

The Auditor-General
Audit Report No.50 2005–06
Performance Audit

**Arrangements to Manage and Account for
Aid Funds Provided Under the
Australia-Indonesia Partnership for
Reconstruction and Development**

Australian Agency for International Development

Department of Foreign Affairs and Trade

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Canberra ACT
27 June 2006

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Agency for International Development and the Department of Foreign Affairs and Trade in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Arrangements to Manage and Account for Aid Funds Provided Under the Australia-Indonesia Partnership for Reconstruction and Development*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name and title.

Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations

AIDCP	Australia-Indonesia Development Cooperation Program
AIPRD	Australia-Indonesia Partnership for Reconstruction and Development
AMC	Australian Managing Contractor
ANAO	Australian National Audit Office
AusAID	Australian Agency for International Development
BAPPENAS	Indonesia's National Planning Board
BRR	Indonesia's Rehabilitation and Reconstruction Agency for Aceh and Nias
CIU	Cabinet Implementation Unit
CPGs	Commonwealth Procurement Guidelines
CPRAMPs	Country Program Risk Assessment and Monitoring Plans
DFAT	Department of Foreign Affairs and Trade
FMA Act	<i>Financial Management and Accountability Act 1997</i>
GST	Goods and Services Tax
OECD	Organisation for Economic Cooperation and Development

Summary and Recommendations

Summary

1. The Indian Ocean earthquake and tsunami on 26 December 2004 was one of the worst natural disasters in recent human history. The tsunami devastated many coastal communities in Indonesia, Sri Lanka, Thailand, the Maldives, Seychelles and India.
2. The greatest impact was on Indonesia, where the number of dead and missing is estimated at about 167 000, with the cost of damage and loss estimated to be about A\$7 billion.



Aceh—devastation after the tsunami.

Photo: AusAID

3. By 31 December 2004, the Australian Government had committed \$60 million for emergency and humanitarian assistance, primarily to Indonesia, Sri Lanka, the Maldives, and Seychelles, and to a lesser extent, to Thailand and India. Assistance included the deployment of Australian Defence Force personnel. The immediate focus was on the provision of food and water, shelter and clothing, medical care, emergency power and public health measures.
4. In addition to the immediate emergency and humanitarian assistance, the Australian Government announced the establishment of the Australia-Indonesia Partnership for Reconstruction and Development (AIPRD) on 5 January 2005.

5. The AIPRD comprises \$500 million in grants and \$500 million in concessional loans over the period to 30 June 2011.¹ It is the largest single aid contribution ever made by Australia, and is on top of ongoing aid to Indonesia (some \$1 billion of anticipated expenditure over the period 2004–05 to 2008–09).

6. At the time of this report, \$947 million of the \$1 billion AIPRD funding had been committed to programme elements. This includes some \$166 million to *emergency preparedness and response*, with the balance of committed funds *promoting broad-based economic growth* in the areas of economic and social infrastructure, human resource development, private sector development, and improved governance.

7. The AIPRD involves a more formal arrangement with the Indonesian Government than is usually the case with Australia's aid programmes. In particular, it involves a *Partnership Framework* that guides joint decision-making in relation to the identification of priority areas for support, as well as individual activities within priority areas, and various other aspects of programme administration. This has involved the development of oversight and administrative arrangements, from a Joint Ministerial Commission through to on-the-ground cooperation between Australian and Indonesian Government agencies in implementing specific activities.

8. The AIPRD is being delivered for the Australian Government by the Australian Agency for International Development (AusAID), which is an administratively autonomous agency within the Foreign Affairs and Trade portfolio. AusAID retains overall responsibility for the management of Commonwealth funds appropriated for the AIPRD, consistent with its obligations under the *Financial Management and Accountability Act 1997*.

9. The development and delivery of the AIPRD presents significant challenges. This is particularly so given the AIPRD's size, and the long lead times normally involved in identifying, designing and implementing suitable projects.

10. In addition, Australian bilateral aid has traditionally been provided in the form of non-repayable grants. AusAID's systems are geared to managing

¹ The Prime Minister's 5 January 2005 announcement of the AIPRD anticipated a five year programme of expenditure (that is, to 30 June 2009). In the context of the May 2006 Budget, this period was extended to 30 June 2011.

contractors delivering that aid on-the-ground in developing countries. In contrast, the AIPRD involves the use of loans for half of the programme.

11. The loans component requires the development of a formal *Partnership Loan Agreement*, and supporting administrative processes to manage and monitor the loans. Loans also present new challenges for AusAID in managing the risk of fraud and corruption. This is because, while AusAID retains responsibility for the management of Commonwealth funds appropriated to the AIPRD, it will have less direct involvement in the disbursement of these funds on-the-ground. In particular, procurement processes for loan funds will not be under AusAID's direct control, as they are for grant funds. Instead, Indonesian Government agencies will contract with individuals and companies to supply goods and services funded by the loans.

12. This approach requires appropriate strategies to facilitate accountability and transparency for the loan funds. The strategy being pursued through the Loan Agreement seeks to balance normal expectations for the borrower to manage tendering arrangements, with Australia's and Indonesia's interests in ensuring that loan funds are used for their stated purposes.

This audit

13. The objective of the audit was to assess the framework being put in place to manage and account for aid funds provided under the AIPRD. In particular, the audit addressed: structures for overseeing the development and delivery of the AIPRD; planning and risk management (including those relating to fraud and corruption); financial management; and arrangements for ongoing monitoring and reporting.

14. The audit focussed on the arrangements being established to monitor, evaluate and report on AIPRD implementation, rather than the management of activities and outcomes achieved. This reflects the fact that the long lead times associated with establishing such a large programme of assistance had meant that only limited activities were underway at the time of audit fieldwork.

15. The ANAO anticipates undertaking an audit in the future of the management of activities and outcomes achieved, when more funds have been expended.

16. It was not the purpose of this audit to examine Australia's immediate emergency and humanitarian response to the tsunami crisis.

Key Findings

Oversight arrangements (Chapter 2)

17. A **Joint Commission** of Australian and Indonesian Ministers is the peak decision-making body of the Australia-Indonesia Partnership for Reconstruction and Development (AIPRD).² It sets the broad strategic directions for the Partnership and agrees major activities for funding under the AIPRD. The Commission is overseen by the Prime Minister of Australia and the President of Indonesia.

18. The two Australian Ministers represented on the Commission are supported by a **Secretaries Committee**. The Secretaries Committee's primary role is the provision of strategic advice to Australian Ministers, and oversight of the AIPRD programme.

19. A **Secretariat**, mainly comprising AusAID staff, has been established to support both Australian Ministers and Secretaries.³ The ANAO found that the arrangement supported timely, high-level consideration of issues by the Secretaries Committee and the provision of advice to Australian Ministers on key AIPRD issues.

20. The risk of duplication between the AIPRD and the ongoing Indonesian aid programme has been addressed by AusAID. It has rationalised the working arrangements between the two programmes for activities where there were synergies. In addition, the AIPRD management teams in Canberra and Jakarta are senior and experienced. The ANAO found that AusAID's internal administrative arrangements were working well.

Planning (Chapter 3)

21. The development and delivery of the AIPRD over a relatively short timeframe presents a substantial challenge. This is particularly so given the lead times normally involved in identifying, designing and implementing suitable projects. Key planning considerations for the AIPRD were:

² The Joint Commission comprises Australia's Minister for Foreign Affairs and Treasurer; and Indonesia's Minister for Foreign Affairs, Minister for Finance, and State Minister of National Development Planning and Chair of the National Planning Board (BAPPENAS).

³ The Secretariat was initially established within the Department of Foreign Affairs and Trade (DFAT). In March 2006 it was relocated to the Australian Agency for International Development (AusAID).

- establishing and obtaining agreement to a *Partnership Framework*. This included the primary objective of the AIPRD, its programme structure of activities along with funding commitments;
- strategies to deliver the objective in a relatively short timeframe, particularly the development of a \$500 million loan programme to target a relatively small number of large infrastructure projects; and
- coordination arrangements with Indonesian agencies and other donors.

22. AusAID advised that a particular challenge in progressing the AIPRD was pressure on Indonesia's planning agencies in the aftermath of the disaster. To address this, AusAID has facilitated progress by taking a leading role in important areas. For example, it led the development of the Partnership Framework.

23. The Partnership Framework to guide the joint identification of priority areas for funding was endorsed by Joint Commission Ministers on 7 December 2005. AusAID used a draft to guide the joint identification of programme activities and associated funding commitments.

24. The Partnership Framework recognises the tight timeframe for AIPRD implementation. It has a strategy of focussing on a small number of areas that will have a substantial development impact.

25. A number of proposals to the Secretaries Committee for commitment of grant funds had less rationale in support of them than others. This reflected limited knowledge of development needs at the time. It will be important to review the continuing appropriateness of commitments, as more information becomes available on development needs. The ANAO has recommended that AusAID review, at regular intervals, AIPRD programme funding commitments, to ensure they remain appropriate as implementation proceeds.

26. The \$500 million loans component of the AIPRD requires the development of a formal *Partnership Loan Agreement* and supporting administrative processes to manage and monitor the loans. A statement of key principles for AIPRD loans has been agreed by the Joint Commission, including zero interest for up to 40 years. However, the formal Partnership Loan Agreement supporting these principles has yet to be agreed with Indonesia.

27. To reduce the risk of delays, AusAID has, therefore, proceeded with the identification and development of individual loan projects in parallel. The

AIPRD will fund two loan projects—\$200 million for education and \$300 million for roads.

28. The disbursement of all \$500 million of loan funds by the initial AIPRD timetable (30 June 2009) would have been particularly challenging, as disbursement depends on the design, alignment and agreement of detailed annual work programmes, as well as programme management arrangements with the Indonesian Government, in accordance with their budgetary timetables. In addition, the amount drawn down will ultimately be determined by the Indonesian Government. It is anticipated that the first education project funds will not be drawn down until mid-2006 (by which time the formal agreement is expected to be signed) and the first roads funds not until 2007–08.

29. In the context of the 2006–07 Budget, Australian Ministers agreed to extend the timetable for disbursement of AIPRD funds from 30 June 2009 to 30 June 2011.

30. An important aspect of effective planning for both the grants and loans programmes is to be aware of the activities of other aid donors in Indonesia. This helps avoid duplication of aid effort and competition for projects. The ANAO found in this regard that AusAID has coordinated with other major aid donors in Indonesia regarding their activities, to inform its planning.

Risk management (Chapter 4)

31. Risk management for a large aid programme such as the AIPRD is complex and requires consideration of both strategic and operational risks for the AIPRD as a whole, and the risks to the effective implementation of specific AIPRD aid activities.

32. Strategic risks for the AIPRD were not formally identified until August 2005, and not underpinned by a systematic risk assessment. AusAID advised that the design of the AIPRD was informed by a risk assessment, although not explicitly articulated until August 2005. By the time the risk management plan had been completed, significant decisions had been made, and some risks had already materialised. For example, delays in reaching agreement on the details of the loan programme.

33. An operational risk management plan for 2005–06 was not completed until February 2006, more than one year after the announcement of the AIPRD, and did not include a number of recognised elements of good risk

management. These include identifying the *likelihood* and *consequence* of a particular risk occurring, to assist the future review of the overall *risk rating*.

34. Risk management is most effective, and of most value in contributing to decision-making, when it is more timely, systematic and structured than in this case. That is, when it is part of the planning process, rather than confirming actions already undertaken.

35. The ANAO also found that there was a variable approach to risk identification for specific activities. Not all proposals to the Secretaries Committee for new activities explicitly identified risks. A more structured approach to briefing on risks would provide greater assurance that risks are being identified and assessed.

36. The variability in approach was also reflected in the development of detailed risk management matrices for activities. To some degree this reflects differences in progress in scoping the activities. However, AusAID could usefully draw on its more systematic approaches to improve risk management across activities. As well, incorporating residual risk, after taking into account treatments, would better inform management about the acceptability of risk.

37. A key risk for activities is that of fraud and corruption. This is a recognised risk in Indonesia, which the Indonesian Government has declared a commitment to tackle.⁴ AusAID is addressing this risk in a number of ways.

38. Key processes for the \$500 million of grant funding, such as procurement and the disbursement of funds, are under its direct control. In this regard, AusAID's contracts for grant funding have standard clauses aimed at preventing contractors and subcontractors from engaging in fraudulent activity. For example, contractors must comply with Australian and partner government laws relating to corrupt practices, including those relating to the bribery of Commonwealth and foreign public officials. The ANAO suggests that, in light of the risk of corruption in procurement in Indonesia, AusAID give consideration to requiring major contractors to formally affirm, at appropriate intervals, their compliance with those contract clauses.

39. AusAID's operational risk management plan identifies only a limited range of fraud and corruption risks. More in-depth consideration of fraud and

⁴ Keynote Speech by the President of the Republic of Indonesia to the *International Conference on Promoting Financial Accountability in Managing Funds Related to Tsunami, Conflict and Other Disasters*, Jakarta, 25-27 April 2005.

corruption risks would provide greater assurance that appropriate mitigation measures will be put in place.

40. Proposed arrangements for the draft \$500 million loan agreement with Indonesia also provide a focus on mitigation of the risk of fraud and corruption. The proposals have yet to be agreed with Indonesia, but include: an Anti-Corruption Action Plan for each project loan agreement; the right to terminate future loan advances for corrupt activities; Commonwealth audit access to relevant material in Indonesian Government agency or contractors' possession or control; and the involvement of independent experts as observers in all procurement processes.

41. As with all risk management, the key challenge for AusAID will be to ensure that risk management plans and mitigation measures are implemented. This includes regular review of the effectiveness of risk mitigation measures, as well as monitoring any changes to risks over the life of the AIPRD.

Financial management (Chapter 5)

42. AusAID is responsible for financial management of the AIPRD, in accordance with the provisions of the *Financial Management and Accountability Act 1997* (FMA Act) and associated Regulations and Orders.⁵

43. Administered (programme) funds were credited to two Special Accounts of \$500 million each, the:

- *Australia-Indonesia Partnership for Reconstruction and Development (Grants) Special Account*; and
- *Australia-Indonesia Partnership for Reconstruction and Development (Loans) Special Account*.⁶

44. Special Accounts are subject to particular reporting requirements. Agencies are required to disclose, among other things, opening balances, receipts, payments, adjustments and closing balances for each Special Account in the Portfolio Budget Statements. AusAID reported this information for 2005–06.

45. AusAID's 2004–05 Financial Statements also met the requirements to disclose total receipts, payments and balances for each Special Account. The

⁵ The Treasurer's Second Reading Speech for the *Appropriation (Tsunami Financial Assistance and Australia-Indonesia Partnership) Bill 2004-2005*, p3, 9 March 2005.

⁶ See <<http://www.comlaw.gov.au/>>

ANAO found that the Statements gave a true and fair view of its financial position at 30 June 2005.

46. Some AusAID salary and administrative costs are being funded out of grant funding. It is not clear that this was envisaged at the time funding arrangements were originally developed—the Australian Government’s stated aim was that the full \$1 billion of AIPRD funds be available for reconstruction and development. In this context, more explicit arrangements are warranted for these salary and administrative costs.

47. Disbursement of funds is anticipated to occur later than initially estimated. At the time of this report, \$947 million of the \$1 billion AIPRD funding had been committed by the Joint Commission (although only some \$70 million, all grants, had been expended at 31 March 2006).

48. The Secretaries Committee has been advised of lower expenditure estimates. However, these briefs have not clearly contrasted these lower estimates with the original Budget estimates. Clearer comparison of revised estimates to original estimates would enhance accountability, and assist in monitoring of progress, particularly as expenditure progresses. The ANAO has recommended that the AIPRD Secretariat regularly brief the Secretaries Committee of variations to overall AIPRD expenditure estimates, and the reasons for those variations.

49. Eligibility criteria for contracts have been modified from usual AusAID practice, to emphasise the bilateral partnership approach. For example, rather than the usual practice of unrestricted international competitive bidding for construction contracts, under the AIPRD construction contracts are restricted to Australian, New Zealand and Indonesian companies.⁷

50. At the request of the Australian Government, bids are being monitored for any impact of the modified arrangements on costs and quality. AusAID has identified ‘warning signs’ that this may be resulting in limited competition, although it is not yet able to reach a definitive conclusion. Monitoring is continuing.

51. The AIPRD \$300 million loan for the roads project is to be made available in parallel with a similar World Bank project. This also provides an opportunity to monitor/benchmark the competitiveness of the different

⁷ Procurement for the purposes of providing foreign aid is exempt from the application of Australia’s bilateral free trade agreements.

eligibility criteria used for the AIPRD, to inform consideration of future arrangements. The ANAO has recommended that AusAID monitor/benchmark the cost of AIPRD works and outcomes for this project against those obtained through the international competitive bidding approach used by the World Bank.

52. The ANAO found that stronger management of certain aspects of contractual arrangements is required to protect the Australian Government's interests and provide greater assurance of value for money. A number of contracts were signed after the provision of services had commenced, including ones delivering aid after the emergency period had passed.

53. The ANAO noted that direct sourcing of contracts (i.e. without open tender) was used well after the emergency response phase, sometimes driven by timetable pressures. This reduces assurance of value for money, and is contrary to the principle of *open and competitive tendering* set out in the Partnership Framework. The ANAO has recommended that AusAID facilitate transparency and accountability in procurement of goods and services by centrally monitoring and reporting to senior management the incidence of, and rationale for, direct sourcing. This would facilitate a more considered view of its use in the context of the Partnership Framework, and would help keep its use to a minimum.

54. The ANAO also found that direct sourced contracts were being incorrectly reported in AusTender as being procured through 'open tender'. The ANAO has recommended that AusAID establish systems to reliably report on contract procurement in AusTender, to meet its procurement reporting obligations. AusAID advised this should be achieved by a new contract management system, recently implemented.

55. With regard to procurement arrangements for loan funding, AusAID is seeking to agree with Indonesia means of mitigating risk associated with procurement in Indonesia, as well as facilitating accountability and transparency. For example, standard international practice is for tendering and other arrangements for project loans to be managed by the borrowing country. However, AusAID is seeking the involvement of Australian or independent experts as participants or observers in procurement and activity monitoring processes. These arrangements have been proposed to Indonesia for inclusion in the Partnership Loan Agreement, but have not yet been finalised.

Monitoring and reporting (Chapter 6)

56. The ANAO examined the arrangements being put in place to monitor progress and manage contractor performance for two early activities under the Aceh Rehabilitation Program, the first major programme to be implemented.

57. Both contracts had a degree of flexibility, allowing contractors to progressively identify, scope and design activities. This reflects the realities of post-crisis aid, but does require a sound approach to performance management. One contract had performance incentives, and a reasonably well developed performance management framework. However, this framework was weakened because the means of verifying performance was not well developed or defined.

58. The other contract lacked specificity in relation to approval processes, controls and performance indicators. This was a contributing factor to performance difficulties encountered with this contract. Nevertheless, AusAID did monitor progress and address performance issues when they arose.

59. The strengths and weaknesses in the performance management frameworks for these contracts provide an opportunity for lessons to be learned and applied to future contracts. Particular issues involve strengthening the clarity and focus of performance measures.

60. Implementation progress is reported to the Secretaries Committee. However, reporting would be enhanced by identifying whether progress is behind schedule/previous expectations, and whether there are any significant project/contractor concerns.

61. The AIPRD was required to report to the Cabinet Implementation Unit (CIU) on progress. However, an Implementation Plan was not finalised until one year after announcement of the AIPRD, undermining the Plan's usefulness as a means of assessing progress. By this time, key decisions had been taken and \$947 million of the \$1 billion had been committed by the Joint Commission.⁸ Sound practice for such a large and complex programme involves completing the Plan at the start of the project, and then reviewing and updating it as required, to improve the quality of monitoring in the early stages of implementation.

62. The Department of the Prime Minister and Cabinet advised that it will examine management of the CIU processes in the light of these audit findings.

⁸ While funding commitments had been made, only a small part had been expended.

63. At the time of audit, AusAID had prepared three public reports on Australia's response to the tsunami and the implementation of the AIPRD. However, consistent with the stated intention of a high degree of public accountability and transparency,⁹ public reporting could be strengthened. For example, reports have contained little information on the expected timing of activities, including progress against expectations. Under-expenditure in 2004–05 was not identified. The ANAO has recommended that AusAID enhance various aspects of future public reports in this regard.

64. A new outcome has been created for the AIPRD—*Australia's national interest [is] advanced by implementing a partnership between Australia and Indonesia for reconstruction and development*. An associated performance framework identifies performance indicators. The key quality indicator—that 75 per cent of activities receive quality ratings of satisfactory or higher—incorporates a target.¹⁰

65. However, other quality and quantity indicators do not incorporate benchmarks, targets or activity levels. The development of such comparators, where possible, would assist AusAID in assessing performance, and strengthen transparency and accountability to the Parliament and stakeholders. The ANAO has recommended that AusAID include targets, benchmarks or activity levels in performance indicators for the AIPRD, where possible.

Overall audit conclusion

66. The Australia-Indonesia Partnership for Reconstruction and Development (AIPRD) is the largest single aid contribution ever made by Australia. The partnership nature of the programme, relatively short timeframe, and the use of loans for half of the programme, present substantial administrative challenges.

67. Notwithstanding these challenges, AusAID has made progress in a number of important areas. This includes establishing high level overview arrangements, in particular the formal *Partnership Framework* with Indonesia. More generally, AusAID has sought to facilitate the AIPRD through means

⁹ The Treasurer's Second Reading Speech for the *Appropriation (Tsunami Financial Assistance and Australia-Indonesia Partnership) Bill 2004-2005*, p2, 9 March 2005.

¹⁰ A similar performance rating system, using the same quality rating target of 75 per cent, has been used by other donors. See ANAO Report No.59 2001-2002, *AusAID Contract Management*.

such as regular coordination meetings and involving Indonesian agencies in developing and implementing activities.

68. Most AIPRD funds have now been committed to programme elements. This includes some \$166 million to *emergency preparedness and response*, with the balance of committed funds *promoting broad-based economic growth* in the areas of economic and social infrastructure, human resource development, private sector development, and improved governance.

69. The formal and systematic identification of risks at the strategic and operational levels has not been timely or sufficiently systematic and structured. By the time risk management plans had been put in place, some risks had already materialised, particularly the pressures on the timely and effective delivery of aid.

70. The actual disbursement of funds committed has been slower than originally expected (\$70 million to 31 March 2006) reflecting, among other things, uncertainty at the time of original estimates and practical considerations in reaching agreement with Indonesian Government agencies.

71. The disbursement of \$500 million of loan funds has proven to be particularly difficult, reflecting delays in establishing a Partnership Loan Agreement with Indonesia.

72. AusAID has adopted a number of approaches to provide a focus and urgency to addressing the risk to the timely disbursement of funds. These include focussing aid on a few areas that will have a substantial development impact, and leveraging off existing aid activities in Indonesia. Also, to hasten initiatives on-the-ground, funds have been committed to some projects with limited supporting rationale, reflecting incomplete knowledge of development needs at the time. In these circumstances it will be important to regularly review the continuing appropriateness of these commitments, as more information becomes available on development needs.

73. The 2006–07 Budget has extended the timeframe for disbursement of loans to June 2011.

74. AusAID has identified fraud and corruption risks in its operational risk management plan, but these need to be addressed in more detail, to provide assurance that appropriate mitigation measures will be put in place. It will be important for AusAID to actively pursue, and monitor the effectiveness of, proposed fraud mitigation measures over the life of the AIPRD.

75. Stronger management of procurement and contractual arrangements is required to protect the Australian Government's interests. This includes better management of the use of direct sourcing of contracts; more consistent attention to performance management in contracts; and greater attention to signing contracts before services commence.

76. The challenges of implementing the AIPRD emphasise the importance of sound monitoring and reporting arrangements. In this regard, there are opportunities to improve briefings to the Secretaries Committee, to better inform it about risks of proposed actions and slippage in program implementation.

77. In addition, reporting of progress to the Cabinet Implementation Unit had deficiencies, which reduced the effectiveness of monitoring in the early stages of implementation.

78. Consistent with the stated intention of a high degree of public accountability and transparency, future public reports on the AIPRD would be strengthened by the inclusion of more information on: the expected yearly disbursement of grant and loan funds; significant milestones in activity implementation; and performance indicators covering effectiveness, quality and quantity.

79. In addition, the development of benchmarks for those quality and quantity indicators that are identified in AusAID's Annual Report would assist AusAID in assessing its performance, and strengthen transparency and accountability to the Parliament and stakeholders.

Recommendations and AusAID's response

80. The ANAO made seven recommendations aimed at improving the framework for the development and implementation of the AIPRD.

81. AusAID's response to the ANAO's report is as follows:

AusAID is satisfied with the outcomes and conduct of the performance audit and has agreed to act upon all of its recommendations.

Recommendations

Recommendation No.1
Para 3.14
Reviewing funding commitments

The ANAO recommends that AusAID review, at regular intervals, AIPRD programme funding commitments, to ensure they remain appropriate as implementation proceeds. This will be particularly valuable for those programmes where limited information was available at the time of the original commitment.

AusAID response: Agreed.

Recommendation No.2
Para 5.14
Briefing on estimates variations

The ANAO recommends that the AIPRD Secretariat regularly brief the Secretaries Committee of variations to overall AIPRD expenditure estimates, and the reasons for those variations.

AusAID response: Agreed.

Recommendation No.3
Para 5.55
Reporting direct sourcing

The ANAO recommends that AusAID facilitate transparency and accountability in procurement of goods and services by centrally monitoring and reporting to senior management the incidence of, and rationale for, direct sourcing.

AusAID response: Agreed.

Recommendation No.4
Para 5.61
Reporting of contracts in AusTender

The ANAO recommends that AusAID establish systems to reliably report on contract procurement in AusTender.

AusAID response: Agreed.

Recommendation No.5

Para 5.74

Monitoring the competitiveness of bids

The ANAO recommends that AusAID monitor/benchmark the cost of AIPRD works and outcomes for the Eastern Indonesia National Road Improvement Project against those obtained through the International Competitive Bidding approach, used by the World Bank for the National Roads Improvement Project. This will complement AusAID's general monitoring of bid competitiveness (requested by the Australian Government), and help inform Australia's consideration of future eligibility criteria.

AusAID response: Agreed.

Recommendation No.6

Para 6.49

Public reporting on AIPRD

The ANAO recommends that AusAID enhance AIPRD accountability and transparency by ensuring that the future public reports on the AIPRD identify and, subsequently, report against:

- the expected yearly disbursement of grant and loan funds, by major grant and loan activity;
- significant activity milestones; and
- performance indicators, covering effectiveness, quality and quantity, particularly for larger activities.

AusAID response: Agreed.

Recommendation No.7

Para 6.59

Performance information

The ANAO recommends that AusAID include targets, benchmarks or activity levels in performance indicators for the AIPRD, where possible, to enable future results to be interpreted against expectations. This will help strengthen transparency and accountability to the Parliament and stakeholders.

AusAID response: Agreed.

Audit Findings and Conclusions

1. Introduction

This chapter provides an overview of the Australia-Indonesia Partnership for Reconstruction and Development (AIPRD). It also outlines the audit approach.

1.1 The Indian Ocean earthquake and tsunami on 26 December 2004 was one of the worst natural disasters in recent human history. The tsunami devastated many coastal communities in Indonesia, Sri Lanka, Thailand, the Maldives, Seychelles and India. The total number of dead was estimated by the United Nations to be more than 230 000.¹¹

1.2 The greatest impact was on Indonesia, where the number of dead and missing was approximately 167 000.¹² The cost of damage and loss in Indonesia was estimated to be about A\$7 billion.



Banda Aceh—destruction in the suburbs.

Photo: AusAID

1.3 By 31 December 2004, the Australian Government had committed \$60 million for emergency and humanitarian assistance, primarily to

¹¹ See <<http://www.tsunamispecialenvoy.org/about/default.asp>>

¹² See <http://siteresources.worldbank.org/INTEASTASIAPACIFIC/Resources/1YR_exec_sum_english.pdf>

Indonesia, Sri Lanka, the Maldives, Seychelles, and to a lesser extent, to Thailand and India. Assistance included the deployment of Australian Defence Force personnel. The immediate focus of the emergency assistance was the provision of food and water, shelter and clothing, medical care, emergency power and public health measures.

Establishment of the Australia-Indonesia Partnership for Reconstruction and Development

1.4 On 5 January 2005, the Australian Government announced the establishment of the Australia-Indonesia Partnership for Reconstruction and Development (AIPRD).¹³ The AIPRD comprises \$500 million in grants and \$500 million in concessional loans¹⁴ over the period to 30 June 2011.¹⁵ The AIPRD funding is in addition to Australia's \$60 million for immediate emergency and humanitarian assistance.¹⁶ The AIPRD is the largest single aid contribution ever made by Australia.

1.5 Australia had already anticipated expenditure of \$1 billion in ongoing aid to Indonesia over the period 2004–05 to 2008–09, through the existing Australia-Indonesia Development Cooperation Program (AIDCP).¹⁷ The AIPRD funds are on top of funds provided under the AIDCP, and the AIPRD is intended to be complementary to the AIDCP.

AIPRD decision-making and delivery

1.6 The AIPRD involves a more formal arrangement with the Indonesian Government than is usually the case with Australia's aid programmes. In particular, it involves a Partnership Framework that guides joint decision-making in relation to the identification of priority areas for support, as well as individual activities within priority areas, and various other aspects of programme administration. This has involved the development of oversight and administrative arrangements to reflect the nature of the AIPRD.

¹³ Media Release, Prime Minister of Australia, 5 January 2005.

¹⁴ Loan funds will remain a Commonwealth financial asset (albeit changing from *cash* to a *loan receivable*).

¹⁵ The Prime Minister's 5 January 2005 announcement of the AIPRD anticipated a five year programme of expenditure (that is, to 30 June 2009). In the context of the May 2006 Budget, this period was extended to 30 June 2011.

¹⁶ In addition, further emergency assistance was provided through other government departments (primarily the Australian Defence Force's *Operation Sumatra Assist*) at a cost of \$37 million.

¹⁷ The AIDCP had four objectives: increasing economic growth; improving accountability; improving productivity; and reducing community vulnerability to conflict and disasters.

1.7 A **Joint Commission** of Australian and Indonesian Ministers is the peak decision-making body of the AIPRD.¹⁸ The Commission is overseen by the Prime Minister of Australia and the President of Indonesia. The two Australian Ministers represented on the Commission are supported by, and receive advice from, a **Secretaries Committee**.¹⁹ A **Secretariat** has been established to support both Australian Ministers and Secretaries.²⁰

1.8 The AIPRD and the AIDCP are being delivered for the Australian Government by the Australian Agency for International Development (AusAID). AusAID is the Australian Government agency responsible for the management of Australia's aid programme. It is an administratively autonomous agency within the Foreign Affairs and Trade portfolio, and reports to the Minister for Foreign Affairs.

1.9 Notwithstanding the oversight arrangements for the AIPRD, AusAID is accountable for the management of Commonwealth funds appropriated for the AIPRD, consistent with its obligations under the *Financial Management and Accountability Act 1997*.

1.10 AusAID has set up a separate administrative structure in both Canberra and Jakarta to implement and manage the AIPRD. AusAID's AIPRD Office in Jakarta also liaises with counterpart Indonesian agencies.

1.11 The oversight arrangements underpinning the AIPRD are examined in more detail in Chapter 2.

AIPRD programme structure and funding commitments

1.12 While the AIPRD has a focus on tsunami-devastated areas, all areas of Indonesia are eligible for assistance.²¹ The AIPRD has an emphasis on economic and social development.

¹⁸ The Joint Commission comprises Australia's Minister for Foreign Affairs and Treasurer; and Indonesia's Minister for Foreign Affairs, Minister for Finance, and State Minister of National Development Planning and Chair of the National Planning Board (BAPPENAS).

¹⁹ The Secretaries Committee comprises the Secretaries of the Departments of Foreign Affairs and Trade (Chair), Prime Minister and Cabinet, Treasury, Finance and Administration, and the Director General of AusAID.

²⁰ The Secretariat was initially established within the Department of Foreign Affairs and Trade (DFAT). In March 2006 it was relocated to the Australian Agency for International Development (AusAID).

²¹ Media Release, Prime Minister of Australia, 5 January 2005.

1.13 The two main themes of the AIPRD are emergency preparedness and economic growth. Within these themes there are seven major areas of cooperation, or programme elements, which have been endorsed by the Joint Commission Ministers.²² Figure 1.1 outlines these areas of cooperation.

1.14 At the time of this report, \$947 million of the \$1 billion AIPRD funding had been committed within the programme elements by the Joint Commission. AusAID has advised that the amounts programmed represent upper limits to commitments and that these may be readjusted as implementation progresses, detailed activity designs are prepared, and contracts let.

²² AIPRD *Partnership Framework*, 7 December 2006, available from <http://www.ausaid.gov.au/publications/pdf/partnership_framework.pdf>.

Figure 1.1

AIPRD programme structure and commitments

To support Indonesia's reconstruction and development efforts, both in and beyond tsunami-affected areas, through sustained cooperation focussed on the Indonesian Government's program of reform, with an emphasis on economic and social development

EMERGENCY PREPAREDNESS AND RESPONSE			
<p style="text-align: center;">Aceh Reconstruction \$151m grants</p> <p>\$80m Aceh Rehabilitation Program. \$25m Aceh Community Infrastructure Program. \$5m Aceh Rural Livelihoods (Water Resources and Aquaculture) Program. \$10m Humanitarian Food Aid. \$10m Rebuilding schools in conflict-affected areas. \$21m for various other activities.</p>	<p style="text-align: center;">Emergency Preparedness \$10m grants</p> <p>Strengthening Indonesia's disaster management and response systems. Also aims to build a closer partnership between Australian and Indonesian disaster coordination agencies.</p>	<p style="text-align: center;">Responding to Other Disasters \$5m grants</p> <p>Providing assistance for other disasters outside of Aceh (i.e. earthquakes in Alor and Nabire).</p>	
PROMOTING BROAD-BASED ECONOMIC GROWTH			
<p style="text-align: center;">Economic and Social Infrastructure \$300m loans \$28m grants</p> <p>For the Eastern Indonesia National Roads Improvement Project. (\$28m in grants is for loan preparation and supervision costs.)</p>	<p style="text-align: center;">Human Resource Development \$78m grants</p> <p>For Australian Partnership Scholarships (600 students).</p>	<p style="text-align: center;">Private Sector Development / Rural Productivity \$25m grants</p> <p>For the Small-Holder Agribusiness Development Program. Aims to assist agribusiness policy and regulatory frameworks.</p>	<p style="text-align: center;">Improved Governance \$50m grants</p> <p>For the Government Partnerships Fund. Aims to facilitate the exchange of skills and expertise between Australian and Indonesian Government agencies.</p>
<p style="text-align: center;">Basic Education Program \$200m loans / \$100m grants</p> <p>For junior secondary school education. (This activity straddles the Economic and Social Infrastructure Program and the Human Resource Development Program.)</p>			

Note: Colours key to the Joint Commission funding decisions set out at Figure 2.2, and other Figures throughout the Report that relate specifically to one of the above programmes.

Source: AIPRD *Partnership Framework*, 7 December 2005; and Joint Ministerial Statements of 17 March, 6 September and 7 December 2005.

1.15 The development and delivery of the AIPRD over a relatively short timeframe will present significant challenges. This is particularly so given the AIPRD's size, and the long lead times normally involved in identifying, designing and implementing suitable projects.

1.16 In addition, Australian bilateral aid has traditionally been provided in the form of non-repayable grants. AusAID's systems are geared to managing contractors delivering that aid on-the-ground in the developing country. In contrast, the AIPRD involves the use of loans for half of the programme.

1.17 The loans component has required the development of a loan agreement, and supporting administrative processes to manage and monitor the loans. Loans also present new challenges in managing the risk of fraud and corruption.²³ This is because, while AusAID retains responsibility for the management of Commonwealth funds appropriated for the AIPRD, it will have less direct involvement in the disbursement of these funds on-the-ground. In particular, procurement processes for loan funds will not be under AusAID's direct control, as they are for grant funds. Instead, Indonesian Government agencies will contract with individuals and companies to supply goods and services funded by the loans. This requires an appropriate focus on managing the risks associated with this approach to delivery.

Audit approach

Audit objective and criteria

1.18 The objective of the audit was to assess the framework being put in place to manage and account for aid funds provided under the AIPRD. In particular, the audit addressed:

- governance and management structures for overseeing the development and delivery of the AIPRD;
- arrangements to plan assistance, and to manage risks, including those relating to fraud and corruption;
- the clarity and transparency of financial management arrangements; and

²³ The Indonesian Government has stated its intention to deal with corruption both generally, and specifically in the context of international aid donations by seeking to prevent the misappropriation of rehabilitation and reconstruction funds.

- arrangements for monitoring, evaluating and reporting on the AIPRD programme.

1.19 The multi-year approach of the AIPRD, and long lead times associated with establishing such a large programme of assistance, have meant that only some \$70 million—all grants—of the \$1 billion had been expended at the end of March 2006.

1.20 The audit, therefore, focussed on the arrangements being established to monitor, evaluate and report on AIPRD implementation, rather than the management of activities and outcomes achieved. The ANAO anticipates undertaking an audit in the future on these aspects, when more funds have been expended.

1.21 The audit did not examine Australia's immediate emergency and humanitarian response to the tsunami crisis.

Audit methodology

1.22 Audit fieldwork was undertaken in the Department of Foreign Affairs and Trade and AusAID, and at the AIPRD Office in Indonesia.

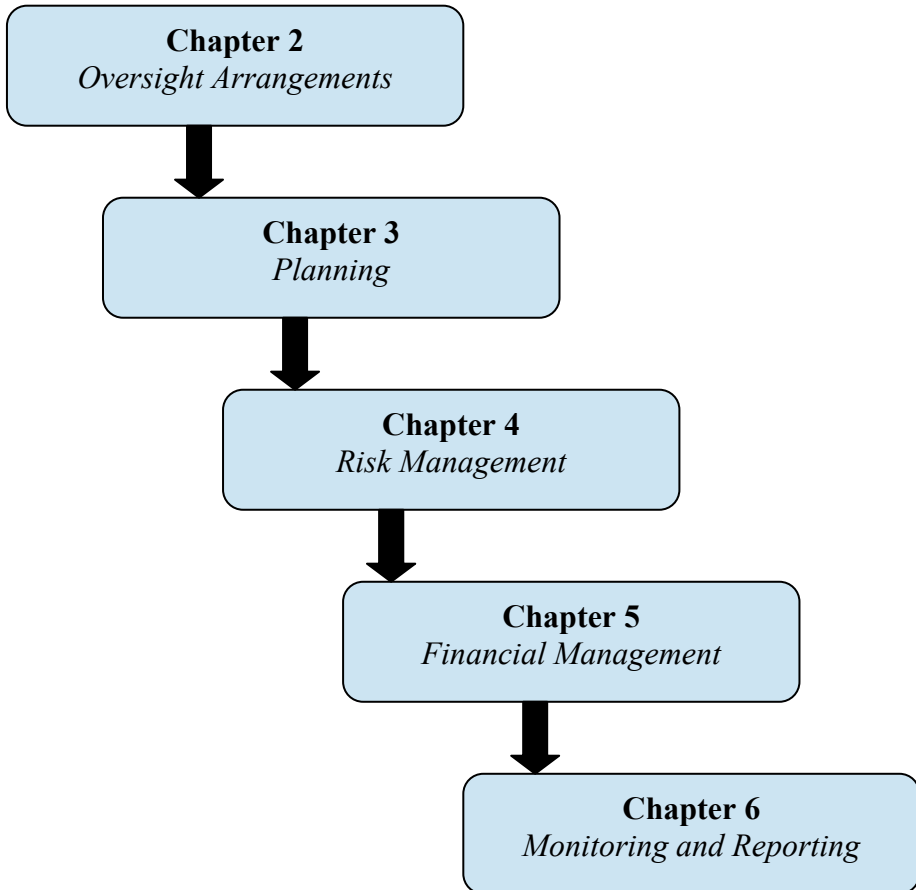
1.23 The ANAO interviewed relevant officers and reviewed files and documentation. This included reviewing some of the first contracts for delivering aid in Indonesia.

1.24 The audit was conducted in accordance with ANAO standards. The cost of the audit to report tabling was \$250 000.

Report structure

1.25 The audit findings are reported in the following five chapters, as illustrated in Figure 1.2.

Figure 1.2
Report Structure



2. Oversight Arrangements

This chapter examines the decision-making framework and management structures that have been established to oversight the development and delivery of the Australia-Indonesia Partnership for Reconstruction and Development (AIPRD).

Introduction

2.1 Governance is the set of responsibilities and practices exercised by decision-makers with the goal of providing strategic direction and ensuring that objectives are achieved, risks are appropriately managed and resources used responsibly. In considering these issues in relation to the oversight arrangements for the AIPRD, in this chapter the ANAO focuses on the roles and responsibilities of the Secretaries Committee, the AIPRD Secretariat and AusAID staff. Other aspects of governance—including planning, risk management and financial management—are covered in later chapters.

2.2 The AIPRD involves a more formal arrangement with the Indonesian Government than is usually the case with Australia's aid programmes. In particular, it involves a Partnership Framework that guides joint decision-making in relation to the identification of priority areas for support, as well as individual activities within priority areas, and various other aspects of programme administration.

2.3 The arrangement is intended to strengthen the relationship between Australia and Indonesia in the aftermath of the tsunami disaster.

2.4 Because the AIPRD involves a range of participants and decision-makers from both Australia and Indonesia it is necessarily more complex and, therefore, requires clear articulation of roles and responsibilities to assist decision-making.

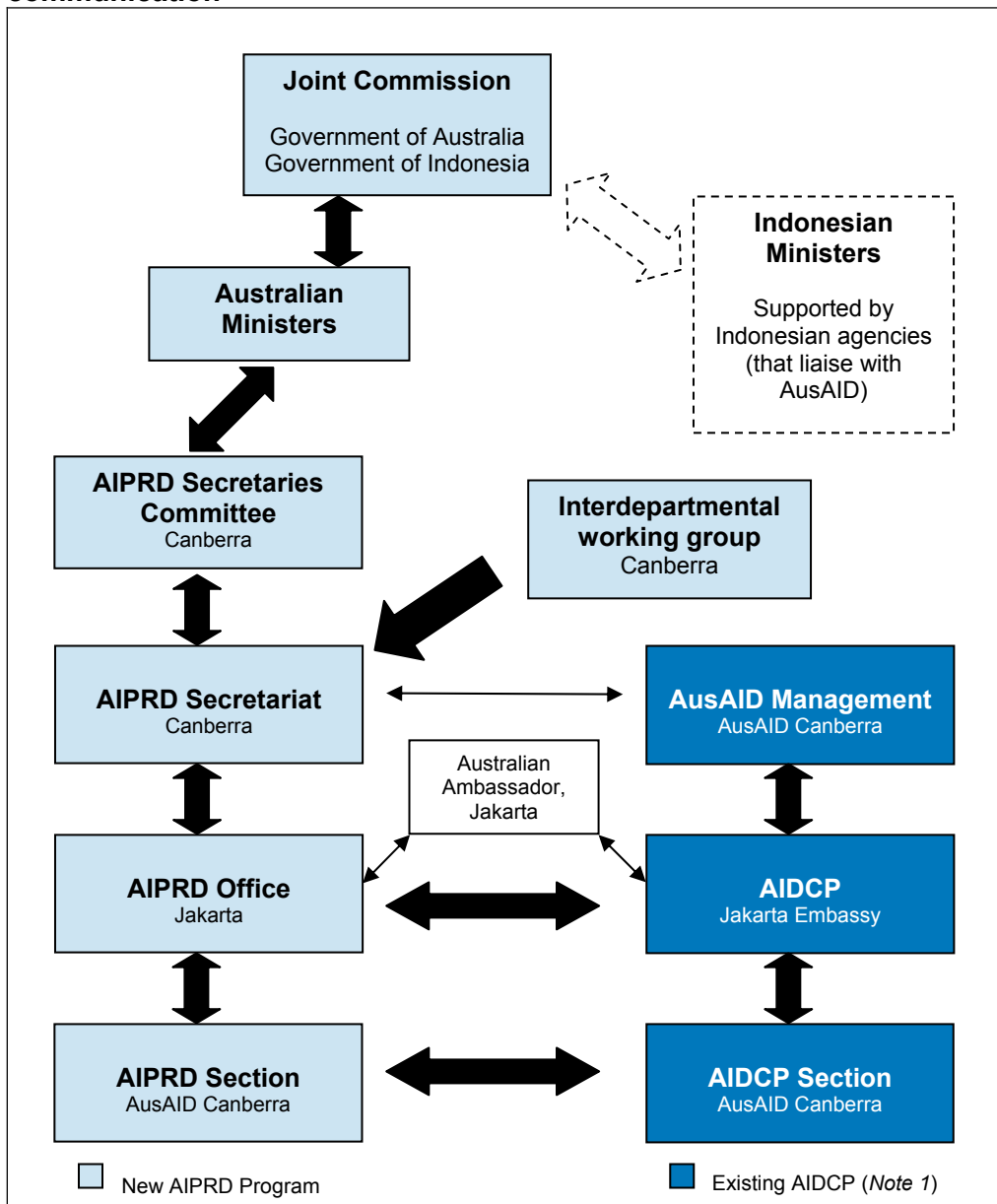
Key Australian participants and lines of communication

2.5 Separate administrative structures have been set up in Canberra and Jakarta to implement and manage the AIPRD. These structures largely parallel those for the existing Indonesian aid programme—the Australia-Indonesia Development Cooperation Program (AIDCP)—which continues.

2.6 Figure 2.1 describes these arrangements.

Figure 2.1

Aid to Indonesia—Key Australian participants and lines of communication



Note: (1) AusAID advised that further rationalisation and integration of the AIPRD and AIDCP team structures has taken place.

Source: ANAO analysis.

Funding commitments by the Joint Commission

2.7 A **Joint Commission** of Australian and Indonesian Ministers is the peak decision-making body of the AIPRD.²⁴ The Commission is overseen by the Prime Minister of Australia and the President of Indonesia. The two Australian Ministers represented on the Commission are supported by, and receive advice from, a **Secretaries Committee**.²⁵ A **Secretariat** has been established to support both Australian Ministers and Secretaries.²⁶

2.8 The Joint Commission sets the broad strategic directions for the AIPRD and agrees major activities for funding.²⁷ Its inaugural meeting was held in Canberra on 17 March 2005.



Inaugural meeting of the Australia-Indonesia Partnership for Reconstruction and Development held in Canberra on 17 March 2005. Photo: Michael Jones AUSPIC

2.9 A number of funding commitments were made by the Joint Commission at its inaugural meeting. Since then, further funding commitments have been agreed and announced by Joint Ministerial Statements

²⁴ The Joint Commission comprises Australia's Minister for Foreign Affairs and Treasurer; and Indonesia's Minister for Foreign Affairs, Minister for Finance, and State Minister of National Development Planning and Chair of the National Planning Board (BAPPENAS).

²⁵ The Secretaries Committee comprises the Secretaries of the Departments of Foreign Affairs and Trade (Chair), Prime Minister and Cabinet, Treasury, Finance and Administration, and the Director General of AusAID.

²⁶ The Secretariat was initially established within the Department of Foreign Affairs and Trade (DFAT). In March 2006 it was relocated to the Australian Agency for International Development (AusAID).

²⁷ AIPRD *Partnership Framework*, 7 December 2005.

of 6 September and 7 December 2005. Figure 2.2 summarises the funding commitments of the Joint Commission, which total \$947 million to date.

2.10 The AIPRD Secretariat expects that meetings will occur once a year. Between meetings, matters are addressed inter-sessionally, as was the case for the Second and Third Ministerial Statements.

Figure 2.2

Joint Commission funding commitments

Inaugural Joint Commission Meeting / Statement—17 March 2005		\$ million
• Aceh Rehabilitation Program (including assistance to renovate the Zainoel Abidin Hospital in Banda Aceh).		50
• Government Partnerships Fund (including assistance from Australian Government agencies to Indonesian counterpart agencies).		50
• Emergency Preparedness Program.		10
• Package of assistance for recent earthquakes in Alor and Nabire.		5
	Subtotal	115
Second Joint Ministerial Statement—6 September 2005		
• Australian Partnership Scholarships scheme involving 600 new scholarships (announced by the Australian Prime Minister and Indonesian President on 4 April 2005).		78
• Aceh Rehabilitation Program increase (to \$80 million).		30
• Aceh Community Infrastructure Program.		25
• Small-Holder Agribusiness Development initiative.		25
• Aceh Rural Livelihoods (Water Resources and Aquaculture) Program.		5
• Aceh Tertiary Education and Training Program.		3
• Facilitation of housing reconstruction in Aceh (Temporary Shelter Technical Assistance). (Amount subsequently determined by officials.)		3
	Subtotal	169
Third Joint Ministerial Statement—7 December 2005		
• Eastern Indonesia National Roads Improvement Project.		328
• Junior secondary school education (Basic Education Program).		300
• Humanitarian Food Aid (World Food Program).		10
• Rebuilding schools in conflict-affected areas.		10
• Rebuilding main port facility in Banda Aceh.		8
• Regional Enterprise Development.		7
	Subtotal	663
TOTAL FUNDING COMMITMENTS AT 7 DECEMBER 2005		947

Note: Colours indicate programme structure, as in the key at Figure 1.1.

Source: Joint Australia-Indonesia Ministerial Statements of 17 March, 6 September and 7 December 2005.



Construction of the new village hall at Kajhu Village, Aceh Besar, under the Aceh Community Infrastructure Program (agreed by Joint Commission Ministers in September 2005). This hall is the first of up to 200 village halls to be rebuilt in the province with technical support and funding from the AIPRD. Photo: AusAID

Secretaries Committee and AIPRD Secretariat

Roles and responsibilities

2.11 The Secretaries Committee's primary role is the provision of strategic advice to Australian Ministers, and oversight of the AIPRD programme.

2.12 The AIPRD Secretariat supports the Secretaries Committee and coordinates implementation of the AIPRD programme. It is headed by a senior AusAID official.

2.13 Originally, DFAT expected the Secretariat to be staffed by officials from the agencies represented on the Secretaries Committee.²⁸ Composition of the Secretariat has been more limited in practice. Instead, an interdepartmental working group provides input to papers prepared for the Secretaries Committee.²⁹

²⁸ The Departments of Foreign Affairs and Trade, Prime Minister and Cabinet, Treasury, Finance and Administration, and AusAID.

²⁹ Representation on the interdepartmental working group mirrors the composition of the Secretaries Committee.

Briefings for the Secretaries Committee

2.14 As at November 2005, the Secretaries Committee had met seven times, with the first meeting taking place on 10 February 2005.³⁰

2.15 Meetings consider papers prepared by the Secretariat addressing key strategic issues and new activities for recommendation to Australian Ministers. On the whole, briefing papers prepared by the Secretariat were succinct and well constructed, and made recommendations for decision. The Secretariat prepared clear and succinct records of the decisions made and circulated these in a timely manner.

2.16 The ANAO found that administrative arrangements have supported timely, high-level consideration of issues by the Secretaries Committee and the provision of advice to Australian Ministers on key AIPRD issues. The ANAO considers that addressing the matters identified elsewhere in this report would contribute to enhancing reports to the Secretaries Committee.³¹

Roles and responsibilities of AusAID staff

AIPRD and AIDCP Branches

2.17 The delivery of the two Indonesia aid programmes, the AIDCP and the AIPRD, lies with two separate AusAID Branches. These Branches have about 100 staff in Canberra and Jakarta including Program Support Unit³² staff.

2.18 The respective roles, responsibilities and liaison arrangements of the two Branches were explored and resolved at a joint workshop in May 2005. The results were communicated to staff, with roles, functions and resources articulated in a single Indonesia Group Business Plan for 2005–06.³³

2.19 Risks of duplication are being managed by rationalising day-to-day working arrangements. For example:

³⁰ One 'meeting' was handled by correspondence.

³¹ These matters include a more structured approach to the identification of risks, and the reporting of slippages and contractor concerns during implementation. See paragraphs 4.13 to 4.15; 5.12 to 5.14; 5.49; and 6.21 to 6.30.

³² Program Support Unit staff are AusAID locally contracted staff in Indonesia.

³³ AusAID advised that further rationalisation and integration of the AIPRD and AIDCP team structures has taken place, while the separate identity of AIPRD funded programmes has been maintained.

- the \$50 million AIPRD Government Partnership Fund (see Figure 1.1) is being managed by the AIDCP. This reflects synergies with its Technical Assistance Management Facility; and
- the AIPRD will manage both the new \$78 million Australian Partnership Scholarships scheme, as well as the AIDCP's Australian Development Scholarships.

2.20 These arrangements were formally advised to Indonesia's National Planning Board (BAPPENAS) in August 2005, to assist counterpart agency understanding.

2.21 One aspect that had not been addressed at the time of audit fieldwork was clear articulation of the roles and responsibilities for the Aceh Rehabilitation Program, which was the first AIPRD programme to be implemented.³⁴ This was important as roles and responsibilities are split over three geographic locations—Canberra, Jakarta, and a small Banda Aceh office. AusAID subsequently advised that it had finalised and documented these roles and responsibilities.

2.22 The AIPRD management teams in the Secretariat, Canberra and Jakarta are senior and experienced. The ANAO found that staff in Canberra and Jakarta had a good understanding of their roles and responsibilities. Working relationships are supported by regular meetings of AIPRD staff to discuss, for example, implementation progress and emerging priorities.

2.23 The ANAO concluded that AusAID's internal administrative arrangements for the AIPRD were working well.

³⁴ The Aceh Rehabilitation Program involves a range of assistance to Aceh in Health, Education and local administration.

Aceh Rehabilitation Program: Reconstruction of Banda Aceh Port at Ulee Lheue

- ✚ Ulee Lheue Port was destroyed by the tsunami on 26 December 2004. The Port was a major transport hub providing ferry services for up to 600 passengers a day, including small traders and poor families. It ferried 15 tonnes of goods a day and provided a large cargo ferry service to Medan and the west coast.
- ✚ The Port had also moored the floating power station, which became stranded some kilometres inland following the tsunami.
- ✚ After the tsunami, access for reconstruction materials became a critical issue—the nearest port was a 30 minute drive away—particularly with the increasing deterioration of the main roads system.
- ✚ In early 2005, Australia contributed to the initial restoration of the Ulee Lheue Port through the provision of \$2.5 million of emergency relief funds to the United Nations Development Program. These funds have enabled the rehabilitation of breakwaters, the reconnection of road access, the removal of debris, harbour dredging and the erection of a temporary terminal building.
- ✚ AIPRD funding of \$8 million is being used to reconstruct the Port to full operational capacity. Activities include:
 - rebuilding a permanent terminal building to house the local port authority and other users. This includes supplying electricity, water and sanitation services;
 - improving roads and access to the Port (see photograph below); and
 - strengthening rock revetments to protect the road and Port.



Photo: AusAID

Source: AusAID information.

3. Planning

This chapter examines the strategic planning framework being established to facilitate the delivery of the Australia-Indonesia Partnership for Reconstruction and Development (AIPRD) in a timely and effective way. It also examines AusAID's coordination arrangements as part of the planning process.

Strategic planning framework

3.1 Planning is an activity that allows programme objectives to be clarified, strategies to be developed and measures agreed to track progress in delivering results.

3.2 Key planning considerations for the AIPRD were:

- establishing and obtaining agreement to a *Partnership Framework*. This included the primary objective of the AIPRD, its programme structure and activities along with funding commitments;
- strategies to deliver the objective in a relatively short timeframe. These involved developing a:
 - \$500 million loan programme to target a small number of large infrastructure projects; and
 - \$500 million grant programme;
- coordination arrangements with Indonesian agencies and other donors; and
- performance information to allow judgements to be made on the extent to which AIPRD objectives are being achieved (see Chapter 6).

Development of the Partnership Framework

3.3 The inaugural Joint Commission meeting of 17 March 2005, directed officials to develop a Partnership Framework to guide the joint identification of priority areas for AIPRD funding (see Figure 3.1).

Figure 3.1

Overview of the Partnership Framework

The Partnership Framework:

- sets out the AIPRD's high-level governance arrangements, its primary objective (see Figure 1.1) and guiding principles; and
- identifies Indonesia's main development needs and challenges, and the proposed focus areas for the AIPRD.

The Partnership Framework recognises the tight timeframe for AIPRD implementation (which, at the time, was to be 30 June 2009). Accordingly, it identifies a strategy of focussing on a small number of areas that will have a substantial development impact.

Source: ANAO analysis.

3.4 The Secretaries Committee approved a draft Partnership Framework in June 2005. Discussions on the draft took place with Indonesian officials in July and August. Although the draft Partnership Framework served as a basis for decision-making, delays in officials agreeing the final document,³⁵ and the postponement of the Third Joint Commission Statement from 11 November until 7 December,³⁶ meant that it was not endorsed by Joint Commission Ministers until 7 December 2005.

3.5 By this time, high-level governance arrangements had already been put in place (see paragraphs 2.5 to 2.6) and \$947 million of the \$1 billion had already been committed to AIPRD programme elements. AusAID advised that the draft document (which was largely unchanged) had guided the joint identification of programme activities.

3.6 Overall, the ANAO concluded that the AIPRD Secretariat had sought to develop and progress the document within the AIPRD arrangement.

Updating the Indonesia Country Program Strategy

3.7 At the time of the announcement of the AIPRD, AusAID was already delivering a substantial programme of assistance to Indonesia through the Australia-Indonesia Development Cooperation Program (AIDCP).³⁷ This assistance was underpinned by the *Indonesia Country Program Strategy 2003*.

³⁵ This is an inherent risk in international negotiations.

³⁶ Joint Press Release by the Hon Alexander Downer MP, Minister for Foreign Affairs and the Hon Peter Costello MP, Treasurer, 7 December 2005.

³⁷ The 2005-06 Budget estimate for the AIDCP was \$169.6 million.

3.8 The Partnership Framework sets out objectives for Australia's contribution to Indonesia's economic and social development through both the AIDCP and AIPRD (see Figure 3.2).

Figure 3.2

Objectives for assistance to Indonesia

- Increase and sustain economic growth by strengthening economic and financial management, developing human resources and financing essential public infrastructure.
- Help build the institutions of democracy, particularly through Australia-Indonesia partnerships.
- Promote stability and security while building national emergency management and response capacity.
- Improve the quality and accessibility of government service delivery, particularly in the poorest and most remote provinces.

Source: AIPRD *Partnership Framework*, 7 December 2005.

3.9 The *Country Program Strategy* has not been updated to reflect the AIPRD. AusAID advised that this would occur in 2006.

AIPRD programme structure and funding commitments

3.10 The AIPRD programme structure and funding commitments (see Figure 1.1) are consistent with the intention that, while there would be a focus on Aceh, all areas of Indonesia would be eligible for assistance.³⁸ It also largely reflects the fact that a substantial amount of funding from other donors is available for reconstruction in Aceh.³⁹

3.11 The ANAO found that a number of funding commitment proposals had less rationale in support of them than others. This reflects the reality of limited knowledge of development needs at the time in some areas. For example, in February 2005, the Secretaries Committee agreed to an initial commitment of \$50 million for the Government Partnerships Fund to strengthen Indonesia's economic governance and public sector management capabilities (see Figure 3.3).

³⁸ Media Release, Prime Minister of Australia, 5 January 2005.

³⁹ The availability of funds from other donors can create 'competition' for projects, reducing the number of quality projects for Australian assistance. Another consideration in determining the initial funding to Aceh was the uncertain operating environment, which may have made it more difficult to expend additional funds before the AIPRD was expected to end in June 2009.

Figure 3.3**Outline of the Government Partnerships Fund**

- ✚ The Government Partnership Fund was announced by the Joint Commission on 17 March 2005. It was one of the first AIPRD programmes to be announced.
- ✚ The Fund will provide up to \$50 million to strengthen Indonesia's economic governance and public sector management capabilities. It will fund activities focusing on economic and financial management; public sector management; or other sectoral priorities determined by the Joint Commission.
- ✚ It provides the opportunity for Australian Government departments and agencies to exchange skills, knowledge and expertise with key public sector institutions in Indonesia, and to build long-term institutional linkages and partnerships.
- ✚ Activities will be delivered primarily in the form of technical assistance and training. This may include: institutional strengthening and/or capacity-building for counterpart agencies in Indonesia; training for counterpart staff in either Indonesia or Australia; secondments and work attachments for counterpart staff with their Australian counterpart agency; secondment of Australian staff to advise or work in their counterpart agency in Indonesia; and technical assistance and applied policy research.
- ✚ Generally, proposed activities are to be self-contained. Multi-year proposals will normally receive funding for the initial 12 months and will be reviewed annually by AusAID.

Source: AusAID.

3.12 The supporting argument provided to the Secretaries Committee for the proposed funding commitment to the Government Partnerships Fund was based on amounts provided to similar programmes.

3.13 In these circumstances, where there had been limited information available upon which to assess development needs, it will be important to regularly review the continuing appropriateness of these commitments. This will provide assurance that funding commitments remain in line with AIPRD priorities, and could be part of regular progress reporting to the Secretaries Committee (discussed at paragraphs 6.21 to 6.30).

Recommendation No.1

3.14 The ANAO recommends that AusAID review, at regular intervals, AIPRD programme funding commitments, to ensure they remain appropriate as implementation proceeds. This will be particularly valuable for those programmes where limited information was available at the time of the original commitment.

AusAID response

3.15 Agreed.

Use of loan and grant funds for particular activities

3.16 The Australian Prime Minister's 5 January 2005 announcement noted that, among other things, grant aid would be directed at areas of priority need, including small-scale reconstruction to re-establish social and economic infrastructure.⁴⁰ Loans would *be directed to reconstruction and rehabilitation of major infrastructure in the first instance.*⁴¹

3.17 Accordingly, the Partnership Framework indicates that loans will be used for *a small number of relatively large infrastructure projects*, with a focus on those that augment growth by improving and facilitating the functioning of local and regional economies.⁴²

3.18 Programme funds were credited to two Special Accounts. The stated purposes of the Special Account determinations for grant and loan funds are similar (discussed at paragraphs 5.3 to 5.6). The one difference is that grant funding may also be applied to fund incidental loan expenses. That is, it may be used to fund costs associated with the preparation of loan agreements, the technical design of loan projects, and the management and monitoring of loan performance and repayments.⁴³ Such work is expected to be undertaken by contractors engaged by AusAID.

3.19 The AIPRD has two loan projects. Both projects use grant funds to support project preparation, management and monitoring (see Figure 3.4). This is partly because AusAID considered that it would facilitate the effective design and supervision of loan projects. It also reflects AusAID's view that Indonesian borrowing for projects is best used to fund infrastructure rather than donor design and monitoring costs.

⁴⁰ At the time of the audit, some grant funds were being used for smaller reconstruction projects in Aceh.

⁴¹ Media Release, Prime Minister of Australia, 5 January 2005.

⁴² AIPRD *Partnership Framework*, 7 December 2005.

⁴³ Explanatory Statement for Determination 2005/02—*Australia-Indonesia Partnership for Reconstruction and Development (Grants) Special Account*.

Figure 3.4

Composition of AIPRD loan projects

Project	Comprises
Eastern Indonesia National Roads Improvement Project.	\$300m in loans . \$28m in grants —to be used to support project preparation, management and monitoring.
Basic Education Program (Junior secondary school education).	\$200m in loans . \$75m in grants . \$25m in grants —to be used to support project preparation, management and monitoring.

Source: Third Joint Ministerial Statement of 7 December 2005 and AusAID papers.

3.20 AusAID advised that the loan for the Basic Education Program will primarily be used for new junior secondary schools in under-served and high demand areas. Together with the Roads Improvement Project loan this exhausts the \$500 million in available loan funds. The \$75 million in grants for the Basic Education Program will be targeted at remote areas, and the poorly resourced Islamic education sector.

3.21 Overall, the use of grant funds for donor design and monitoring is likely to facilitate the timely disbursement of loan funds (by helping ensure the effective design of projects) and strengthen AusAID's monitoring of loan projects.



A temporary school in the basement of the Grand Mosque, Banda Aceh.

Photo: AusAID

Loan programme development

Developing loan expertise

3.22 At the time of the announcement of the AIPRD, AusAID had no previous experience in administering a loan programme. It also had little recent experience in working in the infrastructure sector in Indonesia.

3.23 AusAID undertook discussions with the development banks and other bilateral lenders in Indonesia. Following these discussions it identified the World Bank as a suitable better practice model (see paragraphs 3.36 to 3.38).

3.24 In addition, a Loan Working Group of Australian officials was established to prepare advice for the Secretaries Committee on how to progress the loan agreement.⁴⁴

3.25 The ANAO found that timely and pragmatic approaches have been adopted to address the lack of experience in this area.

Developing an umbrella loans agreement

3.26 Initially, a formal loan contract was intended to be an outcome of the first meeting of the Joint Commission, in March 2005. However, the Loan Working Group established that more time was required to address complex legal and institutional issues.

3.27 As a result, the Secretaries Committee resolved to negotiate a non-binding statement of key principles in time for the March 2005 Joint Commission meeting.

3.28 These principles were agreed at the meeting (Figure 3.5), with detailed arrangements to be formalised in a loan agreement 'as soon as possible'.⁴⁵

⁴⁴ The Loan Working Group was chaired by the AIPRD Secretariat and comprised officials from Treasury, AusAID and the Department of Finance and Administration.

⁴⁵ *Joint Media Release Australia-Indonesia*, 17 March 2005.

Figure 3.5

Key terms and conditions of AIPRD loans

- Up to \$500 million.
- Zero interest for up to 40 years.
- No repayment of principal for 10 years.
- Principal to be repaid in annual instalments from Year 11 to Year 40.
- Repayment at the rate of 2 per cent per annum in Years 11 to 20 and 4 per cent per annum in years 21 to 40.

Source: AIPRD Secretariat documents.

3.29 The *Partnership Loan Agreement* to support these principles was being developed by AusAID at the time of the audit. It is intended to cover, among other things:

- Australian involvement in project activities;
- procurement arrangements, procedures and documentation;
- reporting requirements;
- financial management and audit requirements;
- access to records;
- anti-corruption arrangements; and
- arrangements for the suspension and cancellation of loans.

3.30 The first draft of the Partnership Loan Agreement was provided to the Indonesian Government on 1 November 2005, and discussed with Indonesian agencies in November and December. AusAID had expected the Agreement to be finalised by the end of April 2006. This date was not met and AusAID has advised that Indonesian agency processes are likely to delay finalisation until end June.

3.31 The impact of delays in completing the Agreement is discussed below.

Developing individual loan projects and drawing down funds

3.32 By mid 2005, the AIPRD Secretariat had reached the view that it was unlikely that loan funds would be able to be drawn down prior to 2007, and fully disbursed prior to the then expected termination date of 30 June 2009. This was because of the likelihood of a protracted Partnership Loan Agreement development and approval process, and because of deadlines for the Indonesian State Budget processes.⁴⁶

3.33 As a result, two strategies were pursued:

- options to change the balance between loan and grants funds were considered (although by August 2005 it had been decided that the initial approach remained appropriate); and
- proceeding with the identification and development of individual loan projects in parallel with the development of the Partnership Loan Agreement.

3.34 The ANAO concluded that this approach has helped to manage the risk of further delays. Two loan projects have been identified, as discussed below.

Basic Education Program

3.35 The first of these projects is the Basic Education Program (see Figure 3.6). The Indonesian Government accepted a draft design for this \$300 million programme in October 2005. About \$50 million in loan funds (of the total \$300 million for the project) was included in Indonesia's 2006 supplementary budget process. AusAID expects these funds to be drawn down from mid-2006, although this will be dependent upon finalising the Partnership Loan Agreement with Indonesia.

⁴⁶ Indonesian financial years are calendar years. The effective deadline for including concessional loan proposals in the Indonesian State Budget for 2007 is July 2006.

Figure 3.6**Outline of the Basic Education Program**

- ✚ The Basic Education Program was announced by Joint Commission Ministers on 7 December 2005.
- ✚ It comprises up to \$200 million in AIPRD loan funds and up to \$100 million in grant funds.
- ✚ The Indonesian Government is implementing an education reform strategy, committing to nine years of compulsory universal schooling, and undertaking to allocate 20 per cent of Gross Domestic Product to education by 2009.
- ✚ Increasing education levels are known to have a major impact on economic and social development. In developing the AIPRD proposal, AusAID noted that poor children are significantly under-represented at junior secondary level, where the enrolment rate is around 62 per cent. School retention rates are lowest in under-served, remote areas, where schools are in poor condition and have high drop-out rates.
- ✚ The Program seeks to expand access to junior secondary education through the construction and rehabilitation of school facilities in poor, and under-served districts.
- ✚ AIPRD funds are expected to be used to construct 1 500 new junior secondary schools; and expand 900 integrated primary and junior secondary schools.

Source: AusAID.



The launch of construction of Min Merduati primary school, part of the AIPRD's programme of restoring education facilities and services to Banda Aceh. Photo: AusAID

Eastern Indonesia National Roads Improvement Project

3.36 AusAID's discussions with the World Bank identified an opportunity for the AIPRD to help finance a road project that was under development by the World Bank. The National Roads Improvement Project involves a World Bank loan of US\$300 million to improve 2 500 kilometres of the 8 000 kilometres of national roads.

3.37 AusAID considered a parallel AIPRD roads project to be an attractive prospect because it would enable the AIPRD to draw on Bank procedures and management structures. This would speed up fund disbursement. This led to the development of the \$328 million AIPRD Eastern Indonesia National Roads Improvement Project. This project will involve the AIPRD rehabilitating a further 2 000 kilometres of national roads, and replacing 4 500 metres of bridges.

3.38 The ANAO concluded that parallel financing of the World Bank's road project, and building on established Bank procedures and management structures, mitigated the risks from AusAID's lack of previous experience in administering a loan programme and little recent experience in the infrastructure sector in Indonesia.

3.39 Notwithstanding progress with these projects, the disbursement of \$500 million of loan funds between mid-2006 and the anticipated end date of June 2009, would have been particularly challenging. This is because the draw down of loan funds for the Road Improvement Project will not commence before 2007–08. In addition, all loan funds are expected to be disbursed progressively: payments are expected to be made in tranches to a project-specific bank account in Indonesia, with replenishment taking place following the receipt of evidence of eligible expenditures having occurred.

3.40 AusAID advised that the disbursement will also depend on the design, alignment and agreement of detailed annual work programmes, as well as programme management arrangements with the Indonesian Government, in accordance with their budgetary timetables.

3.41 In addition, the amount drawn down will ultimately be determined by the Indonesian Government. Therefore, some key factors are beyond AusAID's control.

3.42 In the context of the 2006–07 Budget, Australian Ministers agreed to extend the timetable for disbursement of AIPRD funds from 30 June 2009 to 30 June 2011.

Coordination with Indonesian agencies and other donors

Coordination with BAPPENAS and other Indonesian agencies

3.43 The AIPRD involves close coordination with Indonesian officials in both planning and decision-making. This includes the involvement of Indonesia’s national planning agency BAPPENAS.

3.44 AusAID advised that this was a particular challenge as a result of pressures on Indonesia’s planning agencies in the immediate aftermath of the disaster. To address this, AusAID took the lead in a number of areas. For example, it initiated development of the Partnership Framework and the draft Partnership Loan Agreement.

3.45 In addition, AusAID established regular Partnership Coordination Meetings with relevant Indonesian authorities, in accordance with the Partnership Framework.

3.46 AusAID is involving Indonesian agencies in developing and delivering individual programmes and activities. Figure 3.7 illustrates this for the Health Assistance Rehabilitation – Aceh Program.

Figure 3.7

Consultation for Health Assistance Rehabilitation—Aceh Program

- A Program strategy will be developed by the contractor for the first 12 months of the Program. This will be submitted first to AusAID for review, and then to BAPPENAS for approval.
- Management and decision-making will occur at the provincial level through a steering committee, which includes AusAID, and the Aceh reconstruction agency, BRR⁴⁷ and provincial planning and health departments.
- Joint approval from the Australian and Indonesian Governments is required for the contractor to continue beyond the first 12 months.

Note: The Program is described further at paragraph 6.3.

Source: ANAO analysis.

⁴⁷ BRR (Badan Rehabilitasi dan Rekonstruksi NAD-Nias) is the Rehabilitation and Reconstruction Agency for Aceh and Nias, established on 16 April 2005.

Secondment of staff

3.47 The Prime Minister's 5 January 2005 announcement anticipated the secondment of Australian officials to BAPPENAS. DFAT documentation indicates that this was to assist Indonesia implement and manage the AIPRD package. AusAID advised the Australian Government in February 2005, that the placement of an AusAID official in BAPPENAS had taken place.

3.48 However, secondments have not actually occurred. AusAID advised that this was because of practical difficulties, including office space constraints in BAPPENAS. AusAID also advised that, at the time of its February 2005 advice to the Australian Government, it was awaiting a response from the Indonesian Government.

3.49 AusAID also advised that it had offered BAPPENAS and other relevant Indonesian agencies the opportunity of placing staff in the AIPRD Office, but that these offers had not been accepted.

Funding for secondments

3.50 Funding of \$2.1 million in 2005–06 for staff expected to be outposted to BAPPENAS was provided from an Administered rather than Departmental appropriation.⁴⁸ The rationale was that such placements would be in the nature of aid (capacity building assistance to Indonesia). Other AIPRD staffing costs, such as salary and administrative expenses for the grant and loan programmes, were funded from a Departmental appropriation.

3.51 In the absence of secondments, the funding has been used to pay for A-based staff⁴⁹ in the AIPRD Office in Jakarta involved in liaison / coordination activities with Indonesian agencies. AusAID considers that this is consistent with the original idea to develop a partnership approach. The Secretaries Committee was advised of this in October 2005.

⁴⁸ *Administered expenses* are those administered by the agency on behalf of the Government. They are normally related to activities governed by eligibility rules and conditions established by the government or Parliament such as grants, subsidies and benefit payments. Agencies have no discretion over how administered expenses are spent. *Departmental expenses* are expenses over which an agency has control. They represent the ordinary net operating costs of government agencies. Departmental expenses include: salaries; accruing employee entitlements; and operational expenses including depreciation.

Budget Paper No. 4, *Agency Resourcing 2005-06*
<http://www.budget.gov.au/2005-06/bp4/html/bp4_introduction.htm>.

⁴⁹ Australia or A-based staff are appointed to the post from AusAID's head office in Canberra.

3.52 However, the effect is that A-based staff in the AIPRD Office in Jakarta are funded out of both Departmental and Administered funds for undertaking similar functions.

3.53 The ANAO suggests that AusAID review the transparency and appropriateness of this arrangement.

Coordination with other donors

3.54 The ANAO found that AusAID has been monitoring the activities of other major aid donors in Indonesia—both governments, and non-government organisations—to inform its own planning activities.

3.55 Such monitoring helps avoid duplication of aid effort and competition for projects. Together with effective coordination, it reduces the risk that important but lower profile projects may be overlooked by donors.

3.56 For example, AusAID has been participating in a range of donor coordination activities in the context of the reconstruction and rehabilitation of Aceh.

3.57 In addition, AusAID is cooperating with other donors, including the United Nations and the World Bank, in a range of areas. Two examples are set out in Figure 3.8.

Figure 3.8

Examples of Australian cooperation with other donors

World Bank

The AIPRD is working with the World Bank to finance a parallel programme (\$300 million in concessional loans) of road transport infrastructure under the proposed National Roads Improvement Project, being financed by the World Bank. AusAID's goal is to expedite project development and share costs of design, supervision and monitoring.

Germany

In May 2005, the AIPRD entered into a cooperative arrangement with the German Federal Ministry for Economic Cooperation and Development to jointly refurbish and rebuild the Zainoel Abidin Hospital in Banda Aceh (see photograph below).

Source: ANAO analysis of AusAID documents.



Construction works at the emergency ward building, Zainoel Abidin Hospital.

Photo: AusAID

World Bank Multi-Donor Trust Fund for Aceh Reconstruction

3.58 In May 2005, the opportunity arose for Australia to contribute to the World Bank Multi-Donor Trust Fund for Aceh Reconstruction. While this would have assisted donor coordination, it was decided not to contribute⁵⁰ but instead to pursue policy dialogue and coordination objectives, including by participating in the fund's Steering Committee as a non-voting observer. AusAID advised that the AIPRD had been represented at most Fund meetings.

⁵⁰ The Secretaries Committee made the decision not to contribute as it was considered to be inconsistent with the bilateral nature of the AIPRD.

4. Risk Management

This chapter examines the arrangements being developed to manage the risks associated with the implementation of the Australia-Indonesia Partnership for Reconstruction and Development (AIPRD).

Introduction

4.1 While the delivery of aid overseas is inherently risky, it is not possible to eliminate all of the risk. It does, however, need to be managed.⁵¹

4.2 Risk management for a large aid programme such as the AIPRD is complex and requires consideration of both:

- strategic and operational risks for the AIPRD; and
- the risks of specific aid programmes and activities.

4.3 This chapter examines AusAID risk management at these levels. It also considers two key considerations in managing risks for the AIPRD:

- risk associated with the timely disbursement of funds; and
- the risk of fraud and corruption.

Strategic and operational risk management

Strategic risk management

4.4 Strategic risks for the AIPRD were not formally identified until August 2005, and provided to the Secretaries Committee for information (see Figure 4.1). However, by then, a number of these risks had already materialised (for example, *delays in reaching agreement on detail of the loan program*).

⁵¹ See ANAO Audit Report No.59, 2001-2002, *AusAID Contract Management*, p58.

Figure 4.1

AIPRD strategic risks

1. Lack of engagement or lack of understanding by Government of Indonesia agencies, leading to disagreements about fundamental directions of AIPRD and/or delays in key decision-making processes, such as identification and approval of new activities.
2. Level of commitments and progress in implementation of agreed AIPRD activities, particularly in Aceh, does not meet community or media expectations, leading to criticisms of the program.
3. Agreed activities do not appear to achieve their intended impacts, leading to criticisms of the program.
4. Implementation of the AIPRD is rendered ineffective by external circumstances, eg, a second major disaster that diverts aid and other resources, a deteriorating security situation that renders implementation of activities difficult or impossible, in Aceh or elsewhere.
5. Delays in reaching agreement on detail of loan program and/or significant under utilisation of loan program by the Government of Indonesia.

Note: 24 associated risk treatments were also identified.

Source: AIPRD Secretariat, *Strategic Risks and Corresponding Treatments*, August 2005.

4.5 AusAID advised that these risks had informed the design of the AIPRD, notwithstanding that they were not explicitly articulated until August 2005. AusAID also advised that the strategic risks were informed by work that commenced at about that time to assess AIPRD operational risks (paragraph 4.7). However, they were not underpinned by a systematic risk assessment, involving, for example, the prioritisation of the risks and an assessment of their likelihood and consequences.

4.6 The ANAO considers that risk management is most effective when it is systematic—including documenting risks and designing treatments—and part of the planning process, rather than a ‘back-end control’, confirming actions already undertaken.⁵² Timely risk management also facilitates the resourcing and targeting of risk mitigation measures.

Operational risk management

4.7 Work on an operational risk management plan for 2005–06 (the AIPRD Risk and Fraud Management Plan) was also subject to delays.

4.8 Development of the AIPRD Risk and Fraud Management Plan commenced in July 2005. It was managed by the AIPRD Office in Jakarta, with

⁵² See ANAO Better Practice Guide on *Public Sector Governance*, July 2003.

staff workshops held to help identify relevant risks and treatments. However, work was suspended due to competing priorities.

4.9 The ANAO made a number of suggestions to assist completion, including: identifying *likelihood* and *consequence* ratings to assist the future review of the overall *risk rating*, and assessing *residual risk*⁵³ to better inform management about its acceptability.

4.10 The AIPRD Risk and Fraud Management Plan was completed in February 2006, without incorporating these ANAO suggestions. AusAID advised that the Plan would soon be reviewed to take into account recent developments, including revised management arrangements for the AIPRD and AIDCP (see Footnote 33) and the findings of this audit.

4.11 AusAID considers that the preparation of the Plan to be timely, and advised that the level of detail and documentation would improve as specifics of proposed activities became clearer. However, the Plan was not completed until eight months into the relevant financial year, and over 12 months after the announcement of the AIPRD. By this time significant decisions had been made, and a number of risks had already materialised.

4.12 As with the strategic risks, more timely, systematic and structured risk management would have been consistent with sound practice, and have been of greater value in contributing to management decision-making.

Risk management for specific activities and programmes

Advice to the Secretaries Committee

4.13 Identification of key risks is important for governing and advisory bodies considering major projects/proposals.⁵⁴ However, the ANAO found that some proposals for new activities provided to the Committee explicitly identified risks, while others did not.⁵⁵

4.14 AusAID advised that it had not been asked for additional information. It also considers that advice on individual activity risks would have added potentially unnecessary information to briefing material.

⁵³ The risk that remains after taking into account the treatments identified.

⁵⁴ ANAO Better Practice Guide, *Public Sector Governance*, July 2003 (Volume 1, page 19).

⁵⁵ For example, at one meeting a range of risks associated with a proposal were identified, whereas other proposals did not have risks identified.

4.15 While the Secretaries Committee determines its information requirements, a more structured approach to briefing the Committee on risks would provide greater assurance that risks are being identified and assessed, consistent with need—that is, briefing on risks is fit for purpose.

Developing detailed risk management matrices

4.16 The ANAO examined the risk management approach for two AIPRD programmes that were being designed during ANAO audit fieldwork—the Aceh Rehabilitation Program and the Disaster Management Program. Risk management matrices were being developed for both programmes, including a process of peer review.

4.17 There was a systematic approach to developing a risk management matrix for the Aceh Rehabilitation Program (see Figure 4.2).

Figure 4.2

Aceh Rehabilitation Program (\$80 million)

The draft risk management matrix for this programme identified more than 60 risks and allocated them to categories of: AIPRD partnership; donor coordination; strategy development; programme design; programme quality; performance management; risk management; conflict analysis; and programme management.

The risks were categorised for ease of reference and review. Risk likelihood and consequences were rated, with an overall risk rating. Responsibilities and a timeframe for managing the risks were identified. The matrix drew upon, and was cross-referenced to, earlier relevant ANAO audit findings.⁵⁶

The coverage of some risks, such as fraud and corruption, was dealt with at a high level, and will require more detailed coverage in due course at the individual activity level.

Source: ANAO analysis of AusAID documents.

4.18 The Aceh Rehabilitation Program involves a number of component activities. These include health, education and construction activities, which were just commencing during the audit. Tenderers to manage these activities will be required to prepare initial risk management plans, with the successful contractor required to produce programme strategies, workplans and regular reports that address risk.⁵⁷

4.19 The risk management approach for the Disaster Management Program was less systematic (see Figure 4.3).

⁵⁶ ANAO Audit Report No.20, 2003-3004, *Aid to East Timor*.

⁵⁷ The contractor is required to prepare a risk analysis as part of a Program Strategy covering the first 12 months of the programme, and as part of six-monthly workplans. The contractor is then required to report on risk as part of its regular reporting to AusAID.

Figure 4.3

Disaster Management Program (\$10 million)

This programme aims to strengthen Indonesia's disaster management and response systems. The draft workplan included a risk management matrix that identified a limited range (five) risks. The risks were rated high, medium or low, identified consequences and a management strategy.

However, risk likelihood and consequences were not rated, and responsibility for managing the risks was not clearly identified. This would impede management decision-making, review and monitoring.

Source: ANAO analysis of AusAID documents.

4.20 AusAID advised that, at the time it prepared the risk management matrix for the programme, it had not been possible to scope risks and contributing factors in detail. AusAID also advised that it is likely to revise the workplan and risk management matrix to take account of events and risks that have emerged since.

4.21 The more systematic risk management approach that was being developed for the Aceh Rehabilitation Program would be a useful better practice example for AusAID to draw on both for its review of the Disaster Management Program and more widely.

4.22 AusAID's approach could also be enhanced by including residual risk, after taking into account treatments, which would better inform management about the acceptability of risk.

4.23 Overall, the ANAO considered that there was a variable approach to risk identification, both for strategic advice and in developing more detailed risk management matrices.

Risks to timely disbursement of funds

4.24 As discussed at other parts of this report the scale of the AIPRD and timeframe for its implementation (initially to 30 June 2009, recently extended to 30 June 2011), create challenges to the timely disbursement of funds.

4.25 The key approach in the AIPRD to manage this risk is to focus on a small number of activities, across a limited range of sectors, which are expected to have a substantial development impact. This should reduce the extent of design and implementation effort and costs, compared with a broader range of activities.⁵⁸

⁵⁸ AIPRD *Partnership Framework*, 7 December 2005.

4.26 Other measures to manage the risk to the timely disbursement of funds include:

- establishing a management team of senior and experienced officers (paragraph 2.22);
- leveraging off existing activities. For example, the Australian Development Scholarships programme (paragraph 5.45 and Figure 5.2); and
- utilising the experience of others, such as the World Bank to expedite project development and share costs (paragraph 3.36 to 3.38).

4.27 Overall, AusAID has recognised the need to address the risk to the timeframe. The approaches being adopted for this particular risk provide a focus and urgency to this issue. Notwithstanding this, there has been slippage in AIPRD implementation in the first year of the programme (see Figure 5.1).

4.28 The extension of the timetable for disbursement of AIPRD funds from 30 June 2009 to 30 June 2011 provided for in the 2006–07 Budget reflects this slippage.

Risk of fraud and corruption

4.29 Fraud and corruption are recognised risks in many countries in which AusAID works. This is the case in Indonesia, where corruption is reported to be a widespread problem.⁵⁹ Its seriousness was noted in the 2005 Ministerial Statement on Australia’s aid programme.⁶⁰ In addition, it is recognised at the strategic risk level for the AIPRD (Figure 4.1) where one of the risk treatments requires the development of *designs for all major activities that take account of corruption*.⁶¹

4.30 International development banks also report that Indonesia’s procurement system is inherently weak.⁶² Problems include:

- collusion between bidders;

⁵⁹ On Transparency International’s *Corruption Perceptions Index 2005*, Indonesia ranked equal 137th out of 158 countries (the higher the ranking, the higher the perceived corruption).

⁶⁰ *Australia’s Overseas Aid Program 2005-06*, Statement by the Honourable Alexander Downer MP, Minister for Foreign Affairs, 10 May 2005, page 12.

⁶¹ AIPRD Secretariat, *Strategic Risks and Corresponding Treatments*, August 2005.

⁶² See, for example, the World Bank Report *Combating Corruption in Indonesia—Enhancing Accountability for Development*, October 2003.

- supply of poor quality materials and equipment, insufficient quantities or substitution of materials (e.g., wood for steel); and
- requests for unjustified contract amendments.

4.31 AusAID reports that the Indonesian Government has shown encouraging signs of a readiness to tackle corruption.⁶³ The President of the Republic of Indonesia has stated:

I have declared my commitment in fighting against corruption as a national movement in December 2004. We will press on as hard as we can in the fight against corruption. We have registered encouraging progress in dealing with corruption in this country. We are strongly determined and committed to ensure that there will be no corrupt practices in the spending of these rehabilitation and reconstruction funds.⁶⁴

4.32 AusAID advised that there have been six suspected cases of fraud against Australia's overseas aid programme in Indonesia reported over the last four years. These occurred in 2004–05 and 2005–06.⁶⁵ (Appendix 1 shows total suspected cases of fraud across the whole aid programme for the years 2002–03 to 2004–05.)

4.33 AusAID employs a range of approaches to manage the risk of fraud and corruption. These occur within the framework of its *Fraud Control Policy* and associated *Guidelines and Procedures when Suspecting Fraud*. These documents were reissued in July 2005. AusAID is also updating its *Fraud Control Plan* (dated 2003).

4.34 The rest of this chapter addresses management of the risk of fraud and corruption through overarching contractual arrangements, as well as specific approaches for AIPRD grants and loans.

⁶³ See *Indonesia: Analytical Report for the White Paper on Australia's Aid Program*, September 2005.

⁶⁴ Keynote Speech by the President of the Republic of Indonesia to the *International Conference on Promoting Financial Accountability in Managing Funds Related to Tsunami, Conflict and Other Disasters*, Jakarta, 25-27 April 2005.

⁶⁵ They involved a total of \$23,994 and, at the time of audit, were the subject of ongoing investigation.

Contractual arrangements

4.35 A traditional risk mitigation measure used in Australia’s overseas aid is the use of Australian Managing Contractors⁶⁶ to deliver aid on-the-ground. This means that funds are largely channelled through the contractors.

4.36 The contracts have standard clauses aimed at preventing contractors and subcontractors from engaging in fraudulent activity. These are summarised in Figure 4.4.

Figure 4.4

Summary of contract clauses designed to prevent fraud and corruption

The contractor:

- ✓ must not make or receive any offer, gift or payment, which could be construed as an illegal or corrupt practice;
- ✓ must not engage in any fraudulent activity;
- ✓ must prepare a fraud risk assessment and zero tolerance fraud control strategy (with processes and procedures that comply with *Commonwealth Fraud Control Guidelines*);
- ✓ is responsible for preventing and detecting fraud, including by a subcontractor;
- ✓ must report detected or suspected fraud to AusAID;
- ✓ is responsible for the conduct of the investigation (although AusAID reserves the right to appoint its own investigator);
- ✓ must repay money misappropriated due to internal or subcontractor fraud, or make every effort to recover AusAID funds from another party; and
- ✓ must comply with Australian and partner government laws relating to corrupt practices, including those relating to the bribery of Commonwealth and foreign public officials.

Source: ANAO analysis of AusAID standard contract clauses.

4.37 The ANAO examined two AIPRD contracts of over \$2 million value, and found that the relevant clauses were included. The ANAO suggests that, in light of the risk of corruption in procurement in Indonesia, AusAID give consideration to requiring major contractors to formally affirm, at appropriate intervals, their compliance with those contract clauses.

4.38 During the audit, the Organisation for Economic Cooperation and Development (OECD) recommended that AusAID strengthen aspects of its contract clauses relating to the bribery of foreign public officials.⁶⁷ AusAID

⁶⁶ An Australian Managing Contractor (AMC) is typically a large Australian company, partnership or consortium which is contracted to AusAID to deliver the aid project. The AMC often subcontracts to obtain additional expertise required to implement aid activities.

⁶⁷ *Australia: Phase 2—Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, OECD, January 2006.

advised that it considered its standard clauses prohibited all forms of fraud. However, it would adjust them to more explicitly prohibit the bribery of public officials.

4.39 In response to the OECD report, AusAID also revised its standard request for tender documentation to require tenderers to declare any previous bribery conviction or current proceedings that could lead to a conviction. It also revised its standard contract provisions to enable termination where a contractor is convicted of bribery after the contract has been entered.

4.40 AusAID advised that it has access to information from the World Bank and Asian Development Bank relating to corruption disbarments and that this information is checked as part of its normal tendering processes to ensure that bidders have a clean track record.⁶⁸

AIPRD grants

4.41 Key control processes for the \$500 million of grant funding, such as procurement and the disbursement of funds, are under AusAID's direct control.

4.42 The AIPRD Risk and Fraud Management Plan (paragraphs 4.7 to 4.12) identifies a limited range of fraud and corruption risks, and related treatments,⁶⁹ for grant funding:

- contractors receive and/or make illicit payments (rated *High*);
- AIPRD personnel receive and/or make illicit payments (not rated); and
- maintaining integrity and a perception of integrity in selection processes held in Indonesia (rated *High*).

4.43 The Plan does not identify other potential sources of fraud risk. For example, potential fraudulent activity from: beneficiaries, independent observers or monitors, and government officials.

4.44 The ANAO suggests that the intended review of the Plan (paragraph 4.10) address these and other potential risks in more depth. This will help

⁶⁸ The World Bank imposes sanctions on contractors found to have engaged in fraudulent and corrupt activities, disbarring them from future work, and posting their names on the Bank's website. The ANAO suggested that AusAID monitor such disbarments to inform AIPRD procurements and consider the application of similar sanctions against contractors found to have engaged in fraudulent or corrupt activities involving AIPRD procurement contracts.

⁶⁹ Treatments include anti-corruption plans for activities, and training for staff.

provide greater assurance that appropriate measures will be put in place to treat the risks.

4.45 As with all risk management, the key challenge for AusAID will be to ensure that the AIPRD Plan and mitigation measures are implemented. This includes regular review of the effectiveness of risk mitigation measures, as well as monitoring any changes to risks over the life of the AIPRD.

Fraud control measures for Aceh construction

4.46 The ANAO examined the arrangements in place to manage the risk of fraud for a key contract, in place at the time of the audit. This was the Aceh interim construction contract. These measures are set out in Figure 4.5.

Figure 4.5

Aceh interim construction contract—key fraud control measures

Background

- In May 2005, a \$2 million contract was let for construction management in Aceh.
- The contract was let against a background of rising construction costs in Aceh, caused by a shortage of skills and material.

Key Measures

- The contractor works with independent, AusAID-engaged advisors to develop proposals for AusAID consideration for each sector (Health, Education, etc).
- AusAID engaged another contractor to review various aspects of the main contractor's management. These included the risk of collusion between subcontractors bidding for work. Among other things, this review recommended that the number of firms short listed for AIPRD tendering activities be increased from five to no less than eight. The main contractor advised that it had adopted the recommendation, and that a number of tenders had been terminated and re-tendered, where it suspected that collusive bidding had taken place.
- AusAID put in place an arrangement to approve each subcontract. The tender recommendation contained an engineer's estimate for comparison purposes.
- AusAID engaged an Engineering Technical Adviser to provide it with independent advice on the contractor's proposals.

Source: ANAO analysis of AusAID papers.

4.47 In February 2006, AusAID advised that it had built these control arrangements into the subsequent Aceh construction contract.

4.48 The ANAO concluded that AusAID had considered the risk of fraud in this contract and had established controls to reduce risks.

AIPRD Loans

4.49 Procurement processes for the \$500 million of loan funds will not be under AusAID's direct control. Instead, Indonesian Government agencies will contract with individuals and companies to supply goods and services funded by the loans.

4.50 At the time of audit, AusAID was seeking to finalise the Partnership Loan Agreement (see paragraph 3.29 to 3.30). The draft Agreement provides, among other things, for:

- an Anti-Corruption Action Plan—each project loan agreement (unless otherwise agreed) would include a Plan *setting out arrangements and procedures to ensure the highest standards of transparency and accountability in the implementation of the project*;
- termination for corrupt activities—the Commonwealth of Australia would have the right to terminate future loan advances under a project loan where it determines with respect to any contract that corrupt, fraudulent, collusive or coercive practices were engaged in, and to recover amounts involved; and
- audit access—this would enable *the Commonwealth and/or its nominees access to premises, data, records, accounts and other [relevant] material however and wherever stored, [in the Indonesian Government entity's] or contractors' custody, possession or control, for inspection and copying.*

4.51 It is also intended that the Agreement require the involvement of independent experts as *observers* in all procurement processes.⁷⁰

4.52 At this stage of development and negotiation, proposed arrangements through the Partnership Loan Agreement provide an appropriate focus on mitigation of the risk of fraud and corruption in the loan programme.

4.53 One particular approach adopted by the World Bank involves a global 24 hour anti-corruption hotline to report incidents of corruption. While this may not be a viable option for the AIPRD, the ANAO suggested that AusAID actively encourage beneficiary communities to report any corrupt activities

⁷⁰ Initially, AusAID was seeking to involve Australian representatives or independent experts as *participants* or *observers* in procurement, monitoring, audit, quality assurance, and oversight and supervision processes. However, AusAID advised in February 2006 that Indonesian regulations would not permit the involvement of foreigners as *participants* in procurement decision-making. AusAID also advised that it would continue to seek either Australian or independent expert involvement in other processes such as activity monitoring, audit, quality assurance, oversight and supervision.

involving AIPRD funds to AusAID. AusAID advised that the Anti-Corruption Action Plans will provide a mechanism to report incidents of corruption involving AIPRD funds.

Conclusion—fraud and corruption risk

4.54 Overall, there is a focus on the risk of fraud and corruption in the management of the AIPRD. Proposed measures to mitigate these risks provide, at this stage in the development of the AIPRD, a reasonable assurance that these risks are being addressed. The key challenge for AusAID is that these measures are actively pursued over the full life of the AIPRD, and monitored for effectiveness. This includes regular review of the effectiveness of risk mitigation measures, as well as any changes to risks.

5. Financial Management

This chapter examines the financial management arrangements for Australia-Indonesia Partnership for Reconstruction and Development (AIPRD) funds.

Introduction

5.1 AusAID is responsible for financial management of the AIPRD, in accordance with the provisions of the *Financial Management and Accountability Act 1997* (FMA Act) and associated Regulations and Orders.⁷¹

5.2 Administered AIPRD funds were provided through the *Appropriation (Tsunami Financial Assistance and Australia-Indonesia Partnership) Act 2004–2005*.⁷² A related Act—the *Appropriation (Tsunami Financial Assistance) Act 2004–2005*—among other things, provided AusAID with \$1.632 million in departmental funding to support AIPRD operations in 2004–05.⁷³

Special Accounts

5.3 Administered (programme) funds were credited to two Special Accounts of \$500 million each, the:

- *Australia-Indonesia Partnership for Reconstruction and Development (Grants) Special Account*; and
- *Australia-Indonesia Partnership for Reconstruction and Development (Loans) Special Account*.⁷⁴

5.4 A key reason for establishing the two Special Accounts was to ensure that AIPRD funds remain separate from other aid moneys.⁷⁵ Their purposes are similar. Funds can be applied for:

⁷¹ The Treasurer's Second Reading Speech for the *Appropriation (Tsunami Financial Assistance and Australia-Indonesia Partnership) Bill 2004-2005*, p3, 9 March 2005.

⁷² In addition to the \$1 billion AIPRD programme funding, AusAID received \$944 000 for expenses related to the AIPRD Office in Jakarta. The Department of Defence and the Health Insurance Commission also received amounts of \$488 000 and \$94 000, respectively.

⁷³ This Act also funded AusAID and other Australian Government agencies for expenditures incurred in the emergency response to the tsunami (not examined in this audit).

⁷⁴ See <<http://www.comlaw.gov.au/>>

⁷⁵ The Treasurer's Second Reading Speech for the *Appropriation (Tsunami Financial Assistance and Australia-Indonesia Partnership) Bill 2004-2005*, p2, 9 March 2005.

.....relief, rehabilitation and reconstruction assistance to areas in the Republic of Indonesia directly affected by the Tsunami and economic and social development assistance to all areas of the Republic of Indonesia...⁷⁶

and may include activities related to: humanitarian relief; construction, management and operation of health and education facilities; governance assistance; and disaster preparedness assistance (see Appendix 2).

5.5 The one difference between the purposes to which grant and loan funds may be put is that grant funds may also be applied to fund incidental activities related to loans (discussed at paragraphs 3.18 to 3.19).

5.6 The similarity of purpose was to provide maximum flexibility between the two Accounts, as the content of the AIPRD was still being developed at that time.

Reporting of the Special Accounts

5.7 Special Accounts are subject to particular reporting requirements. Agencies are required to disclose, among other things, opening balances, receipts, payments, adjustments and closing balances for each Special Account in the Portfolio Budget Statements. AusAID reported this information for 2005–06.

5.8 AusAID's 2004–05 Financial Statements also met the requirements to disclose total receipts, payments and balances for each Special Account. The ANAO found that the Statements gave a true and fair view of its financial position at 30 June 2005.

Expenditure and management of funds

Disbursement of funds

5.9 The AIPRD had an initial termination date of 30 June 2009, although the Special Account determinations do not limit expenditure to a particular period.⁷⁷ This date was extended to 30 June 2011 in the context of the 2006–07 Budget. Figure 5.1 illustrates the current (May 2006) estimated disbursement of

⁷⁶ This wording is common to both the grant and loan Special Accounts.

⁷⁷ The Special Accounts provide for amounts to be debited from them to reduce their balance, thereby extinguishing all or part of the appropriation which is limited to the balance of the Account. If a balance remains in the Special Account when the programme is completed, this balance would be extinguished by abolishing the Special Account.

the funds through the Special Accounts compared with initial estimates (in March 2005⁷⁸), and those at the time of the 2005 Budget and in February 2006.

Figure 5.1

Estimated disbursements of AIPRD grant and loan funds

\$m	04-05	05-06	06-07	07-08	08-09	09-10	10-11	Total
Grants:								
Mar 2005	60	110	110	110	110	0	0	500
May 2005 (Budget)	10	115	125	125	125	0	0	500
Feb 2006	8	102	(Note 2)	(Note 2)	(Note 2)	0	0	NA
May 2006 (Budget)	8	92	120	130	100	50	0	500
Loans:								
Mar 2005 (Note 1)	0	125	125	125	125	0	0	500
May 2005 (Budget)	0	15	125	180	180	0	0	500
Feb 2006	0	0	(Note 2)	(Note 2)	(Note 2)	0	0	NA
May 2006 (Budget)	0	0	55	90	145	160	50	500
Totals								
Mar 2005	60	235	235	235	235	0	0	1 000
May 2005 (Budget)	10	130	250	305	305	0	0	1 000
Feb 2006	8	102	(Note 2)	(Note 2)	(Note 2)	0	0	NA
May 2006 (Budget)	8	92	175	220	245	210	50	1 000

Notes: (1) 2004–05 and 2005–06 are from the loans Special Account *Explanatory Statement* of March 2005. No estimates were made at that time for 2006–07 to 2008–09: this table therefore assumes the same amount each year as 2005–06.

(2) AusAID advised that the forward estimates would be refined through future budget processes.

Source: Budget papers, AIPRD Secretariat and AusAID.

5.10 As Figure 5.1 illustrates, disbursement of the funds is now anticipated to occur later than initially estimated. Among other things, this reflects the fact that the original estimates were developed prior to the inaugural Joint Commission meeting on 17 March 2005 (which determined initial priorities) and prior to the completion of the initial planning work for the reconstruction of Aceh by the Indonesian Government.

⁷⁸ The *Appropriation (Tsunami Financial Assistance and Australia-Indonesia Partnership) Act 2004-2005*, which appropriated the \$1 billion, was assented to on 22 March 2005.

5.11 The disbursement of loan funds has proven to be particularly difficult, (see discussion at paragraphs 3.32 to 3.41 and 4.24 to 4.27). Loan funds are not expected to be drawn down until 2006–07, initially for the Basic Education Program (see paragraph 3.35).

Reporting overall AIPRD expenditure outcomes to the Secretaries Committee

5.12 The Secretaries Committee has been advised of lower overall AIPRD expenditure estimates. However, these briefs have not clearly contrasted these lower estimates with the original Budget estimates.⁷⁹

5.13 Clearer comparison of revised estimates to original estimates would enhance accountability, and better equip the Secretaries Committee to monitor progress, particularly as expenditure progresses.

Recommendation No.2

5.14 The ANAO recommends that the AIPRD Secretariat regularly brief the Secretaries Committee of variations to overall AIPRD expenditure estimates, and the reasons for those variations.

AusAID response

5.15 Agreed.

Internal budgeting and accounting

5.16 AusAID has established account codes in its financial management information system so that AIPRD grants and loans expenditure can be identified and separately reported, along with individual programmes and activities.

5.17 The financial management information system also enables AusAID to apportion and monitor AIPRD administration and management costs of the AIPRD Secretariat in Canberra, the AIPRD Office in Jakarta, and the grant and loan programmes.

5.18 The ANAO considers that these arrangements provide a basis for future internal and external budgeting, monitoring and accountability.

⁷⁹ For example, Secretaries were advised in November 2005 that '... AIPRD remains on track to achieve the projected expenditure outcome of \$102 million by the end of this financial year'. However, it was not advised that the Budget Estimate was \$115 million in grants and \$15 million in loans (see Figure 5.1).

Funding of some administration costs

5.19 The rationale for providing supplementary funding for the administration costs of Australian Government agencies was to ensure that the full \$1 billion is available for Indonesia's reconstruction and development.⁸⁰ However, there are, in practice, a number of variations to this principle.

5.20 For example, the salary and administrative costs of employing AusAID Program Support Unit⁸¹ staff (estimated at \$1.1 million in 2005–06) are being funded out of grant funding. Another example is the funding of some publications, media information and photography from grants.

5.21 AusAID advised that arrangements reflect those for the AIDCP, which are agreed with the Indonesian Government, as well as arrangements with other partner governments.

5.22 However, it is not clear that this was envisaged at the time funding arrangements were originally developed. In addition, the Secretaries Committee has not been briefed that these costs are being funded from grant funding.

5.23 In the context of the Government's aim that the full \$1 billion be available for reconstruction and development, more explicit arrangements for consideration and approval of such expenditure are warranted.

Procurement arrangements for grant funding

5.24 Procurement by AusAID, for the direct purposes of providing foreign aid, is exempt from the mandatory procurement procedures set out in the Commonwealth Procurement Guidelines (CPGs),⁸² and from the application of all bilateral free trade agreements that Australia has entered into. However, from 1 July 2005, to emphasise accountability and transparency, AusAID elected to apply the CPGs open and competitive procurement procedures for:

- *service* (non-construction) procurements above \$500 000; and
- *construction* procurements above \$6 million.

⁸⁰ The Treasurer's Second Reading Speech for the *Appropriation (Tsunami Financial Assistance and Australia-Indonesia Partnership) Bill 2004-2005*, p3, 9 March 2005.

⁸¹ Program Support Unit staff are AusAID locally contracted staff in Indonesia.

⁸² Appendix B of the *Commonwealth Procurement Guidelines*, January 2005, exempts 'procurement for the direct purpose of providing foreign assistance' from *Division 2 — Mandatory Procurement Procedures*.

5.25 *Service* contracts under Australia's bilateral aid programme are traditionally restricted to companies carrying on business in Australia or New Zealand. Since 1 January 2005, recipient country firms have also been eligible to tender for work in their recipient country. *Construction* contracts are normally subject to the principles of International Competitive Bidding, that is, 'unrestricted'.

5.26 The Government modified these arrangements for AIPRD contracts in two key areas to emphasise the bilateral partnership approach:

- Indonesian companies bidding for work must have *majority* local Indonesian ownership/shareholding;⁸³ and
- the International Competitive Bidding requirement for construction contracts was waived, effectively restricting bidding to Australian, New Zealand and Indonesian companies.

Monitoring the competitiveness of bids

5.27 The Government requested that bids be monitored for any impact of the modified arrangements on costs and quality. Accordingly, AusAID has monitored the competitiveness of bids for AIPRD long-term activities (both service and construction) since June 2005, with provision for referral to Australian Ministers should competition prove insufficient.

5.28 AusAID reported to the Secretaries Committee in February 2006, that while it had not been possible to reach any definitive conclusion, there are warning signs of limited competition. This relates to the small fields of bidders in the infrastructure sector, and relatively high initial bids for one major infrastructure tender. Monitoring and reporting will continue.

5.29 The ANAO suggests that AusAID publicly report the outcomes of this monitoring, to facilitate AIPRD accountability and transparency.

⁸³ The Secretaries Committee amended this arrangement in June 2005 to allow some discretion. In effect, AusAID will assess on a case-by-case basis the eligibility of any organisation that does not strictly meet the AIPRD eligibility criteria but which represents a 'genuine' partnership between Australian or New Zealand and Indonesian firms. An example of this would be an Indonesian company with 60 per cent Australian or New Zealand shareholding and 40 per cent Indonesian shareholding.

Joint management arrangements

5.30 Consistent with the partnership approach to the AIPRD, at the time of the audit AusAID was seeking to put in place joint management arrangements with the Indonesian Government for the procurement of services under AIPRD grants. In particular, involving Indonesian agencies in project design, tender selection and contract management, albeit with successful tenderers contracted by AusAID on behalf of the Australian Government.

5.31 For example, during the audit Indonesian representatives had participated in tender assessment panels for two key contracts in the health and education sectors in Aceh. AusAID advised that the representatives had added value to the process.

Timeliness of putting contracts into place

5.32 The ANAO observed nine contracts had been signed after the provision of services had commenced. In one case, a contractor's work was extended, and the contractor subsequently paid, without a contract being in place for the extended period. AusAID advised that in this case, there was sufficient exchange of correspondence to commit the Australian Government. AusAID also advised that there had been a number of occasions where contracts were never put in place.

5.33 The ANAO notes that, at least in four of the nine cases, AusAID was delivering aid after the emergency period had passed. AusAID advised that this approach is not normal practice, but reflected urgent circumstances. It also advised that the contract terms had been agreed between AusAID and the contractors.

5.34 Notwithstanding this, there are sound reasons for contracts to be finalised prior to work commencing—it protects the Australian Government's interests and makes arrangements clear. The risks to the Australian Government increase the longer a contract remains unsigned.

5.35 The ANAO considers that stronger management of contracting arrangements is required to limit the extent to which this occurs, and the length of any delays.⁸⁴

⁸⁴ A similar finding was made by the ANAO in its Report No.59 2001-2002, *AusAID Contract Management*. Recommendation No.5: 'The ANAO recommends that AusAID assess the risks of contractors undertaking work without a formal variation being in place and consider means of managing this situation in a more systematic manner.' The recommendation was agreed by AusAID.



Launch of construction of a new village hall at Kajhu Village. The tsunami killed over 2 000 of Kajhu's 3 000 residents, destroyed all homes and most infrastructure. Only the mosque was left standing. Photo: AusAID

Direct sourcing for procurement

5.36 The Commonwealth Procurement Guidelines (CPGs) promote the use of competitive tendering to ensure *value for money*, the core principle underpinning the Guidelines. However, the CPGs also provide for circumstances where direct sourcing may be used, including where:

- in response to an approach to the market, no potential suppliers satisfied the conditions;
- the property or services can only be supplied by a particular business; and
- for reasons of extreme urgency brought about by events unforeseen by the agency, the property or services could not be obtained in time under open tendering procedures.

5.37 The ANAO examined six contract files where direct sourcing, rather than competitive tendering, was used.

5.38 The ANAO found that the reason for direct sourcing was recorded, and that an appropriate delegate had approved each proposal.⁸⁵

5.39 Direct sourcing was used in the emergency response phase to quickly contract services, but was also used well after that phase. Reasons given for direct sourcing include:

- the individual is the only person who can provide the service;
- unable to identify other consultants with the same depth of experience;
- the re-engagement of the company will ensure that momentum is maintained on construction works in Aceh, to meet humanitarian needs and political imperatives; and
- the extreme urgency of the situation justifies varying an existing contract to deliver the service within the timeframe.

5.40 Examples are assessed below.

Aceh interim construction contract

5.41 A contractor won a \$2 million contract, through a tender process, to provide construction management support in Aceh following the departure of the Australian Defence Force. The contract ran from the end of April 2005 for three months, with two one-month options to extend. Both options were exercised. At the time the first option was exercised in July, action was underway to address serious concerns with the contractor's performance. (How AusAID addressed these concerns is discussed at paragraphs 6.10 to 6.15.)

5.42 The contractor was awarded a further contract valued at \$20 million⁸⁶ without a tender process. This involves the contractor acting as a construction management consultant. The contractor has responsibility for the management of the entire Aceh construction programme, as well as design, tendering and management of the construction of sub-projects. AusAID advised that, at the time the contract was awarded, its concerns regarding contractor performance had been addressed.

⁸⁵ Financial Management and Accountability (FMA) Regulation 8 provides that an official must have regard to the Commonwealth Procurement Guidelines in procuring property or services. An official who takes action inconsistent with the Guidelines must make a written record of his or her reasons for doing so.

⁸⁶ AusAID advised that the final cost of this contract is expected to be approximately \$11 million.

5.43 The further contract was to run from 1 October 2005 to 28 February 2006, but was also extended to 31 March 2006. AusAID advised that the contract is to be replaced with a longer-term construction contract valued at \$40 million, with the successful contractor selected through a competitive tendering process.

5.44 A key reason for extending the contract from 1 October was to meet expectations that construction of the Banda Aceh hospital emergency ward would be opened by the first year anniversary of the tsunami.⁸⁷

Australian Partnership Scholarships

5.45 A \$78 million contract with AusAID's existing Australian Development Scholarships provider will be used to deliver the AIPRD Australian Partnership Scholarships programme.⁸⁸ The programme is outlined in Figure 5.2.

Figure 5.2

Australian Partnerships Scholarship programme

- ✦ The Australian Partnerships Scholarships programme was announced by the Australian Prime Minister and Indonesian President on 4 April 2005.
- ✦ The programme will provide about \$78 million to fund up to 600 new scholarships for Indonesian students to undertake higher degree (post graduate) study at any Australian university. The scholarships are valued at about \$100 000 each.
- ✦ The objective of the programme is to increase the human resource capacity of Indonesia in the areas of economic governance, public sector management and education. The programme is intended to support Indonesia's reconstruction and development efforts by contributing to the development and advancement of its future leaders.
- ✦ A joint selection process is overseen by the Australian and Indonesian Governments. The programme is managed through the AIPRD Office in Jakarta.
- ✦ Unlike the existing Australian Development Scholarships (300 scholarships each year) applicants for the new programme are required to be public or non-public sector employees.
- ✦ The first intake of scholars was selected for English language training in 2005, prior to commencing studies in 2006.

Source: AusAID.

5.46 AusAID did not go to tender for this contract. In briefing the delegate approving the expenditure, officials noted that the 'extreme urgency' of delivering the scholarships programme in the time available justified the extension of the existing contract. However, the submission did not formally

⁸⁷ The Minister for Foreign Affairs opened the emergency ward on 8 December 2005.

⁸⁸ Most of this expenditure is in the form of transfer payments to institutions and students.

seek approval for direct sourcing. This contrasts with the Aceh interim construction contract discussed above, where formal approval for expenditure and direct sourcing were simultaneously obtained.

5.47 AusAID advised that its actions were consistent with its FMA Act obligations. Also, that it did not consider the risks of contract extension to be significant, as the market had been tested previously; there was a limited market for the services; and the contractor's performance had been satisfactory.

5.48 Notwithstanding these considerations, transparent and accountable decisions for expenditure under the FMA Act are consistent with a more explicit and formal process for approvals for direct sourcing than occurred in this case.

5.49 The ANAO also notes that the Secretaries Committee was not briefed on the potential risks of extending the existing contract.

Monitoring the incidence of direct sourcing

5.50 AusAID requires delegates who decide to direct source to consult with its Australian Partners Branch.⁸⁹ However, this does not always occur.

5.51 Nor does AusAID maintain a central record of such decisions. The incidence of direct sourcing is not reported to AusAID management. It would be better procurement practice for AusAID senior management to monitor exceptions to competitive tendering, as part of a sound financial management framework.

Conclusion—Direct sourcing for procurement

5.52 AusAID's decisions to direct source a range of both small and large contracts have extended well beyond the initial emergency phase of assistance. They were sometimes driven by timetable pressures. However, there are good reasons for not direct sourcing beyond the initial phase. Indeed, the ANAO found that internal AusAID correspondence had warned, as early as February 2005, of the undesirability of direct sourcing beyond the initial phase.

5.53 Contestable and transparent procurement is intended to be a key financial management control for AusAID, addressing, among other things,

⁸⁹ The Australian Partners Branch is responsible for the development and maintenance of contract documentation, public tendering and contractor selection processes, and advice on contract management policy.

the risk of fraud and corruption.⁹⁰ The use of direct sourcing weakens this control, and also:

- reduces assurance of value for money, and that Commonwealth resources are being used efficiently and effectively as required by the FMA Act;
- is contrary to the principle of *open and competitive tendering* set out in the Partnership Framework;
- conflicts with the AIPRD quality performance indicator of *Accountable, open and transparent contracting and tendering processes* (see Figure 6.8);
- may undesirably restrict competition and impact on price; and
- may increase pressure by Indonesian procurement agencies to use direct sourcing in other instances.

5.54 Where direct sourcing is undertaken, centrally monitoring and recording its frequency and rationale would enable the regular reporting of this information to AusAID management. This would facilitate a more considered view of its use in the context of the Partnership Framework, and would help keep its use to a minimum.

Recommendation No.3

5.55 The ANAO recommends that AusAID facilitate transparency and accountability in procurement of goods and services by centrally monitoring and reporting to senior management the incidence of, and rationale for, direct sourcing.

AusAID response

5.56 Agreed.

⁹⁰ Statement by the Director General of AusAID to the Joint Committee of Public Accounts and Audit on 17 August 2005.

Public reporting of direct sourced contracts

5.57 Agencies are required to publish in AusTender details of all contracts with a value of \$10 000 or more.⁹¹ The ANAO examined seven AIPRD contracts in place at the time of the audit and found that all had been published in AusTender.⁹²

5.58 However, the procurement method was being incorrectly reported. All seven contracts were reported as 'open tender'. However, six of those contracts had been direct sourced. This included the Aceh interim construction contract (discussed at paragraph 5.42).

5.59 AusAID advised that its previous management information system that records the status of each aid project did not capture information on the procurement method used. Reporting in AusTender was therefore based on assumptions.

5.60 AusAID advised that a new financial and contract management system, AidWorks, which commenced in December 2005, will address this issue.

Recommendation No.4

5.61 The ANAO recommends that AusAID establish systems to reliably report on contract procurement in AusTender.

AusAID response

5.62 Agreed.

Approval of spending proposals

5.63 An approver of a proposal to spend public money must be satisfied that the proposed expenditure is in accordance with the policies of the Commonwealth, and will make efficient and effective use of the money.⁹³

⁹¹ AusTender is the replacement system for the Gazette Publishing System, and is the main publication to announce agency purchasing decisions.

⁹² Agencies are required to report contracts within six weeks of entering into the arrangement. The ANAO did not examine the timeliness of reporting AIPRD contracts. However, ANAO Report No.27 2005–2006, *Reporting of Expenditure on Consultants*, found that 34 per cent of AusAID contracts did not meet the six-week reporting deadline in 2003–04, see p86.

⁹³ FMA Regulation 9.

5.64 The ANAO found that approvals had been appropriately obtained for all relevant activities covered by the audit.⁹⁴ Delegates with appropriate monetary limits had approved expenditure.

5.65 Approval had simultaneously been sought for the estimated cost of the Goods and Services Tax (GST).⁹⁵ GST had been included in all 14 approvals, but for one activity an error had been made calculating the liability. GST had been calculated at 1 per cent rather than 10 per cent, underestimating the GST liability by \$7.2 million. This matter was brought to the attention of AusAID at the time of the audit and AusAID subsequently obtained approval for the correct amount. AusAID advised that the error will not impact on its 2004–05 Financial Statements.

Entering into contracts

5.66 The ANAO examined a selection of five AIPRD contracts in place at the time of audit and found that each had been signed by an appropriate delegate.⁹⁶

Procurement arrangements for loan funding

5.67 Standard international practice is for tendering and other arrangements for project loans to be managed by the borrowing country. This is because borrowers usually expect substantial control over the use of funds that they will repay.

5.68 However, as discussed at paragraphs 4.49 to 4.51, AusAID is seeking the involvement of Australian or independent experts as participants or observers in procurement and activity monitoring processes. This is to:

- facilitate accountability and transparency; and
- mitigate risks associated with procurement in Indonesia.

⁹⁴ This involved 14 approvals totalling \$205 million across 13 individual activities.

⁹⁵ GST is calculated at 10 per cent, and charged against an agency-wide charge code.

⁹⁶ FMA Regulation 13 requires that a person must not enter into a contract, agreement or arrangement under which public money is, or may become payable unless a spending proposal for the proposed contract, agreement or arrangement has been approved under FMA Regulations.

5.69 These aims are reflected in the draft Partnership Loan Agreement being negotiated with the Indonesian Government at the time of audit—see Figure 5.3.

Figure 5.3

Procurement features proposed for the Partnership Loan Agreement

Each project loan agreement, unless otherwise agreed, is to include:

- procurement guidelines setting out procedures for the procurement of goods and works and the employment of consultants;
- a project management manual setting out, among other things: reporting requirements, financial management procedures and audit procedures; project performance indicators and arrangements for monitoring and evaluation; and requirements for annual workplans; and
- arrangements to involve independent experts as observers in all procurement processes, and Australian or independent expert involvement in other processes such as activity monitoring, audit, quality assurance, oversight and supervision.

Source: AusAID and the draft Partnership Loan Agreement of 1 November 2005.

5.70 Proposed features provide, at this stage in the development of the Agreement, a reasonable basis for managing procurement risks in the loan programme. The key challenge for AusAID is to actively pursue these features over the full life of AIPRD loan projects, and monitor them for effectiveness, and that new and emerging procurement risks are identified and treated.

Monitoring the competitiveness of bids

5.71 The \$300 million road project that AIPRD is to finance in parallel with the World Bank’s National Roads Improvement Project (see paragraphs 3.36 to 3.38), provides a good opportunity to compare the competitiveness of the different eligibility criteria used by the AIPRD and the World Bank. The World Bank utilises International Competitive Bidding, whereas AIPRD restricts bidding.

5.72 AIPRD eligibility criteria will therefore result in a more limited pool of potential tenderers than the World Bank’s approach. Monitoring and benchmarking the cost of works and outcomes for the AIPRD roads project, vis-à-vis the Bank’s more competitive approach, would help inform Australia’s consideration of future eligibility criteria.

5.73 The ANAO notes that AusAID is now proposing to undertake some benchmarking of outcomes against international development bank approaches (paragraph 5.28).

Recommendation No.5

5.74 The ANAO recommends that AusAID monitor/benchmark the cost of AIPRD works and outcomes for the Eastern Indonesia National Road Improvement Project against those obtained through the International Competitive Bidding approach, used by the World Bank for the National Roads Improvement Project. This will complement AusAID's general monitoring of bid competitiveness (requested by the Australian Government), and help inform Australia's consideration of future eligibility criteria.

AusAID response

5.75 Agreed.

6. Monitoring and Reporting

This chapter examines the arrangements that are being established to monitor, evaluate and report on Australia-Indonesia Partnership for Reconstruction and Development (AIPRD) implementation progress and outcomes.

Introduction

6.1 Transparency and accountability have been emphasised as key features of the AIPRD.⁹⁷ Their achievement requires not only a sound financial framework but appropriate performance monitoring and evaluation. This facilitates the reporting of progress and outcomes.

Monitoring contractor performance

6.2 The ANAO examined the arrangements being put in place to monitor progress and contractor performance for two early activities under the Aceh Rehabilitation Program, the first major programme to be implemented. These are for:

- health rehabilitation; and
- interim construction assistance.

Case Study One: Aceh health rehabilitation

6.3 This \$14 million contract was signed in September 2005. The programme aims to strengthen the health system in Aceh through a range of measures, including: health workforce training; and clinical support services in areas of pharmacy and medical supplies. The contract requires the managing contractor to progressively identify, scope and design activities. This reflects the realities of post-crisis aid, but does require a sound approach to performance management.

6.4 The contract also requires the managing contractor to prepare a range of reports to assist AusAID's monitoring of progress, including:

- monthly reports on progress, risks and issues;
- exception reports, identifying unforeseen problems; and

⁹⁷ The Treasurer's Second Reading Speech for the *Appropriation (Tsunami Financial Assistance and Australia-Indonesia Partnership) Bill 2004-2005*, p2, 9 March 2005.

- an annual programme assessment.

6.5 The contract includes a range of provisions for encouraging good contractor performance (see Figure 6.1).

Figure 6.1

Key contract performance provisions for health rehabilitation

- The extension of the project (and contract) from one to two years is contingent on joint approval of the Australian and Indonesian Governments, with contractor performance identified as being a factor to be considered.
- Contractor performance is to be assessed against performance indicators, with financial penalties or bonuses attached to the rating.
- Performance is likely to be assessed by a Technical Advisory Group which would provide AusAID with independent technical advice on the performance of services.

Source: AusAID Health Assistance Rehabilitation—Aceh Program contract.

6.6 Contractor performance is to be assessed against five performance indicators, using a three point rating scale (see Figure 6.2). A rating of *Disappointing* will result in a 5 per cent reduction in Fixed Management Costs,⁹⁸ while bonus payments of 5 per cent and 20 per cent will apply to the *Achieved* and *Exceeded* ratings, respectively.

Figure 6.2

Performance indicators and ratings

Performance Indicators	Three point rating scale
1. Program Strategy Analysis and Design;	<i>Disappointing</i> ;
2. Representing AIPRD’s Interests;	
3. Partnership and Community Involvement;	<i>Achieved</i> ; or
4. Relating to other AIPRD Contractors; and	
5. Performance of Sub-Contractors.	<i>Exceeded</i>

Source: AusAID Health Assistance Rehabilitation—Aceh Program contract.

6.7 This arrangement has a number of strengths:

- there is no ‘neutral’ rating; that is, the contractor is either penalised, or paid a bonus;
- it is relatively simple, with comparative guidance on how to differentiate performance between the three ratings; and

⁹⁸ Fixed Management Costs are a fixed amount over the life of the programme and include profit and management overheads.

- a range of stakeholders will contribute to the assessment, including AIPRD, subcontractors and target communities.

6.8 However, this performance management framework is weakened because the means of verifying performance is not well developed or defined. For example, *media coverage* is to be used to assess how well the contractor has satisfied the indicator *Representing AIPRD's Interests*, but it is not specified how it is to be used. As well, a rating of *Exceeded* in relation to the indicator *Performance of Sub-Contractors* requires *exceptional subcontractors being engaged within short timeframes*. Neither *exceptional* nor *short* are defined.

6.9 The ANAO considers that greater clarity of performance measures, and how they will be assessed, would assist AusAID's management of this contract.

Case Study Two: Aceh interim construction

6.10 This \$2 million contract (see paragraph 5.41) initially ran from the end of April 2005 for three months, and was extended for two consecutive one-month periods. The contract was not signed until several weeks after work had started.

6.11 The contract services entailed continuing reconstruction work that had been commenced by the Australian Defence Forces and volunteers, as well as 'infrastructure-related activities'.

6.12 The scope of work identified in the contract was 'indicative only', with individual activities to be subject to AusAID direction and approval. The contractor was required to provide weekly activity reports on progress, risks and issues, including recommendations for further construction work. However, performance indicators were not identified in the contract.

6.13 Performance management issues arose in relation to the contract. The ANAO found that AusAID had identified and managed these concerns. AusAID worked with the contractor to put in place a range of measures to strengthen AusAID's oversight of contract performance. See Figure 6.3.

Figure 6.3

Performance management—Aceh interim construction contract

Milestone
<p>Mid-June 2005—AusAID developed ‘serious’ concerns about performance, including work progress in relation to the refurbishment of the emergency ward at the Zainoel Abidin Hospital. AusAID met with the contractor to discuss its concerns, and documented the concerns, requesting they be dealt with quickly.</p> <p>Part of the approach to overcome the performance issues involved AusAID approval at all relevant points of each construction project. AusAID and the contractor advised that the new process worked well. AusAID intends to build similar controls into the next contract.</p>
<p>Mid-July 2005—AusAID considered that its concerns had been addressed sufficiently for it to exercise an option to extend the contract for one month. AusAID advised the contractor that a second extension would be subject to satisfactory resolution of performance issues.</p>
<p>Aug to Sept 2005—AusAID engaged an independent consultant to review various aspects of the contractor’s work. The second extension was exercised after receipt of the consultant’s report, which was positive.</p> <p>The consultant’s review was also considered in AusAID’s decision to award a new \$20 million contract to the same contractor (see paragraphs 5.42 to 5.43). In seeking approval for this contract, AusAID advised the Director General that the contractor’s performance concerns had been addressed.</p>

Source: ANAO analysis of AusAID files.

6.14 The ANAO considers that the lack of specificity in the contract in relation to approval processes, controls and performance indicators was a contributing factor to the performance difficulties that arose. Future contracts require greater clarity and focus in these areas, to facilitate contract performance management.

6.15 AusAID advised that the new contract (see paragraph 5.42) includes penalty and incentive payments. AusAID also advised that the contractor’s performance will be assessed against criteria of quality, timeliness, cost, documentation and responsiveness.

Monitoring activities across the AIPRD

6.16 AusAID’s guidelines require the preparation of operational plans for activity monitoring. These plans were known as Country Program Risk Assessment and Monitoring Plans (CPRAMPs).⁹⁹

⁹⁹ The CPRAMP is intended to cover all aid activities for which an AusAID post has monitoring responsibilities. Activities are ranked according to risk. Four levels of risk are normally used: low, medium, high and extreme. CPRAMPs should be produced and updated every six months for all bilateral country programmes.

6.17 AusAID had not prepared a CPRAMP for the AIPRD, although the need for one had been identified.¹⁰⁰ No timetable had been set, or responsibility allocated, for its preparation.

6.18 During the audit, CPRAMPs were replaced by a simplified monitoring tool—the Portfolio Monitoring Plan. AusAID advised that a Portfolio Monitoring Plan covering AIPRD activities would be prepared by April 2006.

6.19 Previous audits undertaken by both the ANAO and AusAID internal audit have found that CPRAMPs for a range of country programmes have been incomplete, out-of-date or non-existent. In this context, a CPRAMP had also not been prepared for the AIDCP.

6.20 In view of previous audit findings in this area, the ANAO considers that compliance with, and reliability of, the new arrangements warrants close management monitoring.

Management reporting

Reporting on progress

6.21 The AIPRD Secretariat commenced reporting to the Secretaries Committee on implementation progress from May 2005. Reports provide information on overall progress on AIPRD activities. For example, the June 2005 report advised that *implementation has commenced on all agreed AIPRD activities*. Tables also reported progress for individual activities. Figure 6.4 provides an example.

Figure 6.4

June 2005 progress report for Zainoel Abidin Hospital

- Replacement of medical and non-medical equipment.
- Re-equipping of pharmaceutical warehouse office equipment, computers, kitchen and cleaning materials.
- The tender process is complete for the interim construction contract, and the successful tenderer has been mobilised to assist with hospital construction and other priority areas.

Source: June 2005 briefing to Secretaries Committee.

¹⁰⁰ Among other things, AusAID had reviewed ANAO Audit Report No.20 2003-2004, *Aid to East Timor*, and identified lessons learned for the AIPRD. As part of this review, AusAID had identified a need to prepare a CPRAMP to guide the frequency of monitoring of aid activities.



Construction at the emergency building, Zainoel Abidin Hospital, Banda Aceh.

Photo: AusAID

6.22 However, the report for this and other activities does not make clear whether the progress reported exceeded or fell short of that intended for that point in time. In part, this reflects the absence of key target milestones when projects were put to the Committee for endorsement. For example, the proposal for endorsement of the Zainoel Abidin Hospital project provided little information on the expected timing of the various components of the project, to facilitate later assessment.

6.23 AusAID advised that, at the time this proposal was put to the Committee, detailed design was not complete. This is understandable given the need to commence projects quickly. However, reporting to the Secretaries Committee on *next steps* also often lacked specific target timeframes. For example, the June 2005 report for the above project identified three next steps (Figure 6.5). Only the first step identifies a milestone.

Figure 6.5

Next steps reported for Zainoel Abidin Hospital

- Tender process and mobilisation (expected late August) of long-term health sector contract.
- Preparation of construction contract for public tender.
- Joint finalisation of the Master Plan for the hospital.

Source: June 2005 briefing to Secretaries Committee.

6.24 Overall, the June 2005 report identified 16 *next steps* for a range of projects, but only four identified a timeframe for action.

6.25 AusAID advised that timeframes may not be identified because of the administrative effort involved. It also advised that it is a judgement call whether more detailed project planning would actually help rapid implementation.

6.26 The ANAO considers that this approach does not represent sound practice planning or project management. Where there is uncertainty, or a need for speed, it is better to have approximate targets than none at all. Specifying targets for high risk projects assists structured project planning and implementation.

Reporting on slippage

6.27 The ANAO found that, where timeframes were identified, subsequent slippage was not explicitly reported. For example, the Secretaries Committee was initially advised that mobilisation of the education sector managing contractor was expected by *late August* 2005. In the August report, *October* mobilisation was expected. Slippage of two months in mobilisation was not identified.

6.28 The ANAO also found that the concerns about performance on the Aceh interim construction contract (see Figure 6.3) and, in particular, slow progress with refurbishing the emergency ward, were not brought to the attention of the Committee.¹⁰¹

6.29 AusAID advised that these concerns were being addressed at the time and did not need to be brought to the attention of the Committee. However, the Committee has an important oversighting role in implementation of the AIPRD. An important governance principle in such implementation arrangements is that significant concerns about unsatisfactory progress are escalated to decision-makers (along with any proposed corrective action) so that risks and impact on higher level outcomes may be assessed, as appropriate.

6.30 It is not a matter of much more detailed reporting, rather of ensuring a focus on reporting significant concerns. The ANAO considers that progress

¹⁰¹ The Australian / German partnership to rebuild the Zainoel Abidin Hospital was publicly announced by the Parliamentary Secretary for Foreign Affairs and Trade on 20 May 2005. The emergency ward was opened by the Minister for Foreign Affairs on 8 December 2005.

reporting would be strengthened, and accountability and transparency improved, by ensuring that progress reports to the Secretaries Committee:

- identify whether progress is ahead or behind schedule (and any significant budget implications); and
- brief on significant slippage and contractor concerns.

Reporting progress to the Cabinet Implementation Unit¹⁰²

6.31 The AIPRD Secretariat was required to report to the Cabinet Implementation Unit (CIU) on progress. In accordance with CIU guidelines, this requires the submission of an *Implementation Plan*¹⁰³ and ongoing *quarterly reports* on progress.

Implementation Plan

6.32 The CIU guidelines require agencies to develop an Implementation Plan within two months of programme approval. The AIPRD Secretariat advised that it was not asked to prepare a Plan until April 2005. The initial deadline for lodgement of the Plan was 30 June 2005, but this was extended on at least three occasions, while issues that might affect the programme were being considered.

6.33 The Plan was finalised in January 2006, one year after announcement of the AIPRD. By this time, key decisions had been taken and most funding committed to individual AIPRD activities.

6.34 Implementation Plans are primarily intended to be project management tools to assist agencies and the CIU assess implementation progress and success. Such delays in completion of Plans undermine their usefulness, particularly in the often critical early stages of implementation. This is the case for the AIPRD, where progress in the first year is likely to be critical in achieving timely disbursement of funds over the life of the programme.

6.35 Sound practice for such a large and complex programme involves completing the Implementation Plan at the start of the project and then

¹⁰² The Cabinet Implementation Unit of the Department of the Prime Minister and Cabinet was established in late 2003, to encourage earlier and more effective planning for implementation of public policy decisions delivered through Government programmes and services <<http://www.pmc.gov.au>>.

¹⁰³ Core components of the Plan are to include: scope; work breakdown; funding; risk management; stakeholder engagement; resources; contracting and procurement; and quality assurance (see CIU *Guide to Preparing Implementation Plans*, CIU, undated—<<http://www.pmc.gov.au>>).

reviewing and updating it as required, to improve the quality of monitoring in the early stages of implementation. This is reflected in the CIU guidelines, which recognise that the scope of work may change, and which emphasise the importance of maintaining Implementation Plans as living documents.

Quarterly reporting of progress to the CIU¹⁰⁴

6.36 Quarterly reports have been submitted to the CIU in accordance with the guidelines. Quarterly reports would normally report against milestones identified in the Implementation Plan.

6.37 However, in the absence of an Implementation Plan, the first quarterly report identified three high-level milestones that had been achieved in the previous quarter, and identified five for the upcoming quarter. Subsequent reports identified progress against milestones identified in previous reports.

6.38 The ANAO considers that the value of the quarterly reporting process was weakened because progress was not able to be assessed with a medium or longer term perspective, which is necessary for good project monitoring.

6.39 The process was further weakened by the vague description of many milestones, limiting the CIU's ability to assess progress. For example, two of the four milestones identified for the September quarter were: *Joint Commission endorsement of new AIPRD activities* and *Progress arrangements for loan program*. In the former, the number and value of new activities is not identified. In the latter, minimal progress with the loan programme would satisfy the milestone.

6.40 AusAID advised that further elaboration of milestones would have required qualification as these outcomes significantly depended on Indonesian agencies and Joint Commission Ministers. While the ANAO acknowledges that this can often be the case, identifying where factors are impacting on progress is one of the values of CIU monitoring. Providing the reasons for delays would better inform Ministers about the causes, and risks to future project progress.

6.41 The ANAO concluded that clearer specification of milestones, including target dates, numbers and amounts where applicable, would have improved AusAID reporting to the CIU.

¹⁰⁴ The quarterly report to the CIU is a one page tabulated update on implementation progress against key milestones identified in the Implementation Plan for the previous quarter and for the next quarter. It is known as the 'traffic light' report as agencies are required to assess implementation progress as green (good), orange (problematic) or red (highly problematic).

6.42 The Department of the Prime Minister and Cabinet advised that it will examine management of the CIU processes in the light of these audit findings.

External reporting

6.43 The Australian Government announced regular public reporting on the status of Australia’s response to the tsunami disaster. This reflected the public’s interest and expectations of transparency and accountability in the management of aid funds.¹⁰⁵

6.44 At the time of audit, AusAID had prepared three reports on Australia’s response to the tsunami (the first two are at Figure 6.6). They covered the periods to 15 April, 30 June and 30 November 2005. They were launched by the Minister for Foreign Affairs on 1 June, 6 September and 8 December 2005, respectively.

Figure 6.6

The first two public reports



Source: AusAID.

¹⁰⁵ *Australia's response to the Indian Ocean disaster: Report for the Period 26 December 2004 to 15 April 2005*, 1 June 2005.

6.45 The first report focused on the emergency response phase. The second and third focussed increasingly on the AIPRD.

6.46 The frequency of reporting has been progressively reduced. AusAID advised that the Minister for Foreign Affairs had now decided that future reports will be produced annually, with the first to be released in June 2006.

6.47 The second and third reports revealed amounts expended in AIPRD grants, and briefly outlined a range of approved AIPRD activities and their funding commitments. However, the reports contained little information on the expected timing of the various AIPRD activities, or on whether the AIPRD was ahead or behind schedule. For example, under-expenditure in 2004–05 (see Figure 5.1) was not identified.

6.48 Consistent with the stated intention of a high degree of public accountability and transparency, public reporting would be strengthened by the inclusion of information on:

- the expected yearly disbursement of grant and loan funds, by major grant and loan activity;
- significant milestones in activity implementation (and achievements against them); and
- performance indicators, and results covering effectiveness, quality and quantity, particularly for larger activities.

Recommendation No.6

6.49 The ANAO recommends that AusAID enhance AIPRD accountability and transparency by ensuring that the future public reports on the AIPRD identify and, subsequently, report against:

- the expected yearly disbursement of grant and loan funds, by major grant and loan activity;
- significant activity milestones; and
- performance indicators, covering effectiveness, quality and quantity, particularly for larger activities.

AusAID response

6.50 Agreed.

Reporting in Portfolio Budget Statements and Annual Reports

6.51 A new outcome has been established for AusAID to reflect the AIPRD (see Figure 6.7).

Figure 6.7

AusAID Outcomes for 2005–06

Existing Outcome	Outcome 1: Australia’s national interest advanced by assistance to developing countries to reduce poverty and achieve sustainable development.
New AIPRD Outcome	Outcome 2: Australia’s national interest advanced by implementing a partnership between Australia and Indonesia for reconstruction and development.

Source: *Foreign Affairs and Trade Portfolio—Portfolio Budget Statements 2005–06*.

6.52 The associated performance framework was developed in consultation with the Department of Finance and Administration, and finalised in March 2005. This establishes eight indicators of effectiveness for the AIPRD (see Appendix 3) and a number of performance indicators (see Figure 6.8).

Figure 6.8

AIPRD performance indicators for 2005–06

Performance indicators for administered items including third party outputs
<p>Quality: 75 per cent of activities receive quality ratings of satisfactory or higher.</p> <p>Quantity: Significant activity outputs contributing to reconstruction and development in areas on Indonesia affected by the 26 December 2004 tsunami. Significant activity outputs contributing to Indonesia's economic and social development, and supporting the Government of Indonesia's programmes of reform.</p>
Performance indicators for individual outputs—Output 2.1 AIPRD Management
<p>Quality: All major programmes carried out in partnership with relevant stakeholders. Programme management tools and processes that ensure a high quality programme reflecting the AIPRD priorities. Accountable, open and transparent contracting and tendering processes.</p> <p>Quantity: Number of activities; number of competitive tenders let under grants and ongoing contracts managed; number of tender/contractual disputes. Price: \$3.91 million</p>

Source: *Foreign Affairs and Trade Portfolio—Portfolio Budget Statements 2005–06*.

6.53 There was limited reporting against most indicators in AusAID's 2004–05 Annual Report. This reflects the fact that funds had been appropriated only in March 2005, and that the early focus was on objectives, administration and governance arrangements, and agreeing priorities with the Indonesian Government. AusAID advised that detailed information against indicators will be provided in future Annual Reports.

Use of benchmarks or targets

6.54 It is recognised sound practice to compare performance quantitatively or qualitatively against specific benchmarks, targets or activity levels.

6.55 The quality indicator for the Administered item—*75 per cent of activities receive quality ratings of satisfactory or higher*—incorporates a target. It is based upon a rating system used by AusAID for other AusAID bilateral aid programmes.¹⁰⁶

6.56 However, other quality and quantity indicators do not incorporate benchmarks, targets or activity levels. This may be understandable in the early stages of AIPRD implementation, as the AIPRD has taken shape. However, the ongoing absence of such benchmarks or reference targets reduces the ability to interpret future results against expectations. Comparators would assist AusAID in assessing its performance, and strengthen transparency and accountability to the Parliament and stakeholders.

6.57 AusAID advised that it is planning to develop a Performance Framework for the AIPRD as a whole, in the context of the Government's recent White Paper on Australia's aid programme.¹⁰⁷

6.58 The ANAO considers that this framework would provide an opportunity to incorporate targets and benchmarks in performance management, for example:

- *number of activities*: a target would assist interpretation of trends, particularly as the number of activities winds down in future years;
- *number of tender/contractual disputes*: a percentage target could be set, based on past experience; and

¹⁰⁶ A similar performance rating system, using the same quality rating target of 75 per cent, has been used by other donors. See ANAO Report No.59 2001–2002, *AusAID Contract Management*.

¹⁰⁷ *Australian Aid: Promoting Growth and Stability*, A White Paper on the Australian Government's Overseas Aid Program, April 2006.

- *number of competitive tenders let under grants and accountable, open and transparent contracting and tendering processes: a target could be set for contracts let through open tender.*

Recommendation No.7

6.59 The ANAO recommends that AusAID include targets, benchmarks or activity levels in performance indicators for the AIPRD, where possible, to enable future results to be interpreted against expectations. This will help strengthen transparency and accountability to the Parliament and stakeholders.

AusAID response

6.60 Agreed, noting that all efforts in this area will also need to be aligned with the directions set out in the new aid White Paper, *Australian Aid: Promoting Growth and Stability* (2006).



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Auditor-General

Canberra ACT
27 June 2006

Appendices

Appendix 1: Reported cases of suspected fraud against AusAID

Financial Year	Number of cases*	AusAID funds involved# \$
2002-03	9	38 735
2003-04	15	665 020
2004-05	19	212 881
TOTAL	43	916 636

Notes: * Some of these cases did not involve a loss to AusAID, or the amount is unknown.

Some funds have been recovered.

Source: AusAID.

Appendix 2: Grants Special Account

Extract from: Financial Management and Accountability Determination 2005/02—Australia-Indonesia Partnership for Reconstruction and Development (Grants) Special Account Determination 2005

5 Purposes of the Australia-Indonesia Partnership for Reconstruction and Development (Grants) Special Account

- (1) The purposes of the Australia–Indonesia Partnership for Reconstruction and Development (Grants) Special Account, in relation to which amounts may be debited from the Special Account, are:
 - (a) relief, rehabilitation and reconstruction assistance to areas in the Republic of Indonesia directly affected by the Tsunami and economic and social development assistance to all areas of the Republic of Indonesia, through the following activities:
 - (i) humanitarian relief, rehabilitation and recovery assistance;
 - (ii) construction, reconstruction or repair of infrastructure;
 - (iii) construction, management and operation of health facilities and assistance to improve health outcomes;
 - (iv) construction, management and operation of education facilities and assistance to improve education outcomes;
 - (v) assistance with sustainable agricultural development and natural resource management;
 - (vi) assistance with systems of governance, including systems of law and justice, economic and financial management, public sector management, democratic institutions and processes, human rights and the development of civil society;
 - (vii) assistance with human resource development, including scholarships, education and training programmes;
 - (viii) assistance with disaster preparedness and management;

- (ix) assistance with economic and social development policy and planning;
 - (x) assistance with organisational capacity development and institution strengthening to ensure sustainability of assistance in key sectors;
 - (xi) assistance to support private sector development in order to create self sustaining employment; and
- (b) activities that are incidental to and directly related to a purpose mentioned in:
- (i) paragraph (a); or
 - (ii) paragraph 5.1 (a) of *Financial Management and Accountability Determination 2005/03—Australia–Indonesia Partnership for Reconstruction and Development (Loans) Special Account Establishment 2005*; and
- (c) to reduce the balance of the Special Account (and, therefore, the available appropriation for that Account) without making a real or notional payment; and
- (d) to repay amounts where an Act or other law requires or permits the repayment of an amount received.
- (2) To avoid doubt, incidental activities include dealing with direct and indirect costs.

Appendix 3: Performance Information for Outcome 2—AIPRD

Effectiveness—Overall achievement of the Outcome

AusAID's administered expenses for Outcome 2 will be allocated to activities aimed at supporting Indonesia's reconstruction and development efforts, both in and beyond tsunami affected areas through sustained cooperation focused on the Indonesian Government's programmes of reform, with an emphasis on economic and social development.

As agreed at the first Joint Commission meeting, there are eight guiding principles which will inform the work undertaken through the Partnership. The Partnership will:

- demonstrate Australia and Indonesia's shared interest in a strong, stable and prosperous Indonesian economy and society;
- recognise the Government of Indonesia's responsibility for setting the priorities for national social and economic development and reform;
- take account of the special characteristics and needs of tsunami-affected areas and those of other areas of Indonesia;
- support Indonesia's development efforts;
- focus on areas where Australia has a comparative advantage in expertise and the delivery of reconstruction and development assistance with special emphasis on the development of linkages between Australian Government agencies and institutions and their Indonesian counterparts as well as the strengthening of people-to-people links;
- identify activities for funding based on merit according to their relative contribution to recovery and reconstruction as well as longer-term economic and social development, with a special emphasis on human resource development and good governance, both in tsunami-affected and other areas of Indonesia;
- implement a partnership approach in the joint identification of funding priorities, the joint identification of activities for implementation, and the joint selection of implementing bodies with decision-making based on principles of transparency and accountability, open and competitive tendering and robust performance monitoring and evaluation systems; and
- coordinate with the activities and planning of other international development partners and, where effective and consistent with the objective of the partnership, utilise a range of international and domestic aid delivery mechanisms, including multilateral agencies and non-governmental organisations.

Source: *Foreign Affairs and Trade Portfolio—Portfolio Budget Statements 2005-06.*

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