

CONFORMED COPY

CREDIT NUMBER 4078-IND

Development Credit Agreement

(Initiatives for Local Governance Reform Project)

between

REPUBLIC OF INDONESIA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated October 11, 2005

CREDIT NUMBER 4078-IND

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated October 11, 2005, between REPUBLIC OF INDONESIA (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Borrower, having satisfied itself as to the feasibility and priority of the Project described in Schedule 2 to this Agreement, has requested the Association to assist in the financing of the Project;

(B) the Borrower has also requested the International Bank for Reconstruction and Development (the Bank) to provide additional assistance towards the financing of the Project and by an agreement of even date herewith between the Borrower and the Bank (the Loan Agreement), the Bank is making a loan to the Borrower in the amount of fourteen million five hundred thousand Dollars (\$14,500,000) (the Loan);

(C) the Borrower has requested a grant from the Government of the United Kingdom and Northern Ireland, acting through its Department for International Development (DFID), in the amount of twelve million Dollars (\$12,000,000) (the DFID Grant) to finance part of the Project, and for this purpose intends to enter into an agreement with the Association acting as administrator of the DFID Grant (the DFID Grant Agreement) for the provision of said grant pursuant to the terms of a memorandum of understanding to be entered into for that purpose between DFID and the Association (the DFID MOU); and

(D) the Borrower and the Association intend, to the extent practicable, that the proceeds of the Credit provided for in this Agreement be disbursed on account of expenditures in respect of the Project before disbursements of the proceeds of the Loan provided for in the Loan Agreement are made; and

WHEREAS the Association has agreed, on the basis, *inter alia*, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The “General Conditions Applicable to Development Credit Agreements” of the Association, dated January 1, 1985 (as amended through May 1, 2004), with the modification set forth below (the General Conditions), constitute an integral part of this Agreement: Section 6.03(c) of the General Conditions is amended by replacing the words “corrupt or fraudulent” with the words “corrupt, fraudulent, collusive or coercive”.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “Additional Participating Kabupaten” means a Kabupaten, other than a Participating Kabupaten, selected by the Borrower for participation in Parts A and C of the Project in accordance with the eligibility and selection criteria set forth in the Local Governance Reform Framework and in accordance with paragraph 5 of, and Annex A to, Schedule 4 to this Agreement.

(b) “APBD” means the budget of a local government within the territory of the Borrower.

(c) “BAPPENAS” means the Borrower’s National Development Planning Agency, and any successor thereto.

(d) “Bupati” means the chief executive of a Kabupaten.

(e) “Displaced Person” means a person who, on account of the execution of Part B of the Project, has experienced or would experience direct economic and social impacts caused by: (i) the involuntary taking of land, resulting in: (A) relocation or loss of shelter; (B) loss of assets or access to assets; or (C) loss of income sources or means of livelihood, whether or not such person must move to another location; or (ii) the involuntary restriction of access to legally designated parks and protected areas, resulting in adverse impacts on the livelihood of such person, and “Displaced Persons” means, collectively, all such Displaced Persons.

(f) “DPRD” means the local legislative assembly of each Participating Kabupaten and Additional Participating Kabupaten.

(g) “Eligible Categories” means Categories 1 through 4 set forth in the table in Part A.1 of Schedule 1 to this Agreement.

(h) “Eligible Expenditures” means the expenditures for goods, works and services referred to in Section 2.02 of this Agreement.

(i) “Financial Monitoring Report” means each report prepared in accordance with Section 4.02 of this Agreement.

(j) “Fiscal Year” and “FY” mean the Borrower’s fiscal year commencing January 1 and ending December 31.

(k) “Grant Agreement” means an agreement entered into between the Borrower through MOF and a Participating Kabupaten for the purposes of financing part of the costs of a Sub-project through a Grant.

(l) “Grant” means a grant made available by the Borrower out of the proceeds of the Credit to a Participating Kabupaten to finance part of the costs of a Sub-project pursuant to the provisions of paragraph 5 of Schedule 4 to this Agreement and of Annex C to said Schedule 4.

(m) “Isolated Vulnerable Persons” means those social groups in Indonesia that have a distinct social and cultural identity, and that are susceptible to being disadvantaged in the development process induced by the Project or any part thereof.

(n) “Kabupaten” means a district, an administrative division of the Borrower.

(o) “Loan Agreement” means the agreement of even date herewith between the Borrower and the Bank for the Project, as such agreement may be amended from time to time; and such term includes the “General Conditions applicable to Loan and Guarantee Agreements” of the Bank, dated May 30, 1995 (as amended through May 1, 2004), as applied to such agreement, and all schedules and agreements supplemental to the Loan Agreement.

(p) “Local Governance Reform Framework” means the framework adopted by the Borrower through the National Steering Committee on March 26, 2004, establishing the eligibility criteria for: (i) Kabupatens to qualify as Participating Kabupatens or Additional Kabupatens and thereafter to maintain their status as such; and (ii) the eligibility criteria for Participating Kabupatens to qualify for Grants, as such; framework may be amended from time to time in accordance with the provisions of paragraph 3 of Schedule 4 to this Agreement.

(q) “MOHA” means the Borrower’s Ministry of Home Affairs, and any successor thereto.

(r) “Musrenbang Kabupaten” means the public consultation and coordination meeting held on an annual basis in each Kabupaten to discuss that Kabupaten’s proposed APBD budget for its following fiscal year.

(s) “National Implementation Committee” means the inter-agency committee established pursuant to Ministerial Decree 193.05-023 of the Minister of MOHA, responsible for the coordination of Project implementation activities at the national level.

(t) “National Management Consultants” means the national-level consultants engaged to provide management and implementation support services to the Project Secretariat under Part C of the Project in accordance with the provisions of paragraph 9 of Schedule 4 to this Agreement.

(u) “National Steering Committee” means the inter-agency committee established pursuant to Ministerial Decree 271/M.PPN/06/2002 of the Minister of BAPPENAS, responsible for providing overall project supervision and policy direction to achieve the objectives of the Project.

(v) “Participating Kabupaten” means the Kabupatens listed in Part 3 of Annex C to Schedule 4 to this Agreement.

(w) “Participating Provinces” means the Borrower’s provinces of Banten, Central Java, East Java, Gorontalo, Yogyakarta, North Sulawesi, South Sulawesi, West Java and West Sumatra, and such other provinces as the Borrower and the Association may agree upon from time to time.

(x) “Phase 1 Grant” means a Grant for which a Participating Kabupaten is eligible to apply in respect of Sub-projects: (i) upon its satisfying the criteria set forth in: (x) the Local Governance Reform Framework for the provision of said grants; and (y) Part 1 of Annex B to Schedule 4 of this Agreement; and (ii) in accordance with the relevant provisions concerning said Grants in the Project Operational Manual, which Sub-projects are to be financed in the Fiscal Year immediately following the attainment of such eligibility; and “Phase 1 Grants” means Phase 1 Grants collectively.

(y) “Phase 2 Grant” means a Grant for which a Participating Kabupaten is eligible to apply in respect of Sub-projects: (i) upon its satisfying the eligibility criteria set forth in: (x) the Local Governance Reform Framework for the provision of said grants to Participating Kabupatens in the twelve (12) month period following that covered by Phase 1 Grants; and (y) Part 2 of Annex B to Schedule 4 of this Agreement; and (ii) in accordance with the relevant provisions concerning said Grants in the Project Operational Manual, which Sub-projects are to be financed in the Fiscal Year immediately following the attainment of such eligibility; and “Phase 2 Grants” means Phase 2 Grants collectively.

(z) “Phase 3 Grant” means a Grant for which a Participating Kabupaten is eligible to apply in respect of Sub-projects: (i) upon its satisfying the eligibility criteria set forth in: (x) the Local Governance Reform Framework for the provision of said grants to Participating Kabupatens in the twelve (12) month period following that covered by

Phase 2 Grants; and (y) Part 3 of Annex B to Schedule 4 of this Agreement; and (ii) in accordance with the relevant provisions concerning said Grants; in the Project Operational Manual, which Sub-projects are to be financed in the Fiscal Year immediately following the attainment of such eligibility; and “Phase 3 Grants” means Phase 3 Grants collectively.

(aa) “PMUs” means the Kabupaten-level teams established within Participating Kabuptens, in each case pursuant to a decree of the Bupati, responsible for the coordination and management of Project implementation at the Kabupaten level in accordance with the provisions of the Project Operational Manual.

(bb) “Procurement Plan” means the Borrower’s procurement plan, dated May 12, 2005, covering the initial eighteen (18) month period of Project implementation, as the same shall be updated from time to time in accordance with the provisions of Section 3.02 to this Agreement, to cover succeeding eighteen (18) month periods (or longer) of Project implementation.

(cc) “Project Operational Manual” means the manual adopted by the Borrower pursuant to the provisions of Section 6.01(b) of, and paragraph 4 of Schedule 4 to, this Agreement, as such Project Operational Manual may be amended from time to time with the prior agreement of the Association.

(dd) “Project Secretariat” means the project secretariat established within the Directorate of Regional Autonomy in MOHA by Ministerial Decree No. 193.05-023 issued by Minister of MOHA on April 21, 2005, and maintained in accordance with the provisions of paragraph 1 of Schedule 4 to this Agreement, responsible for the overall management and coordination of the Project.

(ee) “PRSAP” means the poverty reduction strategy and action plan to be prepared and adopted by each Participating Kabupaten under Part A.1 of the Project and in accordance with the provisions of the Local Governance Reform Framework and of the Project Operational Manual.

(ff) “Regional Management Consultants” means regional-level consultants engaged in accordance with provisions of Paragraph 9 of Schedule 4 to this Agreement: (i) to provide technical support and capacity building for Participating Kabupatens and Additional Participating Kabupatens to implement Parts A and C of the Project; and (ii) to carry out technical reviews of proposed sub-projects under Part B of the Project.

(gg) “Report-based Disbursements” means the Borrower’s option for withdrawal of funds from the Credit Account referred to in paragraph 5 of Part A of Schedule 1 to this Agreement.

(hh) “Safeguards Framework” means the framework adopted by the Borrower through MOHA on February 24, 2004, setting forth the measures and actions to be taken

during the implementation of the Project: (i) to eliminate or offset adverse environmental impacts or to reduce such impacts to acceptable levels in the design and implementation of Sub-projects; (ii) to provide compensation, rehabilitation and resettlement assistance to Displaced Persons; and (iii) for: (x) the informed involvement of Isolated Vulnerable People, through a process of informed participation, in the design and implementation of each Sub-project to be, or being, carried out in a location in which such people reside or use for their livelihood; and (y) designing and implementing mitigation measures on possible impacts of the Project on Isolated Vulnerable People which are socially and culturally acceptable to them; as such framework may be amended from time to time with the prior agreement of the Association.

(ii) "Special Account" means the account referred to in Part B of Schedule 1 to this Agreement.

(jj) "Sub-project" means a project carried out or to be carried out under Part B of the Project by a Participating Kabupaten as part of its PRSAP developed and adopted under Part A.1 of the Project, which project is eligible for financing in part out of the proceeds of a Grant in accordance with the provisions.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to nine million nine hundred and twenty thousand Special Drawing Rights (SDR 9,920,000).

Section 2.02. The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement: (i) for amounts paid (or, if the Association shall so agree, to be paid) by the Borrower on account of a Grant and/or a Sub-loan to meet the reasonable cost of goods, works and services required for a Sub-project and in respect of which the withdrawal from the Credit Account is requested; and (ii) for expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable cost of goods and services required for Part C of the Project and to be financed out of the proceeds of the Credit.

Section 2.03. The Closing Date shall be September 30, 2009, or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty (60) days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent ($3/4$ of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on May 15 and November 15 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each May 15 and November 15 commencing November 15, 2015, and ending May 15, 2040. Each installment to and including the installment payable on May 15, 2025, shall be one and one-fourth percent ($1-1/4\%$) of such principal amount, and each installment thereafter shall be two and one-half percent ($2-1/2\%$) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three (3) consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

- (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and
- (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six (6) months or more

after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five (5) years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall carry out, and cause to be carried out, the Project with due diligence and efficiency and in conformity with appropriate administrative, financial, agricultural, engineering and land management practices, and social and environmental standards acceptable to the Association, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Borrower and the Association shall otherwise agree, the Borrower shall carry out the Project in accordance with the Implementation Program set forth in Schedule 4 to this Agreement.

Section 3.02. (a) Except as the Association shall otherwise agree, procurement of the goods and works required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 3 to this Agreement, as said provisions may be further elaborated in the Procurement Plan.

(b) The Borrower shall update the Procurement Plan in accordance with terms of reference acceptable to the Association, and furnish it to the Association not later than twelve (12) months after the date of the preceding Procurement Plan, for the Association's approval.

Section 3.03. For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the Borrower shall:

(a) prepare, on the basis of guidelines acceptable to the Association, and furnish to the Association not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Association, a plan designed to ensure the continued achievement of the Project's objectives; and

(b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall establish and maintain a financial management system, including records and accounts, and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Association, adequate to reflect the operations, resources and expenditures related to the Project.

(b) The Borrower shall:

(i) have the financial statements referred to in paragraph (a) of this Section for each fiscal year (or other period agreed to by the Association), audited, in accordance with consistently applied auditing standards acceptable to the Association, by independent auditors acceptable to the Association;

(ii) furnish to the Association as soon as available, but in any case not later than six (6) months after the end of each such year (or such other period agreed to by the Association): (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or other period agreed to by the Association), as so audited; and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Association; and

(iii) furnish to the Association such other information concerning such records and accounts, and the audit of such financial statements, and concerning said auditors, as the Association may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Loan Account were made on the basis of reports referred to in Part A.5 of Schedule 1 to this Agreement (Report-based Disbursements) or on the basis of statements of expenditure, the Borrower shall:

- (i) retain, until at least one (1) year after the Association has received the audit report for, or covering, the fiscal year in which the last withdrawal from the Loan Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
- (ii) enable the Association's representatives to examine such records; and
- (iii) ensure that such reports and statements of expenditure are included in the audit for each fiscal year (or other period agreed to by the Association), referred to in paragraph (b) of this Section.

Section 4.02. (a) Without limitation upon the Borrower's progress reporting obligations set out in paragraph 11 of Schedule 4 to this Agreement, the Borrower shall prepare and furnish to the Association a financial monitoring report, in form and substance satisfactory to the Association, which:

- (i) sets forth sources and uses of funds for the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the Credit and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and explains variances between the actual and planned Project implementation; and
- (iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

(b) The first FMR shall be furnished to the Association not later than forty-five (45) days after the end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under the Project through the end of such first calendar quarter; thereafter, each FMR shall be furnished to the Association not later than forty-five (45) days after each subsequent calendar quarter, and shall cover such calendar quarter.

Section 4.03. The Borrower shall make publicly available, and agrees that the Association may also make publicly available, each final audit report referred to in Section 4.01 of this Agreement, promptly after its issuance by the independent auditors referred to therein.

ARTICLE V

Remedies of the Association

Section 5.01. Pursuant to Section 6.02(l) of the General Conditions, the following additional events are specified:

- (a) either of: (i) Law No. 32 of 2004 Regarding Regional Governance or; (ii) Law No. 33 of 2004 Regarding Fiscal Balance between the Central Government and the Regions shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of the Borrower to perform any of its obligations under this Agreement; and
- (b) (i) subject to sub-paragraph (ii) of this paragraph, the right of the Borrower to withdraw the proceeds of the DFID Grant shall have been suspended, canceled or terminated in whole or in part, pursuant to the terms of the DFID Grant Agreement; and
- (ii) sub-paragraph (i) of this paragraph shall not apply if the Borrower establishes to the satisfaction of the Association that: (A) such suspension, cancellation or termination is not caused by the failure of the Borrower to perform any of its obligations under such agreement; and (B) adequate funds for the Project are available to the Borrower from other sources on terms and conditions consistent with the obligations of the Borrower under this Agreement.

Section 5.02. Pursuant to Section 7.01(h) of the General Conditions, the following additional event is specified, namely that the event specified in Section 5.01 of this Agreement shall occur.

ARTICLE VI

Effective Date; Termination

Section 6.01. The following events are specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01(b) of the General Conditions:

- (a) the Loan Agreement has been executed and delivered and all conditions precedent to its effectiveness or to the right of the Borrower to make withdrawals

thereunder, except only the effectiveness of the Development Credit Agreement, have been fulfilled;

(b) the DFID Grant Agreement has been executed and delivered and all conditions precedent to the effectiveness of the DFID Grant Agreement or to the right of the Borrower to make withdrawals thereunder, except only the effectiveness of the Development Credit Agreement, have been fulfilled;

(c) the Project Operational Manual, acceptable to the Association, has been adopted in accordance with the provisions of paragraph 4 of Schedule 4 to this Agreement;

(d) at least eight (8) Participating Kabupatens have met the eligibility criteria referred to in paragraph 5 of Schedule 4 to this Agreement and set forth in Annex A to said Schedule, each in a manner acceptable to the Association; and

(e) the National Management Consultants (the contract for which services is included in the Procurement Plan) have been selected in accordance with the provisions of paragraph 9 of Schedule 4 to this Agreement.

Section 6.02. The following is specified as an additional matter, within the meaning of Section 12.02(b) of the General Conditions, to be included in the opinion or opinions to be furnished to the Association, namely that the Safeguards Framework has been adopted by the Borrower and is legally binding upon the Borrower in accordance with the laws of the Republic of Indonesia.

Section 6.03. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VII

Representative of the Borrower; Addresses

Section 7.01. The Minister of Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance
c/o Directorate General of Treasury
Jalan Lapangan Banteng Timur 2-4
P.O. Box 1139
Jakarta 10710
Indonesia

Cable address:	Telex:	Facsimile:
FINMINISTRY Jakarta	45799 DJMLN-IA 44319 DEPKEU-IA	(21) 381 2859

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:	Facsimile:
INDEVAS Washington, D.C.	248423 (MCI) or 64145 (MCI)	(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Jakarta, Republic of Indonesia, as of the day and year first above written.

REPUBLIC OF INDONESIA

By: /s/ Mulia Nasution

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By: /s/ Andrew Steer

Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

A. General

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each Category and the percentage of expenditures for items so to be financed in each Category:

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>Amount of the Loan Allocated (Expressed in Dollars)</u>	<u>% of Expenditures to be Financed</u>
(1) Grants for Sub-projects	9,715,000	13,370,000	100%
(2) Incremental operating costs	205,000	280,000	100%
(3) Front-end Fee		72,500	Amount due under Section 2.04 of the Loan Agreement
(4) Unallocated	--	777,500	
TOTAL	<u>9,920,000</u>	<u>14,500,000</u>	

2. For the purposes of this Schedule the term “Incremental Operating Costs” means reasonable expenditures incurred by the Project Secretariat (which expenditures would not have been incurred absent the Project) for audit costs, rental of office space, utilities, communications, consumables, staff travel (including per diem), but excluding staff salaries, allowances and honoraria.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures prior to the date of this Agreement.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures for: (i) Grants; (ii) contracts for goods costing less than \$100,000 equivalent; and (iii) incremental operating costs; all under such terms and conditions as the Association shall specify by notice to the Borrower.

5. The Borrower may request withdrawals from the Credit Account to be made on the basis of reports to be submitted to the Association in form and substance satisfactory to the Association, such reports to include the FMR and any other information as the Association shall specify by notice to the Borrower (Report-based Disbursements). In the case of the first such request submitted to the Association before any withdrawal has been made from the Credit Account, the Borrower shall submit to the Association only a statement with the projected sources and applications of funds for the Project for the six-month period following the date of such request.

B. Special Account

1. The Borrower may, for the purposes of the Project, open and maintain in Dollars a special deposit account in Bank Indonesia or in a commercial bank acceptable to the Association, on terms and conditions satisfactory to the Association, including, in the case of a commercial bank, appropriate protection against set-off, seizure and attachment.

2. After the Association has received evidence satisfactory to it that the Special Account has been opened, withdrawals from the Credit Account of amounts to be deposited into the Special Account shall be made as follows:

(a) if the Borrower is not making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) if the Borrower is making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex B to this Schedule 1.

3. Payments out of the Special Account shall be made exclusively for Eligible Expenditures. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for Eligible Expenditures.

4. Notwithstanding the provisions of paragraph 2 of Part B of this Schedule 1, the Association shall not be required to make further deposits into the Special Account:

(a) if the Association, at any time, is not satisfied that the reports referred to in paragraph 5 of Part A of this Schedule 1 adequately provide the information required for Report-based Disbursements;

(b) if the Association determines at any time that all further withdrawals for payment of Eligible Expenditures should be made by the Borrower directly from the Credit Account; or

(c) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01(b)(ii) of this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit

of: (A) the records and accounts for the Special Account; or (B) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based Disbursements or were made on the basis of statements of expenditure, as the case may be.

5. The Association shall not be required to make further deposits into the Special Account in accordance with the provisions of paragraph 2 of Part B of Schedule 1 to this Agreement if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to Section 6.02 of the General Conditions. Upon such notification, the Association shall determine, in its sole discretion, whether further deposits into the Special Account may be made and what procedures should be followed for making such deposits, and shall notify the Borrower of its determination.

6. (a) If the Association determines at any time that any payment out of the Special Account was made for an expenditure which is not an Eligible Expenditure, or was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association, provide such additional evidence as the Association may request, or deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment. Unless the Association shall otherwise agree, no further deposit by the Association into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association determines at any time that any amount outstanding in the Special Account will not be required to cover payments for Eligible Expenditures during the six-month period following such determination, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Association made pursuant to sub-paragraph (a), (b) or (c) of this paragraph 6 shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the provisions of the Development Credit Agreement.

Annex A

to

SCHEDULE 1

Operation of Special Account

When Withdrawals Are Not

Report-based Disbursements

1. For the purposes of this Annex, the term “Authorized Allocation” means the amount of \$2,900,000 to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 2 of this Annex.

2. Withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Bank a request or requests for deposit into the Special Account of an amount or amounts which in the aggregate do not exceed the Authorized Allocation. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested.

(b) For replenishment of the Special Account, the Borrower shall furnish to the Association requests for deposit into the Special Account at such intervals as the Association shall specify. Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to paragraph 3 of Part B of this Schedule 1 for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for Eligible Expenditures. Each such deposit into the Special Account shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.

3. The Association shall not be required to make further deposits into the Special Account, once the total unwithdrawn amount of the Credit minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section

5.02 of the General Conditions shall equal the equivalent of twice the amount of the Authorized Allocation. Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for Eligible Expenditures.

Annex B

to

SCHEDULE 1

Operation of Special Account

When Withdrawals Are

Report-based Disbursements

1. Withdrawals from the Credit Account shall be deposited by the Association into the Special Account in accordance with the provisions of this Schedule. Each such deposit into the Special Account shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.

2. Upon receipt of each application for withdrawal of an amount of the Credit, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account an amount equal to the lesser of:

(a) the amount so requested; and

(b) the amount which the Association has determined, based on the reports referred to in paragraph 4 of Part A of this Schedule applicable to such withdrawal application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such reports.

SCHEDULE 2

Description of the Project

The objective of the Project is to assist the Borrower in supporting local governments of Participating Kabupatens and Additional Participating Kabupatens to improve transparency and participation practices and to undertake reforms in financial management and procurement, and financing of part of Participating Kabupatens' investment development programs.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Association may agree upon from time to time to achieve such objectives:

Part A: Local Governance Reform and Institutional Strengthening

1. Reforming the local government planning and budgeting processes of Participating Kabupatens and Additional Participating Kabupatens by: (a) supporting the development, adoption and implementation of poverty reduction strategy and action plans comprised of Kabupaten-level poverty reduction policies, programs and initiatives; and (b) enhancing public participation in such processes.
2. Improving budget implementation and financial management and reporting by Kabupaten-level governments of Participating Kabupatens and Additional Participating Kabupatens by supporting the development, adoption and implementation of: (a) strengthened procurement policies and procedures; and (b) systems for comprehensive budgeting, cash management and integrated financial management.
3. Improving accountability mechanisms for local governments in Participating Kabupatens and Additional Participating Kabupatens by: (a) developing and carrying out action plans to promote information disclosure and public participation in local government affairs, including in the development of local government policies, legal instruments, budget planning and program and project implementation; and (b) carrying out regional workshops and inter-Kabupaten meetings to exchange views and disseminate experiences in the carrying out of said action plans.

Part B: Investment Support Program for Participating Kabupatens

Carrying out Sub-Projects in Participating Kabupatens through the provision of Grants.

Part C: Project Implementation Support (Management and Monitoring) at the National, Regional and Kabupaten Level; Capacity Building and Training; Piloting

1. Strengthening: (a) the capacity of MOHA to carry out its supervision, training, implementation support and internal monitoring responsibilities under the Project; and (b)

the capacity of Participating Kabupatens and Additional Participating Kabupatens in managing their Project implementation responsibilities under the Project, including, with respect to Participating Kabupatens, the planning and implementation of Sub-projects.

2. Strengthening the capacity of Participating Kabupatens and Additional Participating Kabupatens to implement the procurement and financial reforms under Part A.2 of the Project.

3. Strengthening external monitoring and impact evaluation capacity for the Project at the national, provincial and Kabupaten level.

* * *

The Project is expected to be completed by March 31, 2009.

SCHEDULE 3

Procurement

Section I. General

A. All goods, works and services (other than consultants' services) shall be procured in accordance with the provisions of Section I of the "Guidelines for Procurement under IBRD Loans and IDA Credits" dated May 2004 (the Guidelines), the provisions of Annex A to this Schedule 3 and the provisions of this Schedule.

B. The capitalized terms used below in this Schedule to describe particular procurement methods or methods of review by the Association of particular contracts, have the meanings ascribed to them in the Procurement Guidelines.

Section II. Particular Methods of Procurement of Goods, Works and Services (other than Consultants' Services)

A. International Competitive Bidding. Except as otherwise provided in Part B of this Section, contracts shall be awarded on the basis of International Competitive Bidding.

B. Other Procurement Procedures

1. National Competitive Bidding

Works estimated to cost less than \$1,000,000 equivalent per contract, and goods estimated to cost less than \$200,000 per contract, may be procured under contracts awarded on the basis of National Competitive Bidding and in accordance with the provisions of Annex B to this Schedule 3.

2. Shopping

Goods and works estimated to cost less than \$50,000 equivalent per contract, may be procured under contracts awarded on the basis of Shopping.

Section III. Review by the Association of Procurement Decisions

The Procurement Plan shall set forth those contracts which shall be subject to the Association's Prior Review. All other contracts shall be subject to Post Review by the Association.

Annex A
to
SCHEDULE 3

Without limitation on the provisions of Schedule 3 to the Development Credit Agreement (Schedule 3) and of the Guidelines (as such term is defined in said schedule and referred to hereafter as the Procurement Guidelines), the following provisions shall apply in respect of goods and works to be procured under the Project:

1. To ensure end-user participation in the procurement of goods and works under the Project, the requestor/user of such goods and works (as the case may be) to be acquired, shall be represented on the relevant procurement committee. The criteria for the selection of procurement committee members shall in all cases be consistent with the provisions of the Procurement Guidelines and the Project Operational Manual (provided, however, that in the event of any inconsistency between the Project Operational Manual and the Procurement Guidelines, the provisions of the Procurement Guidelines shall apply).
2. The Procurement Plan, including all updates thereof; shall be made publicly available promptly after their finalization.
3. All bidding documents issued in accordance with Schedule 3 shall be made available to any member of the public promptly upon request, subject only to payment of a reasonable fee to cover the cost of printing and delivery. Each such document will continue to be made publicly available until a year after completion of the contract entered into for the goods and works in question.
4. In cases of pre-qualification, lists of pre-qualified contractors and suppliers shall be made available to any member of the public promptly upon request.
5. A summary of the evaluation of all bids for specific contracts shall be disclosed to all bidders and parties submitting proposals therefor, promptly after the notification of award to the successful bidder. Information in such summaries will be limited to a list of bidders, all bid prices and financial proposals as read out at public openings for bids and financial proposals, all bids declared non responsive (together with reasons for such an assessment), the name of winning bidder and the contract price. Such summaries will be made available to any member of the public promptly upon request.
6. Contract award information for all contracts for goods and works of \$100,000 equivalent or more shall be made publicly available and published widely, and be made available to any member of the public upon request, promptly after such award.
7. A list of all contracts awarded in the three (3) months preceding the date of such request, including, with respect to each such contract, the name of the contractor selected, the contract amount, the number of bidders in respect thereof, the procurement method

followed and the purpose of such contract shall be made available, promptly upon request by member of the public.

8. Representatives of the end-users of goods or works being procured shall be permitted to attend public bid openings in respect thereof.

**Annex B
to
SCHEDULE 3**

1. General

Subject to the provisions of Part B.1 of Section II to Schedule 3 to this Agreement, the procedures to be followed for national competitive bidding shall be those set forth in Presidential Decree No. 80/2003 of the Republic of Indonesia with the clarifications and modifications described in the following paragraphs required for compliance with the provisions of the “Guidelines for Procurement under IBRD Loans and IDA Credits” dated May 2004 (the “Guidelines”).

2. Registration

(a) Bidding shall not be restricted to pre-registered firms and shall not be a condition for participation in the bidding process.

(b) Where registration is required prior to award of contract, bidders: (i) shall be allowed a reasonable time to complete the registration process; and (ii) shall not be denied registration for reasons unrelated to their capability and resources to successfully perform the contract, which shall be verified through post-qualification.

3. Pre-qualification

Pre-qualification shall not be used for simple goods and works. Normally, post-qualification shall be used. Pre-qualification shall be required only for large or complex works with the prior ‘no objection’ of the Association. When pre-qualification shall be required:

(a) eligible bidders (both national and foreign) shall not be denied pre-qualification; and

(b) invitations to pre-qualify for bidding shall be advertised in at least one (1) widely circulated national daily newspaper a minimum of thirty (30) days prior to the deadline for the submission of pre-qualification applications.

4. Joint Ventures

A bidder declared the lowest evaluated responsive bidder shall not be required to form a joint venture or to sub-contract part of work or part of the supply of goods as a condition of award of the contract.

5. Preferences

(a) No preference of any kind shall be given to national bidders.

(b) Regulations issued by a sectoral ministry, provincial regulations and local regulations, which restrict national competitive bidding procedures to a class of contractors or a class of suppliers shall not be applicable to procurement procedures under the Development Credit Agreement.

6. Advertising

(a) Invitations to bid shall be advertised in at least one (1) widely circulated national daily newspaper allowing a minimum of thirty (30) days for the preparation and submission of bids and allowing potential bidders to purchase bidding documents up to twenty-four (24) hours prior the deadline for the submission of bids.

(b) Bid documents shall be made available, by mail or in person, to all who are willing to pay the required fee.

(c) Bidders domiciled outside the area/district/province of the unit responsible for procurement shall be allowed to participate regardless of the estimated value of the contract.

(d) Foreign bidders shall not be precluded from bidding. If a registration process is required, a foreign firm declared the lowest evaluated bidder shall be given a reasonable opportunity for registering.

7. Bid Security

Bid security, at the bidder's option, shall be in the form of a letter of credit or bank guarantee from a reputable bank.

8. Bid Opening and Bid Evaluation

(a) Bids shall be opened in public, immediately after the deadline for submission of bids, and if bids are invited in two (2) envelopes, both envelopes (technical and price) shall be opened at the same time.

(b) Evaluation of bids shall be made in strict adherence to the criteria declared in the bidding documents and contracts shall be awarded to the lowest evaluated bidder.

(c) Bidders shall not be eliminated from detailed evaluation on the basis of minor, non-substantial deviations.

(d) No bidder shall be rejected merely on the basis of a comparison with the owner's estimate and budget ceiling without the Association's prior concurrence.

9. Rejection of Bids

(a) All bids shall not be rejected and new bids solicited without the Association's prior concurrence.

(b) When the number of responsive bids is less than three (3), re-bidding shall not be carried out without the Association's prior concurrence.

SCHEDULE 4

Implementation Program

The provisions of this Schedule shall apply for the purposes of Section 3.01(b) of this Agreement.

1. The Borrower shall: (a) maintain until completion of the Project: (i) the National Steering Committee and the National Implementing Committee, each with functions and responsibilities acceptable to the Association; and (ii) the Project Secretariat with functions and responsibilities, and headed by a Project Manager with qualifications and experience, in each case acceptable to the Association; and (b) provide said Project Secretariat at all times with such facilities, staffing and funding as shall be necessary to accomplish its functions, responsibilities and objectives.

2. The Borrower, through MOHA, shall ensure that each Participating Kabupaten and Additional Participating Kabupaten shall: (a) establish and thereafter maintain until completion of the Project, with functions and responsibilities acceptable to the Association, a PMU; and (b) provide each said PMU at all times with adequate funds and other resources, and with qualified and experienced personnel in adequate numbers, acceptable to the Association and in all cases as shall be necessary to accomplish its functions, responsibilities and objectives.

3. The Borrower, through the National Steering Committee, shall ensure that the Project is carried out pursuant to the provisions of this Agreement and those of the Local Governance Reform Framework. In the event that a provision of the Local Governance Reform Framework shall be inconsistent with any provision of this Agreement, the provision of this Agreement shall prevail. For the purposes of ensuring that said framework at all times facilitates the attaining of the objectives of the Project, the Borrower, through the National Steering Committee, shall carry out regular reviews of said framework as part of, and in accordance with, its undertakings set forth in paragraph 11 of this Schedule 4. The Borrower shall not amend, suspend, abrogate or waive the Local Governance Reform Framework without the Association's agreement.

4. The Borrower, through MOHA, shall adopt and thereafter apply, and cause each Participating Kabupaten and Additional Participating Kabupaten to adopt (through a Surat Keputusan) and thereafter apply, a Project Operational Manual acceptable to the Association for the carrying out of the Project and their respective responsibilities therefore. Such Project Operational Manual shall include:

(a) the description of the institutional arrangements for carrying out the Project, including, without limitation: (A) the functions and responsibilities of those entities referred to in paragraphs 1 and 2 above of this Schedule 4; (B) the responsibilities for Project implementation of all relevant government (national and local) agencies within the Participating Kabupatens and Additional Participating Kabupatens; and (C) the

terms of reference of the management consultants referred to in paragraph 9 of this Schedule 4;

(b) the procurement procedures set out in Schedule 3 to this Agreement and in the Annexes thereto;

(c) standard procurement documentation;

(d) reporting requirements, financial management procedures and audit procedures as set out in Article 4 of this Agreement;

(e) the Project Performance Indicators set out in Schedule 5 to this Agreement;

(f) the Local Governance Reform Framework;

(g) the guidelines and procedures for preparing and adopting PRSAPs and the budgetary, financial management and procurement reform programs to be carried out under Part A of the Project; and

(h) the eligibility criteria and preparation, appraisal and selection procedures for Sub-projects, which criteria and procedures shall include those set out in Annex C to this Schedule 4 and the criteria (including standards), procedures and measures set out in the Safeguards Framework.

Except as the Association may otherwise agree, the Borrower shall not amend, suspend, abrogate or waive the Project Operational Manual or any part thereof.

5. Without limitation upon the provisions and requirements of the Project Operational Manual, the Borrower shall:

(a) ensure that only those Kabupatens that have met the eligibility criteria set forth in Annex A to this Schedule 4 and in the Project Operational Manual may participate in the Project as Participating Kabupatens and Additional Participating Kabupatens;

(b) make available Phase 1 Grants only to Participating Kabupatens that have met the eligibility criteria set forth in the Local Governance Reform Framework and in Part 1 of Annex B to this Schedule 4;

(c) make available Phase 2 Grants only to those Participating Kabupatens that have met the eligibility criteria set forth in the Local Governance Reform Framework and in Part 2 of Annex B to this Schedule 4;

(d) make available Phase 3 Grants only to those Participating Kabupatens that have met the eligibility criteria set forth in the Local Governance Reform Framework and in Part 3 of Annex B to this Schedule 4;

(e) ensure that only those investment projects: (i) which have met the eligibility criteria set forth in Part 1 of Annex C to this Schedule 4; (ii) for which a technical report has been issued in accordance with the provisions of Part 2 of Annex C to this Schedule 4; and (iii) which further meet and comply with the criteria and procedures set forth in the Project Operational Manual, qualify as Sub-projects and be financed out of the proceeds of the Credit;

(f) ensure that the proceeds of Grants shall not be used to finance the acquisition of land; and

(g) inform each Participating Kabupaten that all auditing activities with respect to Sub-projects are to be carried out exclusively by independent auditors appointed by the Project Secretariat in accordance with Section 4.01(b) of this Agreement and in accordance with the manual and terms of reference referred to in sub-paragraph (a) of paragraph 10 of this Schedule 4.

6. Without limitation upon the provisions of paragraph 5 of this Schedule 4, the Borrower shall only:

(a) declare: (i) a Kabupaten to be a Participating Kabupaten or an Additional Participating Kabupaten, as the case may be; and (ii) a Participating Kabupaten to be eligible for funding support through Phase 1 Grants, Phase 2 Grants or Phase 3 Grants, and

(b) make a Grant in respect of a Sub-project,

after certifying through the National Steering Committee to the Association in each case that the relevant eligibility criteria set forth in the Local Governance Reform Framework, this Schedule 4 and the Annexes thereto, and in the Project Operational Manual, have been met.

7. The Borrower shall, through MOHA, take all such action as shall be necessary to ensure that:

(a) not later than September 30 in each year, commencing September 30, 2005, and until completion of the Project, a draft annual work program for all components of the Project to be implemented during the following Fiscal Year (including, without limitation, all training and workshops to take place under Parts A and C of the Project during said year) is prepared and furnished to the Association for its review and comments, including: (i) the scope of the program; (ii) time-based implementation schedules; (iii) cost estimates; and (iv) budget arrangements; and

(b) not later than November 30 in each year, commencing November 30, 2005, finalize the above-mentioned work program, taking into account any such comments, and promptly thereafter carry out said action program.

8. Without limitation upon the requirements of the Local Governance Reform Framework, the Project Operational Manual or the provisions of paragraph 7 of this Schedule 4, in carrying out Part B of the Project, the Borrower shall ensure that each Participating Kabupaten applies the Safeguards Framework, including:

(a) taking all appropriate measures to avoid or minimize the acquisition of land or assets of people and to avoid the displacement of said people;

(b) where the acquisition of land or assets or the displacement of people is unavoidable under a proposed Sub-project, ensuring that all Displaced Persons thereunder shall have been compensated and provided with resettlement and rehabilitation measures prior to the implementation of such Sub-project and in accordance with the provisions of the Safeguards Framework;

(c) taking all such measures and actions set out in said Safeguards Framework for the elimination or offsetting of adverse environmental impacts under a proposed Sub-project, or the reduction of such impacts to acceptable levels; and

(d) taking all such measures as are necessary to:

(i) avoid adverse cultural, social and economic effects on Isolated Vulnerable People under a proposed Sub-project and, if not possible, take appropriate mitigating measures with respect to said effects; and

(ii) through a process of informed participation, involve concerned Isolated Vulnerable People in the design and implementation of Sub-projects so as to ensure that the benefits received by the Isolated Vulnerable People under such Sub-projects are in harmony with their economic, social and cultural preferences and protect their customary user rights.

9. For the purposes of Part C.1 of the Project, the Borrower shall engage national-level, regional-level and Kabupaten-level consultants, each with qualifications and experience and terms of reference satisfactory to the Association and in accordance with the provisions of the DFID Grant Agreement, which provisions are included in the Project Operational Manual, for the purpose of providing management and implementation support services under the Project and as described in the Project Operational Manual.

10. The Borrower shall ensure that auditing activities under the Project, including the audits referred to in Section 4.01 of this Agreement, are carried out in accordance with: (a) BPKP's audit manual dated April 13, 1999, as such manual may be amended from time to time with the prior agreement of the Association; and (b) in accordance with terms of reference approved by the Association.

11. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the indicators set forth in Schedule 5 to this Agreement, the appropriateness of the Local Governance Reform Framework in furthering the attainment of the objectives of the Project, the carrying out of the Project and the achievement of the objectives thereof;

(b) engage, in accordance with the provisions of Schedule 3 to this Agreement, by not later than July 31, 2006, consultants, each with terms of reference acceptable to the Association, for the purpose of carrying out: (a) independent monitoring of the Project, including the Local Government Reform Framework; and (b) independent evaluation of the Project, including the Local Government Reform Framework;

(c) prepare, under terms of reference satisfactory to the Association, and furnish to the Bank, by December 1 and June 1 of each year, commencing December 1, 2005, and until completion of the Project, a report integrating the results of the monitoring and evaluation activities performed pursuant to sub-paragraph (a) of this paragraph 11, on the progress achieved in the carrying out of the Project during the preceding six (6) months and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the six (6) months following such date, which measures shall include: (i) in each report due by December 1 in any year: (x) proposed modifications, where considered appropriate, to the Local Governance Reform Framework, for the Association's consideration and approval; and: (y) a detailed procurement plan for carrying out the Project during the next fiscal year following the date of such report; and (ii) in each report due by June 1 in any year, an update of the detailed procurement plan for the fiscal year in which such month falls;

(d) review with the Association, on or about January 2 and July 1 of each year, commencing January 2, 2006, or such later date as the Association shall request, the report referred to in sub-paragraph (c) of this paragraph 11, and, thereafter, take all measures required to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the twelve (12) months following the date of such report, based on the conclusions and recommendations of said report and the Association's views on the matter;

(e) prepare, under terms of reference satisfactory to the Association, and furnish to the Association, on or about December 31, 2007, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this paragraph 11, on the progress achieved in the carrying out of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date;

(f) review with the Association, by February 1, 2008, or such later date as the Association shall request, the report referred to in paragraph (e) of this paragraph 11, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Association's views on the matter; and

(g) make publicly available the report referred to in sub-paragraph (e) of this paragraph 11, at the same time as it is furnished to the Association pursuant to said sub-paragraph.

**Annex A
to
SCHEDULE 4**

A Kabupaten will become a Participating Kabupaten or an Additional Participating Kabupaten, as the case may be, upon the meeting of the eligibility criteria set out in the Local Governance Reform Framework, including the following criteria:

1. The Kabupaten is within the geographical boundaries of a Participating Province or an Additional Participating Province, as the case may be.
2. The Bupati and the chairperson of the DPRD of said Kabupaten have signed a joint letter addressed to the National Steering Committee confirming the commitment of the Kabupaten to participate in the Project and to: (a) undertake a program of governance reforms as identified and described in the Local Governance Reform Framework; (b) adopt the Project Operational Manual; (c) establish working groups for: (i) transparency and participation and (ii) poverty, each in accordance with the relevant terms of reference set out in the Project Operational Manual; (d) carry out a participatory poverty analysis and prepare and adopt a PRSAP in accordance with the guidelines and procedures set out in the Project Operational Manual; (d) provide access to the auditors appointed by the Borrower pursuant to the provisions of Section 4.01(b) of this Agreement in a manner that permits full and timely discharge of their mandate; and (e) ensure that adequate counterpart funds are made available for the carrying out of all Project activities to be carried out in said Kabupaten pursuant to the provisions of the Local Governance Reform Framework and the Project Operational Manual, including, with respect to Participating Kabupatens, all Sub-projects approved for funding under the Project in accordance with the provisions of Annex B to this Schedule 4 and of the Project Operational Manual.
3. The Bupati of said Kabupaten has issued one or more Surat Keputusan, in each case acceptable to the Association, that provide for: (a) the adoption of the Project Operational Manual and instructing each local government unit within said Kabupaten to apply said Manual to all Project activities (including, with respect to Participating Kabupatens, all Sub-projects) to be carried out in said Kabupaten by or under the supervision of said unit; (b) the implementation of the action program described in the Local Governance Reform Framework; (c) the establishment of a PMU; (d) the establishment of a financial management reforms committee with the membership identified in, and the relevant terms of reference set out in, the Project Operational Manual; and (e) the designation of a local government unit to assume the responsibilities for all procurement reforms to be carried out at the Kabupaten level under the Project, as such reforms are identified in the Local Governance Reform Framework and the Project Operational Manual.
4. An announcement has been made in a local newspaper with mass circulation or other suitable media, providing a summary of said Kabupaten's most recently adopted APBD, the most recent annual accountability speech of the Bupati of said Kabupaten,

and identifying times and locations at which official documents identified in the Local Governance Reform Framework are available to the public.

5. The Secretariat has certified in writing to the National Steering Committee that said Kabupaten has met all the eligibility criteria set forth in the Local Governance Reform Framework.

6. The National Steering Committee has certified to the Association pursuant to the provisions of paragraph 6 of Schedule 4 to this Agreement that said Kabupaten has met all the eligibility criteria set forth in the Local Governance Reform Framework.

**Annex B
to
SCHEDULE 4**

Part 1

A Participating Kabupaten shall only qualify for Phase 1 Grants where the Borrower, through the National Steering Committee, has certified to the Association, in accordance with the provisions of paragraph 6 to Schedule 4 to this Agreement, that the measures set forth in the Local Governance Reform Framework with respect to Phase 1 Grants have been undertaken by the relevant authorities/officials in said Participating Kabupaten in accordance with the criteria and standards set forth in said framework and in accordance with the relevant procedures set forth in the Project Operational Manual.

Part 2

A Participating Kabupaten shall only qualify for Phase 2 Grants where the Borrower, through the National Steering Committee, has certified to the Association, in accordance with the provisions of paragraph 6 to Schedule 4 to this Agreement, that the measures set forth in the Local Governance Reform Framework with respect to Phase 2 Grants have been undertaken by the relevant authorities/officials in said Participating Kabupaten in accordance with the criteria and standards set forth in said framework and in accordance with the relevant procedures set forth in the Project Operational Manual.

Part 3

A Participating Kabupaten shall only qualify for Phase 3 Grants where the Borrower, through the National Steering Committee, has certified to the Association, in accordance with the provisions of paragraph 6 to Schedule 4 to this Agreement, that the measures set forth in the Local Governance Reform Framework with respect to Phase 3 Grants have been undertaken by the relevant authorities/officials in said Participating Kabupaten in accordance with the criteria and standards set forth in said framework and in accordance with the relevant procedures set forth in the Project Operational Manual.

Annex C
to
SCHEDULE 4

Part 1

A. The Borrower shall make available Grants by entering into Grant Agreements with Participating Kabupatens on terms and conditions set forth in the Project Operational Manual.

B. The Borrower shall make available Grants to Participating Kabupatens only in respect of Sub-projects selected in accordance with the following criteria:

1. No Sub-project shall:

(a) include expenditures intended for a military or paramilitary purpose; (b) include civil works for government administration or religious purposes; (c) relate to the manufacture or use of environmentally hazardous goods (including asbestos, pesticides and herbicides), arms or drugs; (d) include the financing of government salaries; (e) relate to the production, processing, handling, storage or sale of tobacco or products containing tobacco; (f) relate to activities within a nature reserve or any other area designated by the Borrower for the management and/or the protection of biodiversity, except with the prior written approval of the Borrower's agency responsible for the management and/or protection of such area; (g) relate to mining or excavation of live coral; (h) relate to water resources development on rivers which flow into or out of another country; (i) relate to alterations to river courses; (j) relate to land reclamation larger than fifty (50) hectares; (k) relate to new irrigation larger than fifty (50) hectares; (l) relate to the construction of water retaining or storage structures of a capacity greater than ten thousand (10,000) cubic meters; (m) relate to chemical water treatment systems; (n) include expenditures for stand-alone motor pumps, electric pumps or generators; (o) relate to national or provincial roads or bridges; (p) relate to the construction of buildings for the police, armed forces, religious affairs or commercial financial activities; or (q) include the provision of micro-credits.

2. No proposed project shall qualify as a Sub-project if: (a) more than one hundred (100) persons would be displaced under said project; or (b) said project is assessed as requiring a full environmental assessment ("AMDAL") pursuant to the provisions of the Safeguards Framework.

3. Subject to the provisions of Part 1, paragraph 1, of this Annex C, each proposed Sub-project shall: (a) be a public infrastructure investment, public rehabilitation, social service investment or a natural resource management project which: (i) is technically, financially, environmentally and socially viable, and economically justified by the number of people benefiting from it and; (ii) is for expenditures for one or more of the items set forth on the Attachment to this Annex C; (b) address issues identified as

priorities in the Participating Kabupaten's PRSAP; and (c) have been proposed by the Participating Kabupaten for financing out of the proceeds of the Credit pursuant to an endorsement to that effect by the Musrenbang Kabupaten.

4. The APBD of the Participating Kabupaten shall include provision for the availability of sufficient funds to meet the entire estimated costs of the proposed Sub-project, including funding out of the proceeds of the Credit and counter-part funding.

5. The estimated cost of a proposed Sub-project shall not be less than Rp.300,000,000.

Part 2

Prior to the carrying out of works under a Sub-project, the relevant Regional Management Consultants shall have completed a technical review of such Sub-project and shall have confirmed in writing to the Project Secretariat the following:

- (i) the criteria described in Part 1 of this Annex C have been complied with;
- (ii) necessary funding to fully finance the proposed Sub-project has been obtained;
- (iii) appropriate engineering and environmental standards and practices that would minimize any acquisition of land and avoid involuntary resettlement of Displaced Persons have been considered in the design of the Sub-project in accordance with the Project Operational Manual and paragraph 2 of Part 1 of this Annex C;
- (iv) the provisions of the Safeguards Framework have been complied with, including, where applicable, the carrying out of appropriate compensation arrangements in accordance with said Framework;
- (v) an implementation plan for the Sub-project has been prepared in accordance with the provisions of the Project Operational Manual; and
- (vi) a maintenance program for the works to be carried out under the Sub-project and related goods has been prepared in accordance with the provisions of the Project Operational Manual.

Part 3

Participating Kabupatens:

Solok (West Sumatera), Tanah Datar (West Sumatera), Lebak (Banten), Bandung (West Java), Majalengka (West Java), Kebumen (Central Java), Magelang (Central Java), Bantul (Yogyakarta), Ngawi (East Java), Lamongan (East Java), Boalemo (Gorontalo), Bolaang Mongondow (North Sulawesi), Gowa (South Sulawesi), Takalar (South Sulawesi), and Bulukumba (South Sulawesi).

**Attachment to Annex C
to
SCHEDULE 4**

Expenditures for the construction or acquisition and installation of the following items are eligible for financing out of the proceeds of Grants in Sub-projects (and such other items as may be agreed between the Borrower and the Association in accordance with the eligibility criteria set out in the Project Operational Manual):

Water Supply Sub-projects

- Wells
- Water catchments/harvesting structures
- Ponds
- Water supply systems (including for public building and motor pumps and electric pumps) (non-revenue generating)
- Community water storage facilities
- Spring improvements (including simple water treatment systems)
- Community filtration systems
- Public taps (non-revenue generating)
- MCK (public bath rooms) (non-revenue generating)
- Community drainage systems

Energy Sub-projects

- Electricity distribution systems (non-revenue generating)
- Solar system generators (non-revenue generating)

Transportation Sub-projects

- Roads (earth, laterite surfaced, gravel surfaced, paved)
- Culverts
- Bridges

- Vented causeways
- Ferry/*rakit* facilities (non-revenue generating)
- Inland waterways improvements
- Bus stations/waiting areas (non-revenue generating)

Irrigation and Flood Protection Sub-projects

- Earth dams and reservoirs
- Spillways
- Canals and distribution systems
- Diversion structures
- Pumping station structures
- Drainage structures
- Flood protection structures/facilities

Natural Resource Management Sub-projects

- Erosion protection structures and facilities
- River bank protection structures and facilities

Community Facilities (non-revenue generating) Sub-projects

- Communal agricultural centers
- Communal training centers
- Communal libraries

SCHEDULE 5

Performance Indicators

Part A of the Project

By December 31, 2005:

- At least twelve (12) Kabupatens have met the entry requirements set forth in the Local Governance Reform Framework for participation in the Project as Participating Kabupatens.

By December 31, 2006:

- At least twelve (12) Kabupatens have finalized PRSAPs as set forth in the Project Operational Manual.
- Suitably staffed financial management reform committees have been established in at least twelve (12) Kabupatens and such Kabupaten committees have prepared a financial management reform action plan.
- At least twelve (12) Participating Kabupatens have established a focal point for procurement reform, and that the focal point has prepared an action plan to implement reform in Kabupaten procurement policies and procedures.

By December 31, 2007:

- At least forty (40) Kabupatens have met the entry requirements as set forth in the Local Governance Reform Framework for participation in the Project as Participating Kabupatens and Additional Participating Kabupatens.
- At least twelve (12) Kabupatens have issued local regulations on mechanisms for public consultation and access to information as set forth in the Project Operational Manual.

By December 31, 2008:

- At least twelve (12) Participating Kabupatens have fully implemented the local regulations on mechanisms for public consultation and access to information and twenty (20) Additional Participating Kabupatens have prepared such draft local regulations in accordance with the provisions of the Project Operational Manual.
- At least twelve (12) Participating Kabupatens have fully implemented PRSAPs and at least twenty (20) Additional Participating Kabupatens have finalized PRSAPs in accordance with the provisions of the Project Operational Manual.

- At least twelve (12) Participating Kabupatens have fully implemented their financial management reform action plans and at least twenty (20) Additional Participating Kabupatens have established suitably staffed financial management reform committees and such Kabupaten committees have prepared financial management reform action plans.
- At least twelve (12) Participating Kabupatens have fully implemented their procurement reform action plans and at least twenty (20) Additional Participating Kabupatens have established a focal point for procurement reform, and that the focal point has prepared an action plan to implement reform in Kabupaten procurement policies and procedures.

Part B of the Project

By December 31, 2006

- At least twelve (12) Participating Kabupatens have qualified for Phase 1 Grants and the implementation of at least twenty-four (24) Sub-projects funded out of said grants has commenced, each in accordance with appropriate technical, financial, procurement and environmental and social safeguards procedures as specified in the Project Operational Manual and the Safeguards Framework.

By December 31, 2007

- At least twelve (12) Participating Kabupatens have qualified for Phase 2 Grants and the implementation of at least twenty-four (24) Sub-projects funded out of said grants has commenced, each in accordance with appropriate technical, financial, procurement and environmental and social safeguards procedures as specified in the Project Operational Manual and the Safeguards Framework.

By December 31, 2008

At least twelve (12) Participating Kabupatens have qualified for Phase 3 Grants and the implementation of at least twenty-four (24) Sub-projects funded out of said grants has commenced, each in accordance with appropriate technical, financial, procurement and environmental and social safeguards procedures as specified in the Project Operational Manual and the Safeguards Framework.

Part C of the Project

By December 31, 2005

- At least eight (8) national-level consultants, thirty (30) regional-level consultants and twenty-four (24) Kabupaten-level facilitators have been recruited by the Project Secretariat to support project implementation, planning and monitoring.

- A project monitoring and evaluation system is in place and functioning.

By December 31, 2006

- At least eight (8) national-level consultants, forty-five (45) regional-level consultants and fifty-five (55) Kabupaten-level facilitators have been recruited by the Project Secretariat to support project implementation, planning and monitoring.

- A project monitoring and evaluation system is in place and functioning.

By December 31 2006

- Independent monitoring by non-governmental organizations and journalists is underway in Participating Kabupatens.

By December 31, 2007

- Mid-term Project evaluation is completed.

By December 31, 2008

- Forty (40) Participating Kabupatens and Additional Participating Kabupatens have received capacity development assistance in the core governance areas.
- Technical studies, surveys, assessment and evaluation are completed.
- Complaints received and resolved satisfactorily.

By March 31, 2009

- Final project evaluation is completed.