

CONFORMED COPY

LOAN NUMBER 7914-ID

Loan Agreement

(Local Government and Decentralization Project)

between

REPUBLIC OF INDONESIA

and

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

Dated June 23, 2010

LOAN AGREEMENT

AGREEMENT dated June 23, 2010, between REPUBLIC OF INDONESIA (“Borrower”) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (“Bank”).

The Borrower and the Bank hereby agree as follows:

ARTICLE I — GENERAL CONDITIONS; DEFINITIONS

- 1.01. The International Bank for Reconstruction and Development General Conditions for Loans, dated July 1, 2005 (as amended through February 12, 2008) (“General Conditions”) constitute an integral part of this Agreement.
- 1.02. Unless the context requires otherwise, the capitalized terms used in this Agreement have the meanings ascribed to them in the General Conditions, or in the Appendix to this Agreement.

ARTICLE II — LOAN

- 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, the amount of two hundred twenty million United States Dollars (US\$220,000,000), as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.07 of this Agreement (“Loan”), to assist in financing Part 1 of the project described in Schedule 1 to this Agreement (“Project”).
- 2.02. The Borrower may withdraw the proceeds of the Loan in accordance with Section IV of Schedule 2 to this Agreement.
- 2.03. The Front-end Fee payable by the Borrower shall be equal to one quarter of one percent (0.25%) of the Loan amount. The Borrower shall pay the Front-end Fee not later than sixty (60) days after the Effective Date.
- 2.04. The interest payable by the Borrower for each Interest Period shall be at a rate equal to LIBOR for the Loan Currency plus the Variable Spread; provided, that upon a Conversion of all or any portion of the principal amount of the Loan, the interest payable by the Borrower during the Conversion Period on such amount shall be determined in accordance with the relevant provisions of Article IV of the General Conditions. Notwithstanding the foregoing, if any amount of the Withdrawn Loan Balance remains unpaid when due and such non-payment continues for a period of thirty (30) days, then the interest payable by the

Borrower shall instead be calculated as provided in Section 3.02(d) of the General Conditions.

- 2.05. The Payment Dates are April 1 and October 1 in each year.
- 2.06. The principal amount of the Loan shall be repaid in accordance with the provisions of Schedule 3 to this Agreement.
- 2.07. (a) The Borrower may at any time request any of the following Conversions of the terms of the Loan in order to facilitate prudent debt management: (i) a change of the Loan Currency of all or any portion of the principal amount of the Loan, withdrawn or unwithdrawn, to an Approved Currency; (ii) a change of the interest rate basis applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding from a Variable Rate to a Fixed Rate, or vice versa; and (iii) the setting of limits on the Variable Rate applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding by the establishment of an Interest Rate Cap or Interest Rate Collar on the Variable Rate.
- (b) Any conversion requested pursuant to paragraph (a) of this Section that is accepted by the Bank shall be considered a “Conversion”, as defined in the General Conditions, and shall be effected in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.

ARTICLE III — PROJECT

- 3.01. The Borrower declares its commitment to the objective of the Project. To this end, the Borrower shall carry out the Project, through the Ministry of Finance, as the executing agency, in accordance with the provisions of Article V of the General Conditions, and BPKP shall carry out the Verification and Reimbursement Procedures in accordance with the VO Terms of Reference, and the Verification Arrangement.
- 3.02. Without limitation upon the provisions of Section 3.01 of this Agreement and except as the Borrower and the Bank shall otherwise agree, the Borrower shall ensure that the Project is carried out in accordance with the provisions of Schedule 2 to this Agreement.

ARTICLE IV — REMEDIES OF THE BANK

- 4.01. The Additional Events of Suspension consist of the following: (a) any of the DAK Implementing Regulations have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the implementation of

the Project; or (b) BPKP at any time shall have ceased to perform the function of the VO in accordance with the VO Terms of Reference or shall have failed to perform its obligations under the Verification Arrangement, without the Borrower having put in place replacement arrangements for verification satisfactory to the Borrower and the Bank; or (c) the TA Funds shall not have been made available in accordance with Section I.C of Schedule 2 to this Agreement in any Fiscal Year of Project implementation.

- 4.02. The Additional Events of Acceleration consist of the following: (a) the event specified in Section 4.01(a) of this Agreement occurs; or (b) the event specified in (b) or (c) of Section 4.01 of this Agreement occurs and is continuing for a period of sixty (60) days after notice of the event has been given by the Bank to the Borrower.

ARTICLE V — EFFECTIVENESS; TERMINATION

- 5.01. The Additional Conditions of Effectiveness consist of the following: (i) the Borrower, through the MOF, shall have adopted the Operations Manual, in form and substance satisfactory to the Borrower and the Bank, including the requirements of Section I.B.1 of Schedule 2 to this Agreement and shall have established the PIU in accordance with the requirements of Section I.A.1 of Schedule 2 to this Agreement; (ii) MPW shall have issued a Ministerial Circular Letter requiring the use of the Supplemental Technical Guidelines (Environmental and Social Safeguards) acceptable to the Borrower and the Bank to all Pilot Local Governments; and (iii) VO Terms of Reference have been agreed between the Borrower and BPKP, and between the Bank and BPKP, and BPKP and the Bank shall have entered into the Verification Arrangement.
- 5.02. The Effectiveness Deadline is the date ninety (90) days after the date of this Agreement.

ARTICLE VI — REPRESENTATIVE; ADDRESSES

- 6.01. The Borrower's Representative is the Minister of Finance of the Borrower.
- 6.02. The Borrower's Address is:

Ministry of Finance
c/o Directorate General of Debt Management
Jalan Lapangan Banteng Timur 2-4
Jakarta 10710
Indonesia

Cable address:	Telex:	Facsimile:
FINMINISTRY45799 Jakarta	DJMLN-IA 44319 DEPKEU-IA	(21) 381 2859

6.03. The Bank's Address is:

International Bank for Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:	Facsimile:
INTBAFRAD Washington, D.C.	248423(MCI) or 64145(MCI)	1-202-477-6391

AGREED at Jakarta, Republic of Indonesia, as of the day and year first above written.

REPUBLIC OF INDONESIA

By: /s/ Rahmat Waluyanto

Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By: /s/ Joachim von Amsberg

Authorized Representative

SCHEDULE 1

Project Description

The objective of the Project is to improve the accountability and reporting of the central government's Specific Purpose Grants (DAK) for the infrastructure sub-sectors within Pilot Local Governments.

The Project consists of the following parts:

Part 1: DAK Reimbursement

Reimbursing the Borrower for Outputs produced by Sub-projects undertaken by Pilot Local Governments financed by annual DAK Transfers and annual LG Contributions for road, water and sanitation, and irrigation.

Part 2: Institutional Strengthening for Central and Local Governments and Project Management Support

2.1. **Developing a Monitoring and Evaluation System.** Designing and implementing a monitoring and evaluation system for financial and technical/output reporting on DAK by: (i) strengthening MOF's monitoring of financial reports and building capacity of Pilot Local Governments in developing an integrated system of financial and physical reports that can be automatically generated and linked to the Borrower's existing systems; (ii) developing a strategy for monitoring and evaluation of DAK and building capacity in MPW and strengthening MPW's management information system to provide information on activities and physical outputs; and (iii) developing instruments to monitor progress and provide feedback on the quality of service delivery and implementation, and to detect problems for timely correction.

2.2. **Web-Based Monitoring and Reporting System.** (i) Expanding and enhancing MOF's web-based transfer monitoring system to become a Web-Based Reporting System, which will be used to report all transfers from MOF to Local Governments, including DAK allocations, disbursement of DAK transfers and verification of physical progress and Outputs; and (ii) making the Web-Based Monitoring and Reporting System accessible to and providing training in its use by MOF, Local Governments MPW, MOHA and BAPPENAS.

2.3. **Technical Assistance for Central and Local Governments.** Providing technical assistance and capacity building for: (i) strengthening of the operational institutional framework at the central level (other than with respect to development of a monitoring and evaluation system); and (ii) strengthening Local Governments' ability to meet requirements for DAK planning, usage and reporting.

2.4. **Project Management Support.** Provision of technical advisory services and other material support to strengthen the PIU and support the management of the incremental activities generated by the Project.

Part 3. Verification of Outputs. BPKP undertaking its own strengthening of capacity to conduct verification of Outputs, which includes technical (engineering), procurement, financial management and environmental and social safeguards.

SCHEDULE 2**Project Execution****Section I. Implementation Arrangements****A. Institutional Arrangements**

1. The Borrower, through MOF, shall:
 - (a) establish and maintain until completion of the Project, a steering committee comprising representatives of MOF, MPW, BAPPENAS and MOHA;
 - (b) establish and maintain, until completion of the Project, the PIU in the Directorate General of Fiscal Balance of MOF responsible for the management and monitoring of the Project, headed by a project manager and including qualified staff in adequate numbers (including a general coordinator and administrative support staff) and supported by expert consultants in the following areas: (i) an environmental-social-technical coordinator; (ii) a civil works monitoring/supervising engineer; (iii) a financial management specialist; and (iv) a procurement specialist, in each case with experience and qualifications acceptable to the Borrower and Bank;
 - (c) ensure that the PIU is at all times provided with adequate funds and other resources as shall be necessary to accomplish the objectives of the Project; and
 - (d) ensure that the PIU shall coordinate the management of the Project with designated staff in BPKP and MPW, in each case meeting the requirements of paragraphs (b) and (c) of this Section I.A of this schedule 2, respectively.
2. **BPKP**
 - (a) The Borrower shall maintain, until completion of the Project, an arrangement with BPKP pursuant to which MOF has requested and BPKP has agreed to undertake verification of Outputs for the Project in accordance with the VO Terms of Reference, which shall include the Verification and Reimbursement Procedures set out in paragraph 5 of Section I.B of this Schedule 2.

- (b) BPKP and the Bank shall enter into the Verification Arrangement pursuant to which BPKP shall undertake, until the completion of the Project, verification of Outputs for the Project in accordance with the VO Terms of Reference, including the Verification and Reimbursement Procedures set out in paragraph 5 of Section I.B of this Schedule 2.
- (c) The following institutional arrangements at BPKP are conditions for the Bank to provide any Advance Payment or Reimbursement to the Borrower under the Project. BPKP shall at all times during Project implementation, maintain adequate staffing arrangements (including in technical, procurement, financial management and environmental and social safeguards capacity) with qualified personnel, technical assistance consultants and/or arrangements with personnel of MPW or other agencies of the Borrower in order to accomplish the verification of Outputs in accordance with the VO Terms of Reference.

3. **MPW**

- (a) The Borrower shall ensure that MPW shall enter into an arrangement, with BPKP, satisfactory to the Bank, as necessary, to define and agree MPW's participation in verification activities conducted by BPKP in accordance with the VO Terms of Reference and Section I.A.2(c) of this Schedule 2, prior to BPKP commencing such verification activities for the first time.
- (b) The Borrower shall ensure that MPW shall, in consultation with the PIU and BAPPENAS, undertake monitoring and evaluation of the Project, including: (i) preparing annual monitoring and evaluation reports based on Outputs delivered by March 31 in each year of Project implementation; and (ii) with the PIU, conducting the mid-term review in accordance with paragraph 2 of Section II.A of this Schedule 2.
- (c) The Borrower shall ensure that, at all times during Project implementation, MPW shall maintain adequate staff and/or technical assistance consultants in adequate numbers and be provided at all times with adequate funds and other resources as shall be necessary: (i) in the Inspectorate General of MPW to undertake activities to support Verification of Outputs, including technical, environmental and social safeguards monitoring and evaluation of Sub-projects; and (ii) in the Secretary General of MPW, to support Pilot Local Governments in the technical, environmental and social safeguards planning and implementation of Sub-projects, in each case as necessary to accomplish the objective of the Project.

4. **Local Governments.** The Borrower, through the PIU, shall ensure that each Local Government shall submit a Commitment Letter to the PIU, satisfactory to the Bank, as a condition for such Local Government to participate in the Project as a Pilot Local Government. No Advance Payment or Reimbursement may be made with respect to any Local Government which has not entered into a Commitment Letter. Each Commitment Letter shall set out, inter alia:
- (a) the Pilot Local Government's obligations to: (i) deliver the Outputs in accordance with the financial and technical conditions and the standards for budgeting, planning, procurement, contract management and financial management set out in the Technical Guidelines; (ii) comply with environmental and social safeguards technical and reporting requirements set out in the Technical Guidelines and the Supplemental Technical Guidelines (Environmental and Social Safeguards); (iii) comply with the Anti-Corruption Guidelines applicable to recipients of Loan proceeds other than the Borrower and the Anti-Corruption Action Plan; (iv) monitor outputs, indicators, and comply with the reporting requirements applicable to each activity; (v) enable the required audits and the verification of the Outputs and performance conditions by BPKP; (vi) provide the LG Contribution; and (vii) enable the Borrower and the Bank to review the documents related to the Sub-projects and enter the sites to review the implementation of the Sub-projects; and
 - (b) the provision that in the event that any Sub-project is not implemented in accordance with the Technical Guidelines and the Supplemental Technical Guidelines (Environment and Social Safeguards), then Outputs from such Sub-project shall not be eligible for Advance Payment or Reimbursement.

B. Implementation Arrangements for Reimbursement

1. **Project Operations Manual.** The Borrower, through the PIU, shall:
- (a) adopt and, thereafter ensure that the Project is implemented in accordance with, an Operations Manual, acceptable to the Bank, which shall include: (i) the Technical Guidelines and the Supplemental Technical Guidelines (Environment and Social Safeguards) and safeguards compliance indicators form; (ii) restrict any Sub-project contract with value of \$400,000 or more equivalent; (iii) the Reference Unit Costs; (iv) the Eligibility Criteria for Outputs; (v) the VO Terms of Reference; (vi) the Verification and Reimbursement Procedures, including the method of Sample (which, except as may be otherwise

agreed in writing between the Borrower and the Bank, will include every Pilot Local Government and twenty percent (20%) of total contracts per Pilot Province), determination of Qualifying Percentage and calculation of Advance Payment and Reimbursement; (vii) the form of and requirements for Verification Reports; (viii) the Borrower's current annual DAK Transfer schedule; (ix) the form of Commitment Letter and a copy of each Commitment Letter after signature by MOF and the respective Pilot Local Government; (x) the Anti-Corruption Guidelines and the Anti-Corruption Action Plan; (xi) the procurement procedures set forth in Section III of this Schedule 2; (xii) reporting requirements, financial management procedures and audit procedures as set forth in Section II of this Schedule 2; (xiii) the Performance Indicators agreed between the Borrower and the Bank; and (xiv) the other implementation obligations set forth in this Schedule 2; and

(b) not amend, suspend, abrogate, repeal or waive any provisions of the Operations Manual without the prior written agreement of the Borrower and the Bank.

2. **Sub-project Technical Guidelines.** The Borrower, through the PIU and MPW, shall ensure that each Sub-project shall, at all times during Project implementation, be implemented by a Pilot Local Government in accordance with the planning, budgeting, engineering, procurement, financial management and social and environmental safeguards requirements as set out in the Technical Guidelines and the Supplemental Technical Guidelines (Environment and Social Safeguards). In the event that any Sub-project is not implemented in accordance with the Technical Guidelines and the Supplemental Technical Guidelines (Environment and Social Safeguards), then Outputs from such Sub-project shall not be eligible for Advance Payment or Reimbursement.
3. **Reference Unit Costs for Outputs Produced by Sub-projects.** The Borrower shall ensure that MPW shall provide to the Bank and BPKP a list of Reference Unit Costs for Outputs produced by Sub-projects acceptable to the Borrower and the Bank for each Fiscal Year of Project implementation by no later than February 15 of such Fiscal Year, starting with February 15, 2011. In the event that the Bank does not receive such acceptable list of Reference Unit Costs by February 15 of any Fiscal Year, then no Outputs from that Fiscal Year shall be eligible for Advance Payment or Reimbursement.
4. **Eligibility Criteria for Reimbursement of Outputs.** Outputs shall consist of measurable results produced by roads, irrigation and water and sanitation Sub-projects undertaken by Pilot Local Governments and financed by DAK Transfers and LG Contribution. The requirements for Outputs financed by DAK and LG Contribution to be eligible for Advance Payment or Reimbursement in any

Fiscal Year shall be included in the Operations Manual and shall at all times during Project implementation include the following, except as may be otherwise agreed in writing between the Borrower and the Bank.

- (a) The physical realization of Outputs is evidenced by construction completion certificates and compliance with technical specifications as set out in the Technical Guidelines.
- (b) The Sub-projects which produced the Outputs have been procured in compliance with the procurement provisions set out in Section III.B of this Schedule 2.
- (c) The Sub-projects which produced the Outputs are in compliance with environmental and social safeguards set out in the Supplemental Technical Guidelines (Environmental and Social Safeguards), as evidenced by a duly completed and satisfactory compliance indicators form in the form set out in the Operations Manual.
- (d) The Sub-projects which produced the Outputs were included on the list of Sub-projects that the Pilot Local Government submitted to BPKP for verification, from which list BPKP shall have selected a Sample of Sub-projects to verify and shall have carried out verification for technical and financial compliance in accordance with paragraph 5 of this Section.
- (e) The Sub-project was not for a contract value of \$400,000 or more equivalent.
- (f) The Sub-project which produced the Outputs were undertaken by a Pilot Local Government which has concluded a Commitment Letter.
- (g) Any Output that does not meet the Eligibility Criteria shall not be eligible for Advance Payment or Reimbursement.

5. **Output Verification and Reimbursement Procedures.** Reimbursement of Outputs (and confirmation of Advance Payment) is conditional upon the verification procedures set out below having been followed, except as may be otherwise agreed in writing between the Borrower and the Bank.

- (a) ***BPKP Verification Activities.*** BPKP shall verify the timeliness and accuracy of the financial and technical reports submitted, respectively, to MOF and MPW by Pilot Local Governments to ensure that Outputs have been achieved in compliance with the Technical Guidelines and the Supplemental Technical Guidelines (Environmental and Social Safeguards).

- (b) BPKP shall undertake the verification process during each Fiscal Year of Project implementation in accordance with the VO Terms of Reference in all Pilot Local Governments, in each case on a representative Sample basis, acceptable to the Borrower and the Bank.
- (c) BPKP shall complete and submit to the PIU a Verification Report, for each Fiscal Year of Project implementation in accordance with the VO Terms of Reference, by April 30 of the subsequent Fiscal Year (or such other date as may be agreed in writing between the Borrower and the Bank). The PIU shall submit the Verification Report to the Bank. Each Verification Report shall follow the template specified in the VO Terms of Reference, shall report on the compliance with Output Eligibility Criteria and shall propose the amount of Reimbursement for such Fiscal Year determined in accordance with the reimbursement procedures meeting the requirements of sub-paragraph (d) – (k) of this paragraph 5. The PIU shall use such report as the sole basis to request a Reimbursement.
- (d) ***DAK Transfers made by the Borrower to Pilot Local Governments.*** The Borrower shall annually allocate a total amount of DAK funds for Pilot Local Governments for each Fiscal Year of Project implementation in accordance with the schedule set out in the DAK Implementing Regulations, and shall notify the Bank of this amount by no later than March 31 in such Fiscal Year, commencing with March 31, 2011 (Annual DAK Allocation). MOF shall make payments of DAK funds (DAK Transfers) from the Borrower's budget to each Pilot Local Government in accordance with the DAK Regulations in each Fiscal Year of Project implementation.
- (e) ***Advance Payments against Outputs.*** The Borrower may request withdrawal of the proceeds of the Loan as an Advance Payment against Outputs in each Fiscal Year of Project Implementation, beginning with Outputs produced in Fiscal Year 2011. Each Advance Payment shall be subject to the procedures and conditions set out below, except as may be otherwise agreed in writing between the Borrower and the Bank.
 - (i) The amount of the Advance Payment in any Fiscal Year shall not exceed the sum of the Rupiah values of the first of the DAK Transfers made by MOF to each Pilot Local Government by March 31 in such Fiscal Year as such transfers are verified by BPKP, provided however that in no event shall the Advance Payment exceed thirty percent (30%) of the Annual DAK Allocation for that Fiscal Year.

(ii) The Advance Payment in any given Fiscal Year may be made prior to the verification of Outputs; provided, however that it is subject to set-off, as set out in sub-paragraph (g) of this paragraph, following the receipt by the Bank of the Verification Report for Outputs for that Fiscal Year to ensure that proceeds of the Loan are not disbursed in excess of the Value of Total Reimbursement for all Pilot Local Governments for that Fiscal Year.

(f) ***Reimbursement of Verified Outputs.*** The Borrower may request withdrawal of the proceeds of the Loan as a Reimbursement against Outputs in each Fiscal Year of Project implementation, beginning with Outputs produced in Fiscal Year 2011. Each Reimbursement shall be subject to the procedures and conditions set out below, except as may be otherwise agreed in writing between the Borrower and the Bank.

(i) BPKP shall verify that each Pilot Local Government has entered into a Commitment Letter.

(ii) BPKP shall verify that the Reference Unit Costs were provided by February 15 in the subject Fiscal Year.

(iii) BPKP shall list all Outputs reported by each Pilot Local Government by December 31 of the subject Fiscal Year.

(iv) BPKP shall calculate the **Value of Potential Reimbursement** for each Pilot Local Government by multiplying the volume of Outputs produced by Sub-projects undertaken by Pilot Local Government by their Reference Unit Costs.

(v) BPKP shall verify a Sample of the Sub-projects in each Pilot Local Government in accordance with the VO Terms of Reference to determine compliance with the Eligibility Criteria. Based on the Outputs in the Sample for each Pilot Local Government that meet the Eligibility Criteria, BPKP shall calculate the **Qualifying Percentage** for that Pilot Local Government for that Fiscal Year.

(vi) BPKP shall calculate the **Value of Qualifying Reimbursement** for each Pilot Local Government for that Fiscal Year by multiplying the Qualifying Percentage by the Value of Potential Reimbursement.

- (vii) BPKP shall calculate the **Value of Total Reimbursement** that may be made by the Bank to the Borrower for that Fiscal Year which shall be the sum of the Value of Qualifying Reimbursement for all Pilot Local Governments.
- (viii) BPKP shall calculate the **Value of Final Reimbursement** that may be made by the Bank to the Borrower for that Fiscal Year, by subtracting the Advance Payment made in that Fiscal Year from the Value of Total Reimbursement.
- (ix) BPKP shall calculate the **LG Reimbursement** for each Pilot Local Government by multiplying the Value of Qualifying Reimbursement for that Pilot Local Government for that Fiscal Year by ten percent (10%); it being understood that this percentage may, by prior written agreement between the Borrower and the Bank, be revised for the purposes of calculating the LG Reimbursement. Upon receipt by the Borrower of Reimbursement from the Bank in any Fiscal Year, the MOF shall transfer to each Pilot Local Government its respective LG Reimbursement.
- (x) Notwithstanding the foregoing, the Value of Total Reimbursement made by the Bank to the Borrower in any Fiscal Year shall in no event exceed the Annual DAK Allocation made by the Borrower for such Fiscal Year plus 10% (attributable to a portion of the LG Contribution).
- (g) **Set-Off.** In the event that the amount of the Advance Payment in any Fiscal Year exceeded the amount eligible for reimbursement by the Bank (the Value of Total Reimbursement) at the end of the Fiscal Year as set out in the Verification Report for that Fiscal Year, then the amount of the Advance Payment will be reduced in the subsequent Fiscal Year by the amount of overpayment in that Fiscal Year (Advance Payment minus Value of Total Reimbursement). The Bank may, by notice to the Borrower, reduce the amount of the Advance Payment, or decline to provide any Advance Payment, for any subsequent year of Project implementation in the event that this clause was invoked in any Fiscal Year.
- (h) **Review of Verification Reports.** Notwithstanding the foregoing provisions of this paragraph 5, the Bank retains the right to review any Verification Report and, based on such review, to not disburse, or to disburse a lesser amount of the proceeds of the Loan for, any particular requested Advance Payment or Reimbursement.

- (i) Without limiting the provisions of Article VII of the General Conditions, if the Bank shall have determined at any time that any Outputs did not comply with the Technical Guidelines or the Supplemental Guidelines (Environmental and Social Safeguards) or that a Pilot Local Government has failed to deliver all the Outputs of a Sub-project, the Bank may at that time: (A) in any year of Project implementation except the last year, offset future Advance Payments and/or Reimbursements by the amount equal to the amount of Loan proceeds disbursed to finance Outputs not delivered by such Pilot Local Government; or (B) obtain a refund to the Bank from the Borrower of an amount equal to the amount of Loan proceeds disbursed to finance Outputs not delivered by such Pilot Local Government. Refunds to the Bank pursuant to sub-paragraph (B) shall be credited to the Loan Account for subsequent withdrawal or for cancellation in accordance with the provisions of this Agreement, including the General Conditions.
- (j) The Verification Report shall provide reasonable details satisfactory to the Borrower and the Bank of any cases of corrupt practice, collusive practice, fraudulent practice, coercive practice or obstructive practice (in each case as defined in the Anti-Corruption Guidelines) which come to BPKP's attention in the carrying out of the activities set out in the VO Terms of Reference.
- (k) ***Provision of TA Funds.*** Notwithstanding the foregoing provisions of this paragraph 5:
 - (i) if either of the PIU or BPKP has not provided to the Bank the Work Plan and documentation of TA Funds for the period July 1 – December 31, 2010 in accordance with paragraph 2(a) or (b), respectively, of Section I.C of this Schedule, then the Bank will not make any Advance Payment or Reimbursement for Outputs produced in Fiscal Year 2011; and
 - (ii) for each Fiscal Year beginning with Fiscal Year 2011, if either of the PIU or BPKP has not provided the Work Plan and documentation of TA Funds or BPKP budget in accordance with paragraph 3(a) or (b), respectively, of Section I.C of this Schedule, then the Bank will not make any Advance Payment or Reimbursement for Outputs produced in such Fiscal Year.

C. Implementation Arrangements for Part 2 and Part 3 of the Project

1.
 - (a) Except as may be otherwise agreed in writing between the Borrower and the Bank, the Borrower shall make available TA Funds in an amount equal to not less than \$8,500,000 equivalent over the period of Project implementation on the schedule agreed between the Borrower and the Bank in accordance with this paragraph for the purpose of carrying out the activities under Part 2 of the Project.
 - (b) The TA Funds referred to in the foregoing sub-paragraph (a) exclude the capacity building requirements of BPKP. BPKP shall provide the budget and staffing requirement for its own capacity activities under Part 3 of the Project, which shall be as set out in the VO Terms of Reference and agreed between BPKP and MOF and between BPKP and the Bank.
2.
 - (a) The Borrower, through the PIU, shall submit to the Bank by the date which is no later than 30 days after the Effectiveness Date, a Work Plan, satisfactory to the Borrower and the Bank, for Project-related activities to be undertaken by MOF (Project management and support to Local Governments), and MPW (evaluation and verification support activities and support to Local Governments) for the period July 1 – December 31, 2010. Such plan shall include the needs assessment, work plan, staffing and procurement plan and terms of reference and TA Funds budget, as evidenced by revised DIPA for each such agency.
 - (b) In accordance with the VO Terms of Reference, BPKP shall submit to the Bank, by the date which is no later than 30 days after the Effectiveness Date, a Work Plan, satisfactory to the Bank, for verification activities, including technical and environmental and social safeguards capacity, for the period July 1 – December 31, 2010. Such plan shall include the needs assessment, work plan, staffing, procurement plan and BPKP budget.
3.
 - (a) The Borrower, through the PIU, shall submit to the Bank, by no later than October 31 of each Fiscal Year (beginning with October 31, 2010), a Work Plan, satisfactory to the Borrower and the Bank, for Project-related activities to be undertaken by MOF (Project management and support to Local Governments), and MPW (verification support activities and support to Local Governments) for the upcoming Fiscal Year. Such plan shall include the needs assessment, work plan, staffing and procurement plan and terms of reference and TA Funds budget, as evidenced by the SAPSK budget document, for each such agency. The PIU shall also, at the request of the Bank, provide evidence of the TA Funds of each such agency in the DIPA during the subject Fiscal Year.

- (b) In accordance with the VO Terms of Reference, BPKP shall submit to the Bank, by no later than October 31 of each Fiscal Year (beginning with October 31, 2010), a Work Plan, satisfactory to the Bank, for verification activities, including technical and environmental and social safeguards capacity, for the upcoming Fiscal Year. Such plan shall include the needs assessment, work plan, staffing, procurement plan and BPKP budget.

- 4. **Web-Based Monitoring and Reporting System.** In carrying out Part 2.2 of the Project, the Borrower, through the PIU, shall develop the Web-Based Monitoring and Reporting System under terms of reference and with specifications acceptable to the Borrower and the Bank to increase transparency of and access to information regarding allocation and transfer of DAK by the Borrower and contribution to, disbursement of and outputs from DAK by the Local Governments, including providing public access to information.

D. Environmental and Social Safeguards

- 1. The Borrower shall take all actions necessary to ensure that each Pilot Local Government shall undertake Sub-projects in accordance with the Supplemental Technical Guidelines (Environmental and Social Safeguards) setting out requirements for Sub-projects in Pilot Local Governments, including:
 - (a) avoiding and, if it is unavoidable, limiting land acquisition and resettlement;
 - (b) setting forth the measures and actions to be taken during the implementation of the Project for the provision of compensation, rehabilitation and resettlement assistance to Displaced Persons, including the requirement to submit a land acquisition and resettlement action plan (LARAP) and/or the Indigenous Peoples Plan (IPP), satisfactory to the Borrower and the Bank, to the local planning agency (BAPPEDA) for approval prior to submission of the Sub-project to be proposed for DAK financing during the planning and programming stage;
 - (c) setting forth the measures and actions to be taken during the implementation of the Project for: (i) the informed involvement of Indigenous Peoples or Isolated Vulnerable Peoples, through a process of free, prior and 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 (ii) designing and implementing measures to provide benefits which are socially and culturally acceptable to them, and reduce, mitigate and offset adverse impacts of Sub-projects;

- (d) setting forth the measures and actions to be taken during the implementation of the project for: (i) identifying potential adverse environmental and social impacts and safeguard instruments required through an environmental screening process and social assessment; and (ii) designing environmental management and monitoring measures to prevent, minimize, or mitigate potential adverse environmental and social impacts and to enhance positive impacts;
- (e) setting forth the negative list of types of Sub-projects the Outputs of which shall not be eligible for Advance Payment or Reimbursement out of the Proceeds of the Loan, including, without limitation, each as defined in the Supplemental Guidelines (Environmental and Social Safeguards):
 - (i) Sub-projects using or producing ozone-depleting substances, pesticides, tobacco or tobacco products;
 - (ii) Sub-projects using or producing, storing or transporting hazardous materials (toxic, corrosive or explosive) or generating "B3" (hazardous) wastes;
 - (iii) Sub-projects located in a Protected Area or that may change the purpose and/or designation of a Protected Area;
 - (iv) Sub-projects involving conversion of critical natural habitat;
 - (v) Sub-projects that would degrade or damage cultural property, including not only physical artifacts and structures but also sites considered sacred or otherwise having spiritual importance; or
 - (vi) Sub-projects for new swamp reclamation network or continuation of existing swamp reclamation network; and
- (f) additional procedures for monitoring, reporting and evaluation of environmental management and social safeguard plans, and monitoring measures to prevent, minimize, or mitigate potential adverse environmental and social impacts, as specified in the Supplemental Guidelines (Environmental and Social Safeguards).

The Supplemental Guidelines (Environmental and Social Safeguards) may be amended from time to time with the prior written agreement of the Bank and the Borrower.

E. Anti-Corruption

The Borrower shall ensure that the Project is carried out in accordance with the provisions of the Anti-Corruption Guidelines and the Anti-Corruption Action Plan.

Section II. Project Monitoring, Reporting and Evaluation**A. Project Reports**

1. The Borrower, through the PIU, shall monitor and evaluate the progress of the Project and prepare Project Reports in accordance with the provisions of Section 5.08 of the General Conditions and on the basis of Performance Indicators agreed with the Bank. Each Project Report shall cover the period of one (1) calendar quarter, and shall be furnished to the Bank not later than forty-five (45) days after the end of the period covered by such report. Project Reports shall include reporting required by the Technical Guidelines (Environmental and Social Safeguards).
2. The Borrower, through the PIU, shall prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, by no later than December 31, 2012, a mid-term report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph 1 of this Section II.A, 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.

B. Financial Management, Financial Reports and Audits

1. The Borrower, through the PIU, shall maintain or cause to be maintained a financial management system in accordance with the provisions of Section 5.09 of the General Conditions.
2. The Borrower, through the PIU, shall prepare and furnish to the Bank as part of the Project Report not later than forty-five (45) days after the end of each calendar quarter, interim unaudited financial reports for the Project covering the quarter, in form and substance satisfactory to the Bank.
3. The Borrower, through the PIU, shall have its Financial Statements audited in accordance with the provisions of Section 5.09(b) of the General Conditions. Each audit of the Financial Statements shall cover the period of one (1) fiscal year of the Borrower. The audited Financial Statements for each such period shall be furnished to the Bank not later than six (6) months after the end of such period.

Section III. Procurement

A. General

1. **Goods, Works and Services other than Consultants' Services.** All goods, works and services other than consultants' services required for the Project and to be financed out of the proceeds of the Loan shall be procured in accordance with the requirements set forth or referred to in Section I (excluding paragraph 1.16) of the Procurement Guidelines, and with the provisions of this Section.
2. **Definitions.** The capitalized terms used below in this Section to describe particular procurement methods or methods of review by the Bank of particular contracts refer to the corresponding method described in the Procurement Guidelines.

B. Particular Methods of Procurement of Goods, Works and Services other than Consultants' Services

1. **Performance-Based Procurement.** Contracts for goods, works and services other than consultants' services shall be awarded in accordance with paragraph 3.14 of the Procurement Guidelines, using competitive procurement methods acceptable to the Bank..

C. Review by the Bank of Procurement Decisions

All contracts shall be subject to Post Review by the Bank.

D. Improvement of Procurement Systems by Pilot Local Governments

1. The Borrower, through the PIU, shall ensure that each Pilot Local Government shall undertake procurement for Sub-projects through its respective procurement services unit (ULP). The Borrower shall ensure that: (a) no later than December 31, 2011, a decree for establishing the ULP has been issued by each Participating Local Government Dinas head; (b) by no later than December 31, 2012, each such ULP has been properly staffed and budgeted; and (c) by no later than December 31, 2012, all procurement using DAK funds shall be carried out in each Participating Local Government by its respective ULP.
2. The Borrower, through the PIU, shall ensure that each Pilot Local Government shall develop an annual procurement plan stating at least the following information: contract packages and amount, procurement methods, and procurement schedule prior to commencing any procurement process. The Borrower shall have adopted a template for such procurement plan acceptable to the Borrower and the Bank by December 31, 2011.

3. The Borrower, through the PIU, shall ensure that each of the procurement plans referred to in paragraph 1 of this Section D, together with documents pertaining to the procurement and contracting process, shall be retained in the Pilot Local Government's files and shall be subject to review by BPKP as the VO, and a copy of which, shall, at the request of the Bank, be provided to the Bank.

Section IV. Withdrawal of Loan Proceeds

A. General

1. The Borrower may withdraw the proceeds of the Loan in accordance with the provisions of Article II of the General Conditions, this Section, and such additional instructions as the Bank shall specify by notice to the Borrower (including the "World Bank Disbursement Guidelines for Projects" dated May 2006, as revised from time to time by the Bank and as made applicable to this Agreement pursuant to such instructions), to finance Eligible Expenditures as set forth in the table in paragraph 2 below.
2. The following table specifies the categories of Eligible Expenditures that may be financed out of the proceeds of the Loan ("Category"), the allocation of the amounts of the Loan to each Category, and the percentage of expenditures to be financed for Eligible Expenditures in each Category.

Category	Amount of the Loan Allocated (expressed in USD)	Percentage of Expenditures to be Financed (inclusive of Taxes)
(1) Payments for Outputs of Sub-projects under Part 1 of the Project	220,000,000	100% of the Value of Total Reimbursement
TOTAL AMOUNT	220,000,000	

B. Withdrawal Conditions; Withdrawal Period

1. Notwithstanding the provisions of Part A of this Section, no withdrawal shall be made from the Loan Account until the Bank has received payment in full of the Front-end Fee.

2. Notwithstanding the provisions of Part A of this Section, no withdrawal shall be made for any Outputs produced prior to January 1, 2011.
3. For each Fiscal Year of Project implementation, the Borrower agrees that it shall not submit any application for withdrawal for that Fiscal Year unless:
 - (a) the Bank has received a Verification Report for that Fiscal Year in accordance with the VO Terms of Reference, acceptable to the Borrower and the Bank;
 - (b) the Borrower has made the TA Funds for such Fiscal Year available in accordance with paragraphs 2 and 3 of Section I.C of this Schedule 2; and
 - (c) BPKP remains the VO for that Fiscal Year, the VO Terms of Reference remain in effect as between BPKP and MOF, and BPKP and the Bank, respectively, and the requirements stipulated in Section I.A.2(c) of this Schedule 2 are fulfilled as of the date of the withdrawal request.
4. The Closing Date is June 30, 2014.

SCHEDULE 3

Amortization Schedule

1. The following table sets forth the Principal Payment Dates of the Loan and the percentage of the total principal amount of the Loan payable on each Principal Payment Date (“Installment Share”). If the proceeds of the Loan have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined by the Bank by multiplying: (a) Withdrawn Loan Balance as of the first Principal Payment Date; by (b) the Installment Share for each Principal Payment Date, such repayable amount to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

Principal Payment Date	Installment Share (Expressed as a Percentage)
October 1, 2019	2.17
April 1, 2020	2.22
October 1, 2020	2.28
April 1, 2021	2.34
October 1, 2021	2.40
April 1, 2022	2.46
October 1, 2022	2.52
April 1, 2023	2.58
October 1, 2023	2.64
April 1, 2024	2.71
October 1, 2024	2.78
April 1, 2025	2.85
October 1, 2025	2.92
April 1, 2026	2.99
October 1, 2026	3.07
April 1, 2027	3.14
October 1, 2027	3.22
April 1, 2028	3.30
October 1, 2028	3.38
April 1, 2029	3.47
October 1, 2029	3.56
April 1, 2030	3.65
October 1, 2030	3.74
April 1, 2031	3.83
October 1, 2031	3.93

April 1, 2032	4.02
October 1, 2032	4.12
April 1, 2033	4.23
October 1, 2033	4.33
April 1, 2034	4.44
October 1, 2034	4.71

2. If the proceeds of the Loan have not been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined as follows:
- (a) To the extent that any proceeds of the Loan have been withdrawn as of the first Principal Payment Date, the Borrower shall repay the Withdrawn Loan Balance as of such date in accordance with paragraph 1 of this Schedule.
 - (b) Any amount withdrawn after the first Principal Payment Date shall be repaid on each Principal Payment Date falling after the date of such withdrawal in amounts determined by the Bank by multiplying the amount of each such withdrawal by a fraction, the numerator of which is the original Installment Share specified in the table in paragraph 1 of this Schedule for said Principal Payment Date (“Original Installment Share”) and the denominator of which is the sum of all remaining Original Installment Shares for Principal Payment Dates falling on or after such date, such amounts repayable to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.
3. (a) Amounts of the Loan withdrawn within two (2) calendar months prior to any Principal Payment Date shall, for the purposes solely of calculating the principal amounts payable on any Principal Payment Date, be treated as withdrawn and outstanding on the second Principal Payment Date following the date of withdrawal and shall be repayable on each Principal Payment Date commencing with the second Principal Payment Date following the date of withdrawal.
- (b) Notwithstanding the provisions of sub-paragraph (a) of this paragraph, if at any time the Bank adopts a due date billing system under which invoices are issued on or after the respective Principal Payment Date, the provisions of such sub-paragraph shall no longer apply to any withdrawals made after the adoption of such billing system.

4. Notwithstanding the provisions of paragraphs 1 and 2 of this Schedule, upon a Currency Conversion of all or any portion of the Withdrawn Loan Balance to an Approved Currency, the amount so converted in the Approved Currency that is repayable on any Principal Payment Date occurring during the Conversion Period, shall be determined by the Bank by multiplying such amount in its currency of denomination immediately prior to the Conversion by either: (i) the exchange rate that reflects the amounts of principal in the Approved Currency payable by the Bank under the Currency Hedge Transaction relating to the Conversion; or (ii) if the Bank so determines in accordance with the Conversion Guidelines, the exchange rate component of the Screen Rate.
5. If the Withdrawn Loan Balance is denominated in more than one Loan Currency, the provisions of this Schedule shall apply separately to the amount denominated in each Loan Currency, so as to produce a separate amortization schedule for each such amount.

APPENDIX**Section I. Definitions**

1. “Advance Payment” means the amount of the proceeds of the Loan that may be withdrawn by the Borrower from Category 1 of the table in Section IV.A of Schedule 2 to this Agreement against expected Outputs for a particular Fiscal Year during Project implementation, calculated in accordance with paragraph 5(e) of Section I.B of Schedule 2 to this Agreement (as some of these expressions are defined hereafter).
2. “Annual DAK Allocation” means the allocation made in the Borrower’s national budget (APBN) in each Fiscal Year of Project implementation for DAK Transfers to Pilot Local Governments (as some of these expressions are defined hereafter).
3. “Anti-Corruption Action Plan” means the Borrower’s plan, included in the Operations Manual, designed to integrate the contents of the Anti-Corruption Guidelines and to give effect thereto, and giving details of a program of actions, measures and policies designed to reduce or eliminate fraud and corruption in all its forms under the Project, including: enhanced information disclosure provisions; expansion and enhancement of Web-Based Monitoring and Reporting System for allocation and transfer of DAK by the Borrower and contribution to, disbursement of and outputs from DAK by the Local Governments; civil society oversight provisions focused on awareness and possibilities for use of the Web-Based Reporting System; and a complaint handling mechanism, focused on establishment and integration of a complaints handling system into the Web-Based Reporting System; and an appropriate regime of sanctions and remedies, as applicable to each Sub-project, as the Anti-Corruption Action Plan may be updated from time to time by written agreement between the Borrower and the Bank (as some of these expressions are defined hereafter).
4. “Anti-Corruption Guidelines” means the “Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants”, dated October 15, 2006.
5. “APBN” means *Anggaran Pendapatan Belanja Negara*, the Borrower’s national budget in any given Fiscal Year (as some of these expressions are defined hereafter).
6. “BAPPENAS” means *Badan Perencanaan Pembangunan Nasional*, the Borrower’s National Development Planning Agency, and any successor thereto.

7. “BPKP” means *Badan Pengawasan Keuangan dan Pembangunan*, the Borrower’s Financial and Development Supervisory Board, or any successor thereto as may be agreed in writing between the Borrower and the Bank for the purposes of the Project.
8. “Category” means a category set forth in the table in Section IV of Schedule 2 to this Agreement.
9. “Circular” means an instruction to be issued by the Minister of Public Works with respect to the Supplemental Technical Guidelines (Environment and Social Safeguards).
10. “Commitment Letter” means each letter to be submitted by each Pilot Local Government to the PIU setting forth the obligations in the implementation of Sub-projects in accordance with paragraph 4 of Section I.A of Schedule 2 to this Agreement.
11. “DAK” means *Dana Alokasi Khusus*, or central government’s specific purpose grants, the Borrower’s system of inter-governmental transfers to Pilot Local Governments to fund investment expenditures considered to be national priorities of the Borrower as listed in the Technical Guidelines.
12. “DAK Implementing Regulations” means, collectively, the regulations pursuant to which the DAK is budgeted, allocated and implemented pursuant to: (a) Government Regulation No. 55/2005 on Balance Funds, pursuant to which the Ministry of Finance must provide the DAK allocation for a given Fiscal Year within two (2) weeks of the issuance of the APBN and pursuant to which MPW must issue technical guidelines to govern implementation of DAK in the infrastructure sector; (b) PMK 21/PMK.07/2009 on Implementation and Accountability of Transfer to Regions Fund; (c) the Technical Guidelines; and (d) the Supplemental Guidelines (Environmental and Social Safeguards), as such regulations may be supplemented or amended from time to time.
13. “DAK Transfer” means a transfer by the Borrower of DAK funds to a Pilot Local Government for infrastructure in accordance with the DAK Implementing Regulations, including the schedule and number of transfers to be made in any Fiscal Year; and “DAK Transfers” means more than one DAK Transfer.
14. “Dinas” means each Local Government (as defined hereafter) public works department.
15. “DIPA” means *Daftar Isian Pelaksanaan Anggaran*, a government budget document.

16. “Displaced Person” means a person who, on account of the execution of the Project, has experienced or would experience direct economic and social impacts caused by: (a) the involuntary taking of land, resulting in: (i) relocation or loss of shelter; (ii) loss of assets or access to assets; or (iii) loss of income sources or means of livelihood, whether or not such person must move to another location; or (b) 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.
17. “Eligibility Criteria” means the criteria for determining Outputs set out in paragraph 4 of Section I.B of Schedule 2 to this Agreement.
18. “Fiscal Year” and “FY” means the Borrower’s fiscal year commencing January 1 and ending December 31.
19. “General Conditions” means the “International Bank for Reconstruction and Development General Conditions for Loans”, dated July 1, 2005 (as amended through February 12, 2008).
20. “Indigenous People or Isolated Vulnerable People” 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.
21. “Kabupaten” means a district, an administrative division of the Borrower.
22. “Kota” means an urban district, an administrative division of the Borrower.
23. “LG Contribution” means the funds required to be contributed by a Local Government toward activities for which a Local Government uses DAK Transfers received by it from the Borrower.
24. “LG Reimbursement” means the portion of a Reimbursement made by the Bank to the Borrower which is attributable to a Pilot Local Government and which shall be transferred by MOF to the Pilot Local Government in as set out in paragraph 5(f)(ix) of Section I.B of Schedule 2 to this Agreement.
25. “Local Government” or “LG” means a government of a Kabupaten, Kota or Province.
26. “Ministry of Finance” and “MOF” means the Borrower’s Ministry of Finance, and any successor thereto.

27. “Ministry of Home Affairs” and “MOHA” means the Borrower’s Ministry of Home Affairs and any successor thereto.
28. “Ministry of Public Works” and “MPW” means the Ministry of Public Works of the Borrower, and any successor thereto.
29. “Operations Manual” means the manual to be adopted by the Borrower, through MOF, pursuant to Section 5.01(i) of this Agreement and to be used by the Borrower in implementing the Project, meeting the requirements of paragraph 1 of Section I.B of Schedule 2 to this Agreement, and such expression includes all schedules and annexes to said manual; as such Operations Manual may be amended or updated from time to time with the prior written agreement of the Bank and the Borrower.
30. “Output” means any of the units referred to in that constitute a Sub-project (e.g., kilometers or other units of measurement) meeting the Eligibility Criteria and meeting the requirements to be financed out of the proceeds of the Loan in accordance with this Agreement and verified by BPKP, as set forth in paragraphs 2 – 5 of Section I.B of Schedule 2 to this Agreement; and “Outputs” means more than one Output.
31. “Part” means a part of the Project described in Schedule 1 to this Agreement.
32. “Performance Indicators” means the performance indicators for the Project agreed between the Borrower and the Bank through letter dated as of the date of this Agreement, as such indicators may be revised from time to time with the written agreement of the Borrower and the Bank.
33. “Pilot Local Government” means the government of each Pilot Province and of each Kabupaten and Kota in a Pilot Province which has entered into a Commitment Letter, and which shall carry out, or cause to be carried out, a Sub-project in accordance with this Agreement and the Technical Guidelines and the Supplemental Technical Guidelines (Environmental and Social Safeguards), and “Pilot Local Governments” means more than one Pilot Local Government.
34. “Pilot Province” means each of the five Provinces in the Project: Jambi, East Java, Central Kalimantan, West Sulawesi and North Maluku, as such list of Pilot Provinces may be changed from time to time by prior written agreement of the Borrower and the Bank, it being understood that any such change must be agreed prior to January 1 in any Fiscal Year in order for such change to be applied to such Fiscal Year and “Pilot Provinces” means more than one Pilot Province.

35. “PIU” means the central-level Project management unit established in the Directorate General of Fiscal Balance of MOF and operating in accordance with paragraph 1 of Section I.A of Schedule 2 to this Agreement.
36. “PMK” means a *Peraturan Menteri Keuangan*, a regulation issued by the Ministry of Finance.
37. “Procurement Guidelines” means the “Guidelines: Procurement under IBRD Loans and IDA Credits” published by the Bank in May 2004 and revised in October, 2006.
38. “Protected Areas” means those areas identified in the Minister of the State for the Environment Decree Number KEP-11/MENLH/2006, entitled “Concerning the Types of Businesses Activities Required to Complete an Environmental Impact Assessment and including: forest protection areas; marine/freshwater conservation areas; nature tourism parks; areas surrounding lakes and reservoirs; coastal mangrove areas; national parks; coastal edges; forest parks; cultural reserves; areas surrounding springs; scientific research areas; and nature conservation areas.
39. “Province” means an administrative sub-division of the Borrower’s territory at the first level below the national level.
40. “Qualifying Percentage” means, for each Pilot Local Government in each Fiscal Year, the percentage of compliance with the Eligibility Criteria for Outputs produced by Sub-projects undertaken by that Pilot Local Government and verified on a Sample basis by BPKP in accordance with paragraph 5 of Section I.B of Schedule 2 to this Agreement.
41. “Reference Unit Cost” means the cost of goods, works, non-consultant services and consultant services required to produce units of Outputs, acceptable to the Borrower and the Bank, to be notified by MPW to the Bank and to BPKP by February 15 of each Fiscal Year of Project Implementation and included in the Operations Manual.
42. “Reimbursement” means an amount of the proceeds of the Loan that may be withdrawn by the Borrower from Category 1 of the table in Section IV.A of Schedule 2 to this Agreement against verified Outputs in accordance with this Agreement, which shall not exceed in any Fiscal Year the Value of Total Reimbursement for that Fiscal Year.
43. “Rupiah” and “Rp” means the currency of the Borrower.

44. “Sample” means the method, to be set out in the VO Terms of Reference and agreed by the Bank, by which BPKP shall review an agreed sub-set of Pilot Local Government’s Sub-projects and Outputs produced using the proceeds of DAK Transfers from the Borrower to the Pilot Local Government and from the Pilot Local Government’s LG Contribution.
45. “SAPSK” means *Satuan Anggaran Per Satuan Kerja*, the government’s Borrower’s budget approval document at the work unit level in each ministry of the Borrower’s government.
46. “Sub-project” means a specific infrastructure project/contract (*paket pekerjaan*) undertaken by a Pilot Local Government or a designee thereof and meeting the requirements of the Technical Guidelines and Supplemental Technical Guidelines (Environment and Social Safeguards), which is financed by DAK Transfers and/or LG Contribution, and “Sub-projects” means more than one Sub-project.
47. “Supplemental Technical Guidelines (Environment and Social Safeguards)” means the supplement to the Technical Guidelines, acceptable to the Borrower and the Bank, meeting the requirements of Section I.D of Schedule 2 to this Agreement, to be issued by MPW, and binding on all Pilot Local Governments, setting out requirements for Sub-projects in Pilot Local Governments.
48. “TA Funds” means the budget to be provided by the Borrower for carrying out Part 2 of the Project, as such TA Funds may be agreed by the Bank and the Borrower, as applicable, for each Fiscal Year in accordance with Section I.C of Schedule 2 to this Agreement.
49. “Technical Guidelines” means the guidelines, issued by MPW and binding on all Local Governments, including the Supplemental Technical Guidelines (Environmental and Social Safeguards) on the implementation of the DAK for each infrastructure subsector (Ministerial Decree No. 42/PRT/M/2007), and subsequent letters of instruction (*surat edaran*) which include the list of eligible types of Sub-projects (mainly maintenance, rehabilitation and upgrading or improving existing infrastructure), technical requirements, implementation requirements, reporting, monitoring and evaluation requirements, and procedures and requirements for environmental and social safeguards management during the planning, implementation and operation of Sub-projects, including monitoring, reporting and evaluation, as such guidelines may be further amended, updated or supplemented from time to time and applied to the Project with the prior written agreement of the Bank and the Borrower.

50. “ULP” means a *Unit Layanan Pengadaan* procurement services unit.
51. “Value of Final Reimbursement” means, for each Fiscal Year, the Value of Total Reimbursement minus the Advance Payment, which shall not exceed the Annual DAK Allocation plus ten percent (10%).
52. “Value of Potential Reimbursement” means, for each Pilot Local Government in each Fiscal Year, the volume of Outputs by that Pilot Local Government, multiplied by their Reference Unit Costs.
53. “Value of Qualifying Reimbursement” means, for each Pilot Local Government in each Fiscal Year, the Value of Potential Reimbursement multiplied by the Qualifying Percentage.
54. “Value of Total Reimbursement” means, for each Fiscal Year, the sum of the Value of Qualifying Reimbursement for all Pilot Local Governments (which may also be calculated as the total of (i) the Advance Payment and (ii) the Value of Final Reimbursement for all Pilot Local Governments, the Reimbursement to be made by the Bank to the Borrower).
55. “Verification Arrangement” means the arrangement to be entered into between the Bank and BPKP pursuant to paragraph 2(b) of Section I.A of this Agreement and setting out the arrangements pursuant to which BPKP will undertake the activities of the VO Terms of Reference.
56. “Verification and Reimbursement Procedures” means, collectively, the procedures for verification of Outputs, Sample, determination of the Qualifying Percentage for any given Project period, and the reporting requirements of the VO as set out in the VO Terms of Reference and meeting the requirements set out in paragraph 5 of Section I.B of Schedule 2 to this Agreement.
57. “Audit of Outputs Terms of Reference” or “AO Terms of Reference” means the terms of reference document of BPKP setting out the requirements for technical (engineering), procurement, financial management and environmental and social safeguards specialists to perform the output verification function described in paragraph 5 of Section I.B of Schedule 2 to this Agreement on the basis of the Sample, acceptable to the Borrower and the Bank, as such document may be updated or amended from time to time with the prior written agreement of the: (i) Borrower and BPKP; and (ii) the Bank and BPKP.
58. “Verifier of Outputs” or “VO” means BPKP as staffed to meet the requirements set out in paragraph 2 of Section I.A of Schedule 2 to this Agreement, including the engagement of technical (engineering), procurement, financial management

and environmental and social safeguards experts in accordance with the VO Terms of Reference.

59. “Verification Report” means a verification report for Fiscal Year of Project Implementation, satisfactory to the Bank and the Borrower, issued by the VO in accordance with the Verification Procedures, and meeting the requirements of paragraph 5 of Section I.B of Schedule 2 to this Agreement, including certifying the Qualifying Percentage and the proposed amount of Reimbursement.
60. “Web-Based Monitoring and Reporting System” means the system to be established by the Borrower under Part 2 of the Project, through upgrading and enhancing the existing web-based transaction monitoring system of the Ministry of Finance, to increase transparency and effectiveness of DAK, including as set out in the Anti-Corruption Action Plan.
61. “Work Plan” means: (i) the consolidated annual work plans of each of MOF, BAPPENAS and MPW; and (ii) the work plan of BPKP for supplementing and strengthening technical, financial management, procurement and environmental and social safeguards capacity required for Project implementation, in each case satisfactory to the Bank.

Section II. Modifications to the General Conditions

The modifications to the General Conditions are as follows:

1. Paragraph (1) of Section 7.02 is modified to read as follows:

“Section 7.02. *Suspension by the Bank*

... (1) *Ineligibility*. The Bank or the Bank has declared the Borrower (other than the Member Country) or the Project Implementing Entity ineligible to receive proceeds of any financing made by the Bank or the Bank or otherwise to participate in the preparation or implementation of any project financed in whole or in part by the Bank or the Bank, as a result of a determination by the Bank or the Bank that the Borrower or the Project Implementing Entity has engaged in fraudulent, corrupt, coercive or collusive practices in connection with the use of the proceeds of any financing made by the Bank or the Bank.”

2. The following terms and definitions set forth in the Appendix are modified or deleted as follows, and the following new terms and definitions are added in alphabetical order to the Appendix as follows, with the terms being renumbered accordingly:
 - (a) The definition of the term “Conversion Date” is modified to read as follows:

“‘Conversion Date’ means, in respect of a Conversion, the Execution Date (as herein defined) or such other date as requested by the Borrower and accepted by the Bank, on which the Conversion enters into effect, and as further specified in the Conversion Guidelines.”