stages remains, along with a limited focus by the DPR on medium-term budget issues and on the results of policies embedded in the annual budget. The State Finances Act 17/2003 calls for approval by parliament of the annual budget law two months prior to the beginning of the new fiscal year<sup>6</sup>; nonetheless, DPR committees continue to be involved in budget approval after the annual budget law has been adopted in plenary session. The DPR’s follow-up on the external audits of the Supreme Audit Institution (BPK) remains weak.

5. **Tax legislation and administration has been considerably revised and improved.** The “General Provisions and Tax Procedures” (KUP) law adopted in July 2007—and effective since January 2008—improved the balance between taxpayers rights and the efficiency of the tax powers of DG Tax (DGT). Existing regulations already allowed banks to provide the DGT with information on taxpayer’s banking transactions in the context of a bona fide audit<sup>7</sup> and gave DGT the authority to freeze and seize a tax debt. The revised law

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<sup>4</sup> The FPO’s English website is available at <http://www.fiskal.depkeu.go.id/ENG/default.asp>.

<sup>5</sup> The fiscal risk statement covers (a) sensitivity analysis of the state budget and the budgetary impact of the state-owned (SOEs) to variations in key macroeconomic assumptions, (b) public debt risk of the central government, (c) contingent liabilities of the central government related to infrastructure development projects, civil service pensions, the financial sector, legal claims on the government, membership in International Financial Organizations and Agencies, and natural disasters, (d) risks related to fiscal decentralization, and (e) other risks.

<sup>6</sup> In contrast, in many countries, the annual budgets must be adopted prior to the beginning of the new fiscal year (i.e., by a few days, not two months before the start of the new fiscal year).

<sup>7</sup> One limitation, however, is that individual taxpayers and small and medium enterprises are not required to provide their Taxpayer Identification Number when opening bank accounts. This will make it difficult, in practice, to obtain the information from banks.

enhances the implementation of existing regulations. Furthermore, improvements in taxpayers' rights include the possibility for taxpayers to defer "full payment"<sup>8</sup> of a disputed tax while the case is under objection or appeal. Finally, two new laws—the law on VAT on Goods and Services and Sales Tax on Luxury Goods (UU No. 42/2009) and the Income Tax law (UU No. 36/2008)—have recently been approved by the parliament.

**6. Despite major reforms, some tax legislation and administration issues remain to be addressed.** Reforms aimed at balancing taxpayers' rights and DGT efficiency left out some important issues. In particular, (i) current procedures governing the process of seizing the taxpayer's assets deposited in banks should be streamlined, as procedures under several laws need to be met before the issuance of orders to banks for disclosure of balances can be made;<sup>9</sup> and (ii) the MoF's Inspectorate General (IG) and Supreme Audit Agency (BPK) investigations unit staff would need to be provided with unrestricted access to taxpayer information available to the DGT (presently, it must submit data requests to the MoF on a case-by-case basis; this, in practice, has led to extensive delays in treating such requests, which can significantly impair the IG's and BPK's ability to gather evidence of misconduct by DGT staff). The IG's effectiveness is also limited by its inability to investigate potential criminal action by MoF staff and inaction by the law enforcement body tasked with this responsibility.

**7. Steps have been taken to improve tax officers' conduct.** Reforms have taken place in two areas recommended in the 2006 fiscal transparency ROSC. First, the code of conduct for tax officers is now applied to all tax offices (MoF Decree No. 1/PM.3/2007) and new provisions in the KUP law<sup>10</sup> will renew the code of conduct and significantly strengthen sanctions for violations. Second, tax officers acting beyond their authority, as stated in tax regulations, can be reported to the internal inspection and investigation unit in the MoF, and can eventually be sanctioned (Article 36A paragraph 2, KUP); in this vein, the DGT established Internal Audit and Criminal Investigation units in January 2007; these are

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<sup>8</sup> Although taxpayers no longer have to pay the full amount, they nevertheless must pay at least an amount agreed by the taxpayer in the final discussion of audit results (closing conference) before letters of objection can be submitted.

<sup>9</sup> Current rules entail specific procedures to seize the assets of tax bearers. These include the issuance of a request by the DGT to BI to instruct the bank(s) to disclose the balance(s) deposited in the tax bearer's account(s). While the DGT can in principle freeze the account(s), it will take considerable time until the balance is disclosed and the DGT can determine if it is sufficient to cover the taxpayer's liabilities. The DGT should be able to request the balance at the same time the account is frozen, following international good practice.

<sup>10</sup> See the Third Amendment to Law 6/1983 Regarding General Provisions and Tax Procedures (Law 28/2007 of July 17, 2007). Provisions include (i) requiring the MoF to establish a DGT code of conduct and a Committee for the Code of Conduct to supervise its administration and review all violations; (ii) placing extortion or taxpayer abuse for personal gain under the criminal code and bribery under the anti-corruption law; (iii) extending the IG's responsibility to investigate tax officers who intentionally act beyond their authority; and (iv) clarifying that criminal and civil sanctions will not apply where the tax officer has acted in goodwill and within the provisions of tax legislation.

designed to strengthen internal controls and to complement the MoF IG's efforts to fight corruption.

8. **However, some human resources reforms and practices limit incentives for high performance of tax officials.** Extensive rotation of skilled and specialized DGT staff to comply with the general civil service commission policy is diluting the job specific expertise accumulated by staff. For example, in large taxpayer offices, large taxpayer audits require employees with advanced auditing skills often in specialized areas or sectors, such as international tax, computer audit or the financial sector. These skills may take several years to develop. Staff rotation to unrelated positions results in the loss of expertise that will take new individuals substantial time to develop.

9. **Civil service personnel reform has started.** It is based on the concept of "management based on competency" and aims at providing staff training, building an Assessment Center, supporting staff rotation, improving recruitment procedures and fostering staff integrity. The reform will introduce a new integrated management information system for human resources (SIMPEG).<sup>11</sup> The reform aims at introducing a performance-related pay component based on key performance indicators. So far, the measures adopted have resulted in pay increases, with higher rates of increase for staff in strategically important positions, higher staff rotation, the establishment of the Assessment Center System, changes in recruitment procedures, the adoption of a code of conduct for government staff, and the use of Balance Score Cards (BSC) to measure performance.

10. **Transparency of the oil and gas sector has not materially improved, though the legal basis for EITI implementation is now in place.** In December 2008, the government announced its intention to participate in the Extractive Industries Transparency Initiative (EITI). The most significant milestone towards the EITI implementation is the signature of the EITI Presidential regulation<sup>12</sup>, which provides for: (i) multi-level governance and oversight of the process, (ii) industry and civil society representation and (iii) local governments focus. The regulation mandates the appointment of a multi-stakeholder Implementing Team, which will consider further steps towards EITI Candidacy. The public disclosure of oil and gas revenue flows would strongly increase should an EITI report be made public; BPK has stated in its 2008 report that information on oil and gas revenues are disclosed. Nonetheless, oil and gas revenues are not deposited directly to the state treasury as per the budget mechanism; this policy has been approved by parliament. While, no progress

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<sup>11</sup> The MoF issued ministerial decree 30/KMK.01/ 2007 outlining the following reforms: (i) a major reorganization within the Secretary General's office to improve the human resource management function; (ii) a systematic review of business processes to ensure more effective service delivery to the clients; (iii) a comprehensive process of developing new standard operating procedures, work load analysis, and job descriptions and classifications; (iv) improvement of overall human resource management in the MoF; and (v) creation of a remuneration system linking remuneration more directly to job responsibilities and workloads to improve incentives, transparency and fairness in compensation across the MoF.

<sup>12</sup> See Presidential Regulation 26/2010 on Transparency of National and Local Industry Revenues, signed into force in May 2010.

has so far been made in publishing externally audited accounts for Pertamina since 2003, Pertamina's opening balance for 2003 was issued on January 30, 2008 by the Ministry of Finance (MoF decree No.023/KMK.06/2008) and the company's financial reports for 2004 through 2007 are being audited by an independent international auditor.<sup>13</sup> Finally, the government does not use the non-oil fiscal balance to inform its policy decisions.

11. **Progress has been made in rationalizing government bank accounts.** The adoption of new government cash management regulations in July 2007 was an important step forward for improving government banking arrangements. The regulations strengthen the Minister of Finance's powers to consolidate government bank accounts. On this basis, the MoF conducted a census of government bank accounts operated by ministries and budget users outside treasury control. The ensuing ministry-by-ministry analysis of accounts led to either the closure of bank accounts or the extension of control by DG Treasury of hundreds of off-budget bank accounts. This was a sizeable step towards establishing an operational treasury single account (TSA). An agreement was formalized between the MoF and Bank Indonesia (BI) to establish a mechanism for remunerating government deposits held at BI starting on January 1, 2009.

12. **Significant progress with the presentation of the 2009 government financial statements allowed the external auditor - the Audit Board of the Republic of Indonesia (BPK) - to express a qualified opinion.** Previously, BPK had not been able to express an opinion due to audit scope limitations, internal control weaknesses, as well as non-compliance with some rules and regulations. Efforts were made to address these weaknesses in a gradual fashion that peaked in the preparation of the 2009 annual government financial statements, where significant improvements have been made, in particular with regard to the disclosure of foreign grants, foreign loans, government bank accounts, and permanent investments. Moreover, previous audit limitations on tax payer's data have been reduced considerably to a level that, combined with other improvements, has made it possible for the BPK to express a qualified opinion.

13. **The disclosure of fiscal information to the public has also improved significantly.** This has been supported by amendments to ministerial decrees. In particular, Ministerial Decree No.91/PMK.05/2007 on the chart of accounts requires that the budget, in-year fiscal reports, and annual financial statements use the same terminology. Furthermore, Ministerial Decree No.86/PMK.05/2008 on accounting system of government debts, Ministerial Decree No.40/PMK.05/2009 on accounting system of grant, and Ministerial Decree No.120/PMK.05/2009 on accounting and reporting system of transfer to local government were issued to improve the quality of government financial statement. This should improve the quality of information and simplify budget monitoring. Ministerial Decree No. 171/PMK.05/2007 clarified the powers of the minister of finance and should improve central government accounting and financial reporting systems. The publication of a

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<sup>13</sup> Pertamina's Financial reports for 2003 - 2007 cannot be made public yet because the Ministry of Finance requested these reports to be re-audited (See the Ministry of Finance Decree No.023/KMK.06/2008).

comprehensive fiscal risk statement accompanying the annual budget document significantly improves the transparency of fiscal policies and associated risks. FPO's risk management unit now assesses risks of selected (risk-based) SOEs, thanks to improved reporting of information from SOEs to the Ministry of SOEs and the MoF. The improved understanding of fiscal risks from SOEs was disclosed in the fiscal risk statement accompanying the 2009 budget. The reporting of information on central government debt is now comprehensive and timely, and key contingent liabilities are disclosed in the annual fiscal risk statement (including those related to public-private partnerships).<sup>14</sup> However, progress is still needed on reporting general government debt, and debt accumulated by public enterprises.

14. **Progress has been achieved in strengthening the effectiveness of external audit body and in fighting corruption among public officials.** The BPK mandate has been strengthened by adoption of law 15/2006. BPK staff headcount has been significantly increased (currently 6,000 staff covering 33 provinces) and training has been ongoing, even though needs remain significant. Both the MoF's Inspectorate General and the BPK are experiencing difficulties in accessing taxpayers data (these are needed, for example, to investigate potential misconduct of tax officials) owing to taxpayers privacy concerns (the law, however, provides for both institutions such access, albeit indirectly, as permission of the Minister of Finance on a case-by-case basis is required; e.g., Article 34 of KUP for the IG). Memorandum of understandings between the MoF and the internal and external auditors to address this issue are still pending. The role of the Internal Audit Agency (BPKP) as an internal audit body has not been reviewed. Recently, the Corruption Eradication Commission (KPK) has become more vigorous in its investigations and prosecutions of corruption cases, including those dealing with senior government officials.<sup>15</sup> In line with its efforts to combat corruption, the number of public complaints against corruption received by KPK has increased noticeably since 2004. The KPK is currently reviewing about 36,000 complaints of official corruption received from the public.<sup>16</sup>

15. **Steps have been taken to improve the availability of consolidated fiscal information for general government but further steps are needed.** The revenue and expenditure assignments of different levels of government have improved thanks to clarifications in the recently approved law on local government taxation (law No. 28/2009 on Local Tax and Redistribution). Although budget reporting by regional governments is beginning to improve, due to the application of the legal sanction mechanism provided in Government Regulation No.56/2005, reporting from local governments to the MoF on budget execution is still subject to excessively long lags. Moreover, the fiscal reports of local

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<sup>14</sup> Information on debt stock and flows, as well as the calendar of debt issuance, is available from the DG Debt Management's website at <http://www.dmo.or.id/> (only in Bahasa).

<sup>15</sup> Recent high profile KPK activities include investigations and/or arrest against the (former) central bank governor, two members of parliament, two former ambassadors, and a state attorney. KPK, in coordination with DG Customs, also launched a widely reported investigation into corruption among custom officials.

<sup>16</sup> Since it began operations in 2004, KPK has successfully convicted 88 high-ranking government officials, conducted preliminary investigation of 276 cases, completed investigations of 142 cases and prosecution in 115 cases. It has successfully recovered over Rp 564 billion in assets. Most enforcement actions relate to allegations of bribery and irregularities.

governments do not follow GFS reporting.<sup>17</sup> Finally, although local governments are now required to submit their annual report to the central government, the MoF does not obtain comprehensive and timely information on borrowing and debt making it difficult to monitor general government debt trends.

### III. IMF STAFF COMMENTARY

16. **Indonesia has further improved fiscal transparency over the past four years.** An effective fiscal policy office has been established, tax legislation has been substantially revised, tax administration is improving, legal and administrative measures have been adopted to improve public sector governance, and important steps have been taken to rationalize government banking arrangements. Additionally, there have been significant improvements in the disclosure of fiscal information, with very useful analysis of fiscal policies published in the Financial Notes that accompanies the draft annual budget. Besides analyzing revenue, expenditure and deficit-financing in detail, this document comprehensively covers fiscal risks in an annually-updated fiscal risk statement. All this information is publicly available. Significant progress with the presentation of the 2009 government financial statements has been achieved, resulting in the Supreme Audit Agency (BPK)'s issue of a qualified opinion on the 2009 financial report for the first time since the audit was introduced in 2004.

17. **However, much remains to be done to improve transparency further.** The legal basis for the Extractive Industries Transparency Initiative (EITI) implementation is now in place, but further progress is needed to ensure public access to data on government revenues from the exploitation of non-renewable resources. The disclosure of oil and gas revenue flows through the EITI would significantly improve fiscal transparency and would align Indonesia with the numerous oil producing countries that participate in the initiative. Transparency would also benefit from reforms of the role of the parliament in the budget process and from continued implementation of revenue administration reforms. Further steps are needed to bring in the TSA accounts that are controlled by spending ministries or agencies, outside of DG Treasury oversight. Also, improving the comprehensiveness and quality of the government's annual financial statements and pressing ahead with accrual accounting reforms would allow BPK to improve further the auditing of government accounts. Finally, there is a large but crucial agenda to improve the monitoring of subnational budgetary and debt developments, so as to improve the transparency and quality of fiscal policy at the general government level.

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<sup>17</sup> Aside from not following GFS standards, another complication is that local governments do not have homogenous classifications of expenditures, which makes it impossible to derive expenditure data classified by GFS's standard functions (and sub functions).