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RESTRUCTURING PAPER
ON A
PROPOSED PROJECT RESTRUCTURING
OF THE
INITIATIVES FOR LOCAL GOVERNANCE REFORM PROJECT

The Loan Agreement (Loan No. 4790-IND)
The Development Credit Agreement (Credit No. 4078-IND)

October 11, 2005 and amended on September 29, 2009

TO THE
REPUBLIC OF INDONESIA

ABBREVIATIONS AND ACRONYMS

DFID	UK Department for Foreign International Development
GOI	Government of Indonesia
ILGRP	Initiatives of Local Governance Reform Project
PCT	Provincial Coordination Team

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INDONESIA
INITIATIVES FOR LOCAL GOVERNANCE REFORM PROJECT

CONTENTS

	Page
A. SUMMARY.....	4
B. PROJECT STATUS.....	4
C. PROPOSED CHANGES	5

INITIATIVES FOR LOCAL GOVERNANCE REFORM PROJECT

RESTRUCTURING PAPER

SUMMARY

1. This restructuring paper seeks the approval of the Country Director to introduce the following changes in the Indonesia Initiatives for Local Governance Reform Project, Loan/Credit No. 4790-IND/4078-IND and any accompanying amendments to the Project's legal documents. The proposed changes, as requested by the Government of Indonesia (GOI) through the Ministry of Finance, are intended to maintain implementation support for part C of the Project through the end of FY 2011 by allowing expenditures previously financed by a DFID co-financing grant to also be covered from loan proceeds after the DFID grant closes on 31 December, 2010. The Borrower's proposed changes include: (i) adding an expenditure category of "*Goods, consultant services, workshops and training*" under Loan/Credit; and (ii) reallocating the undisbursed "*Grants for Sub-projects*" to finance "*Goods, consultant services, workshops and training*" in the amount of US\$ 1,310,000.

2. The implementation support in FY 2011 will mainly focus on the institutionalization of the reform agenda in districts participating in ILGRP, particularly in the best performing districts, supervision of sub-project construction, and final evaluation of the program. Two objectives of the final evaluation are: (i) to have a comprehensive evaluation of program implementation and achievements; and (ii) to provide lessons learned for similar or scale-up projects in the future. Transfer of assets from the Central Government to Local Governments will also be carried-out in FY 2011 and has to be completed before the Project closes.

PROJECT STATUS

3. **Past Performance and Implementation Issues.** Since the Project's restructuring, which simplified the Local Governance Reform Framework and kept the number of participants to the existing participating districts, progress towards achieving the Project Development Objectives is well on track. Reforms in transparency, participation and accountability have been undertaken extensively, adapting to specific local circumstances, as have the reforms related to financial management and procurement. For example, publication of various types of public information now occurs more regularly in most districts. Some districts have progressively improved their allocation to their villages. The quality of districts' financial reports, as verified by the State Audit Agency, has significantly improved, and the Procurement Units that some districts created have increased efficiency in procurement processing. Moreover, the Provincial Coordination Teams (PCTs) have been actively promoting the local governance reforms of the Project to all non-participating districts in their provinces. Some provinces have

begun replicating the Project's reform incentives in their districts. Poverty-targeted investments are also advancing, from 141 sub-projects in January 2009, before the Mid-Term Review, to 256 sub-projects, with a total contract amount of US\$30.5 million, which are expected to be completed at the end of the project. A recent study of cost effectiveness shows that ILGRP sub-projects have an economic internal rate of return of more than 15%. Based on the overall progress described above, and the improvements that have been made since the Sixth Implementation Support Mission, the Project is currently rated as Satisfactory.

Table 1. Implementation Support Ratings of ILGRP Implementation

Aspect	Rating		
	6 th Implementation Support Mission (Dec 22, 2009)	7 th Implementation Support Mission (Jun 30, 2010)	8 th Implementation Support Mission (Nov 24, 2010)
<i>Overall</i>			
Implementation Progress	MS	S	S
Development Objectives	MS	S	S
<i>By Components:</i>			
A. Local Governance Reform	S	S	S
B. Poverty Targeted Investment	MS	S	S
C. Implementation Support	MS	S	S
Program Management	MS	S	S
Financial Management	MS	MS	MS
Procurement	MU	MS	S
Provision of Counterpart Funds	HS	HS	HS
Safeguards	MS	S	MS
Monitoring and Evaluation	MS	MS	MS
Anti Corruption	MS	MS	MS

Note: HS=Highly Satisfactory, S=Satisfactory, MS=Moderately Satisfactory, MU=Moderately Unsatisfactory, U=Unsatisfactory, NR=Not Rated.

4. **Disbursement.** As of November 24, 2010, disbursement of Loan 4790-IND/Credit 4078-IND had reached 79%. The completion of on-going sub-project construction by the end of the project is estimated to increase the disbursement up to 91% of the total Loan/Credit.

Table 2. Disbursement Progress (as of November 2010)

Special Accounts	Allocated amount	Disbursed	Undisbursed Balance
Loan 4790-IND	\$ 14.5 million	\$ 9.5 million	\$ 5 million
Credit 4078-IND	SDR 9,920,000 (\$ 15 million)	SDR 9,119,774 (\$ 14 million)	SDR 800,226 (\$ 1 million)
Total	\$ 29.5 million	\$ 23.5 million	\$ 6 million

PROPOSED CHANGES

5. *The primary change to the loan/grant agreement proposed would allow activities currently financed by a DFID co-financing grant to also be financed from loan/grant proceeds after the DFID grant closes on 31 December, 2010. These activities were always part of the project description and no change to the project per se is required.*

6. *Reallocating the undisbursed parts of the “Grants for Sub-projects” to finance “Goods, consultant services, workshops and training”. Currently, 79% of the “Grants for Sub-projects” from Loan/Credit have been disbursed and it is estimated that by the end of the project, the total disbursement for this category will reach US\$27 million or 93% of the total Loan/Credit for this category. GOI requests that the undisbursed part of this category be reallocated to finance “Goods, consultant services, workshops and training” to enable the Project to continue support to participating districts, particularly to institutionalize reforms in the best performing districts, and to carry-out a final project evaluation.*

7. *Add an expenditure category of “Goods, consultant services, workshops and training” under Loan/Credit. Currently, the category of “Goods, consultant services, workshops and training” is fully financed by a DFID Grant (TF-055913/IND), which will be closed on December 31, 2010. Therefore, to enable the reallocated funds to be utilized after the Grant closes, this additional expenditure category has to be created. Table 3 below provides the revised category of expenditure and allocation of the Loan/Credit.*

Table 3. Revised Category of Expenditure and Allocation of Loan/Credit

Category of Expenditure		Allocation				% of Financing	
Current	Revised	Current		Revised		Current	Revised
		Credit (SDR)	Loan (USD)	Credit (SDR)	Loan (USD)		
Grants for Sub-projects	Grants for Sub-projects	9,670,000	13,446,500	9,670,000	12,136,500	100%	100%
Incremental Operating Cost	Incremental Operating Cost	250,000	981,000	250,000	981,000	100%	100%
Front-end Fee	Front-end Fee	-	72,500	-	72,500	Amount due under Section 2.04 of the Loan Agreement	
-	Goods, consultant services, workshops and training	-	-	-	1,310,000	-	100%
Unallocated	Unallocated	-	-	-	-	-	-
TOTAL		9,920,000	14,500,000	9,920,000	14,500,000		

8. The amended Loan Agreement will incorporate a full section of procurement methods for this new expenditure category.

