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**The World Bank**

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**APPRAISAL REPORT**

**FOR A**

**PROPOSED MULTI DONOR FUND FOR ACEH AND NORTH SUMATRA (MDF) GRANT**

**IN THE AMOUNT OF US\$ 100 MILLION**

**TO**

**THE GOVERNMENT OF INDONESIA (GOI)**

**FOR THE**

**INFRASTRUCTURE RECONSTRUCTION FINANCING FACILITY**

**OCTOBER 26, 2006**

**INFRASTRUCTURE DEPARTMENT  
EAST ASIA AND THE PACIFIC REGION**

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**CURRENCY EQUIVALENTS**  
**(EXCHANGE RATE EFFECTIVE JULY 26, 2006)**

Currency Unit = Indonesian Rupiah  
IDR 1,000 = US\$ 0.110434  
US\$ 1 = IDR 9,055.20

**FISCAL YEAR**

January 1 – December 31

**ABBREVIATIONS AND ACRONYMS**

ADB	Asian Development Bank
BRR	Bureau for Rehabilitation and Reconstruction for Aceh and Nias
CQ	Selection based on Consultants' Qualifications
EA	Environmental Assessment
EIA	Environment Impact Assessment
EMP	Environmental Management Plan
FM	Financial Management
FMA	Financial Management Agent
GAM	Free Aceh Movement
GOI	Government of Indonesia
IBRD	International Bank for Reconstruction and Development
IAP	Immediate Action Program
ICB	International Competitive Bidding
IC	Individual Consultants
IDA	International Development Association
IFR	Interim Financial Report
IPM	Infrastructure Program Management
IREP	Infrastructure Reconstruction Enabling Program
IRFF	Infrastructure Reconstruction Financing Facility
LARAP	Land Acquisition and Resettlement Action Plan
LGIP	Local Government Annual Investment Plan
MDF	Multi-Donor Trust Fund for Aceh and North Sumatra
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NCB	National Competitive Bidding
NGO	Non-Government Organization
O&M	Operations and Maintenance
PGIP	Provincial Government Annual Investment Plan
PIP	Project Implementation Plan
PMU	Project Management Unit
QBS	Quality-Based Selection
QCBS	Quality and Cost Based Selection
RFP	Request For Proposal
SA	Special Account
SOE	Statement of Expenditure
SSS	Single-Source Selection
TA	Technical Assistance
TOR	Terms of Reference
UNDP	United Nations Development Program
WFP	World Food Program

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**INDONESIA**  
**INFRASTRUCTURE RECONSTRUCTION FINANCING FACILITY**

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**INDONESIA**  
**INFRASTRUCTURE RECONSTRUCTION FINANCING FACILITY**  
**EAST ASIA AND PACIFIC REGION**  
**EASUR**

<b>Date:</b> October 26, 2006 <b>Country Director:</b> Andrew Steer <b>Sector Director/Sector Manager:</b> Christian Delvoie/Keshav Varma <b>Project ID:</b> P101785 Lending Instrument: Grant (MDF)	<b>Team Leader:</b> Aniruddha Dasgupta Sectors: Urban Infrastructure Themes: Infrastructure Services, Risk Management Environmental Screening Category: B Safeguard Screening Category: Limited Impact		
<b>Project Financing Data</b>			
<input type="checkbox"/> Loan <input type="checkbox"/> Credit <input checked="" type="checkbox"/> Grant <input type="checkbox"/> Guarantee <input type="checkbox"/> Other:			
<b>Total Project Costs:</b> US\$291 million <b>MDF Grant Amount:</b> US\$100 million <b>Government Contribution:</b> US\$191 million			
<b>Financing Plan (US\$m)</b>			
<b>Source</b>	<b>Local</b>	<b>Foreign</b>	<b>Total</b>
<b>Borrower</b>	<b>191</b>	<b>0</b>	<b>191</b>
<b>MDF</b>	<b>85</b>	<b>15</b>	<b>100</b>
<b>Total</b>	<b>276</b>	<b>15</b>	<b>291</b>
<b>Grant Recipient:</b> Government of Indonesia <b>Responsible Agency:</b> BRR <b>Address:</b> Jl. Muhammad Thaher no.20, Lueng Bata, Banda Aceh 23247 <b>Contact Person:</b> Eddy Purwanto, CEO Deputy, Department of Housing, Infrastructure, and Spatial Planning			
<b>Estimated disbursements (CY/US\$m)<sup>1</sup></b>			
<b>FY</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09</b>
<b>Annual</b>	25	50	25
<b>Cumulative</b>	25	75	100
<b>Project implementation period:</b> January 2007   End: January 2010 <b>Expected closing date:</b> 6/30/2010			
Does the project depart from the CAS in content or other significant respects? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No			
Does the project require any exceptions from Bank policies? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No			
Have these been approved by Bank management? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No			
Is approval for any policy exception sought from the Board? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No			
Does the project include any critical risks rated "substantial" or "high"? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No			
Does the project meet the Regional criteria for readiness for implementation? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No			
<b>Project development objective:</b> The objective of the Infrastructure Reconstruction Financing Facility is to assist the province of Aceh and 12 local governments in Aceh and Nias to reconstruct/rehabilitate strategic infrastructure and extend key infrastructure services of adequate quality standards that meet the needs of communities where infrastructure was damaged by the tsunami of 2004 and the subsequent earthquake.			
<b>Project description</b> (i) <i>Financing of Infrastructure Reconstruction and Rehabilitation Investments.</i> Financing of individual infrastructure reconstruction and rehabilitation subprojects in 12 local governments and strategic investments at the provincial level, including civil works and installed equipment in subprojects in the			

<sup>1</sup> Although IRFF's implementation period is January 2007-January 2010, the disbursement schedule will span two and a half years between January 2007-June 2009, to be coterminous with the currently scheduled completion of BRR's mandate. If subprojects are not completed by June 2009, they can be financed by IRFF till June 2010 (when the project is scheduled to close) in line with post-BRR institutional arrangements, detailed in a transition strategy to be prepared by June 2008, and agreed by GOI and the Bank.

following sectors: roads, ports, water and sanitation, drainage, flood control, coastal protection and restoration of major irrigation canals.

- (ii) *Targeted Support to Infrastructure Subproject Planning, Design, Supervision, and Implementation Oversight.* Need-based support to local and provincial governments for identification, design and preparation of infrastructure reconstruction subprojects, technical assistance for transition to a post-BRR timeframe and institutional arrangements beyond June 2009, including extension of TA provided under IREP, and capacity building and infrastructure asset maintenance programs for local and provincial governments, as well as assistance in conducting performance and financial audit (over and above external audit) of project financial statements.

Which safeguard policies are triggered, if any? The project will not have any large scale or irreversible adverse environmental impacts. The project triggers the World Bank Safeguards Policies on Environmental Assessment (OP/BP 4.01), Indigenous Peoples (OD 4.10), and Involuntary Resettlement (OP/BP 4.12). The project is classified as environment Category “B”.

Significant, non-standard conditions, **if any**: None

## EXECUTIVE SUMMARY

Following the tsunami and earthquake of December 2004, the Government of Indonesia (GOI) created, in April 2005, a dedicated Rehabilitation and Reconstruction Agency - *Badan Rehabilitasi dan Rekonstruksi* (BRR) - to provide leadership and management across all aspects of recovery. The first reconstruction priority was the provision of housing. This program is now well underway. The second reconstruction priority is to rebuild essential infrastructure and much work remains to be done on that front.

The BRR has outlined an Infrastructure Reconstruction Strategy, which encompasses three phases, each one of which receives funding from the Multi-Donor Trust Fund for Aceh and North Sumatra (MDF)<sup>2</sup>:

- An Immediate Action Plan is under implementation. It addresses key infrastructure bottlenecks mainly in transport, logistics and flood protection.
- An Infrastructure Reconstruction Enabling Program (IREP) has just become effective. IREP is providing technical assistance (TA) to BRR and to local and provincial governments in Aceh and Nias for the selection, preparation and implementation of infrastructure investments.
- The proposed Infrastructure Reconstruction Financing Facility (IRFF) would contribute US\$100 million from the MDF (and about US\$191 million from BRR) to the reconstruction of basic infrastructure in Aceh and Nias. There is close strategic integration between IREP and IRFF as IRFF focuses to a large extent on financing the individual infrastructure projects (called subprojects in the rest of the report to distinguish them from the overall IRFF project itself) prepared with the IREP TA.

Given the magnitude of the damage caused by the tsunami and the extent to which people's basic needs remain to be met, the GOI puts great emphasis on a swift implementation of the Infrastructure Reconstruction Strategy. BRR has been given about five years to accomplish its mission, with a mandate that is expected to end in June 2009. BRR and MDF will co-finance investments under IRFF according to a 70:30 ratio starting on January 1, 2007. IRFF is therefore being processed under an accelerated schedule to ensure that project implementation can start before November 2006 when BRR's 2007 budget needs to be finalized and approved by Parliament.

Various financing options were considered for IRFF, including (i) MDF and BRR parallel financing; (ii) MDF and BRR co-financing; and (iii) MDF, BRR, and local government co-financing. Given the project's priorities of delivering a significant volume of high-quality infrastructure within a short implementation period, while instilling ownership of local and provincial government – the MDF and BRR co-financing was found to be the most appropriate option. While local government financing may enhance their commitment, differences in budgeting cycles between the local governments and BRR would pose challenges with respect to co-financing arrangements and lead to significant delays in implementation. These delays would be a major reputational risk for the World Bank, BRR, and the MDF – and would weaken confidence of the people of Aceh and Nias in the project and local government(s).

IRFF includes alternate strategies for building local and provincial government ownership and capacity (as highlighted in Annex 10). First, a *Programmatic co-financing* arrangement is in place in which the BRR and the local/provincial governments will co-finance Local Government Investment Plans (LGIPs) and Provincial Government Investment Plans (PGIPs). The BRR will finance some of the subprojects

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<sup>2</sup> The Multi-Donor Fund brings together a pool of over US\$520 million from 15 donors and is a partnership of the Indonesia government, international community and civil society to support the recovery in Aceh and Nias. At the request of the Government of Indonesia these donors came together to avoid duplication and reduce transaction costs for the central government, the BRR and the affected communities. The Multi-Donor Fund is co-chaired by the BRR, the European Commission and the World Bank. The World Bank administers the Fund and acts as its trustee.

under the LGIP/PGIP with IRFF funds, while local governments (and donors) will fund the others. Second, an MOU between the BRR and local and provincial governments will include confirmation of the subprojects the BRR will finance in the LGIP/PGIPs through IRFF, as well as formal commitment by the local and provincial governments to allocate necessary budgetary resources to maintain these investments on the basis of a maintenance plan. Operations and maintenance of all IRFF subprojects will be supported by detailed financial and maintenance assessments/plans developed by IREP technical assistance (West Coast, Nias, and Strategic Planning, Design, and Construction Supervision consultants).

Only some of the investments to be financed by IRFF have been identified up to now (Section X and Annex 11 of the PAD present the information available about those investments). As a result, a primary concern in designing IRFF is to ensure that an appropriate framework is in place to enable adequate planning, selection, preparation, execution and supervision of infrastructure subprojects during the course of IRFF implementation:

- TA is in place, through IREP, to help BRR prepare strategic programs and sector plans based on a sound understanding of infrastructure needs and priority projects, and on an adequate allocation of responsibilities between the major entities active in the infrastructure field (see, inter alia, Section XI).
- New institutional mechanisms have been set up to ensure that annual investment plans are prepared through participatory processes involving BRR, local and provincial governments, as well as other stakeholders (see, inter alia, Section IV).
- Eligibility and prioritization criteria have been identified (and will be further refined by BRR and local/provincial governments) to help select the specific sub-projects – included within the annual investment plans mentioned above – that will receive IRFF funding (see Section V and Annex 4).
- TA is in place - through IREP and IRFF<sup>3</sup> - to support subproject preparation and implementation: consultants will assist in producing subprojects detailed designs, in supervising contractors, in ensuring that environmental and social issues are adequately addressed, in promoting sound financial management and procurement practices, and in combating corruption (see Section IV). An Environmental and Social Safeguards Framework (see Annex 8), Financial Management Arrangements (see Annex 7), a Procurement Plan (see Annex 6), and an Anti-Corruption Action Plan (see Annex 9) have been agreed during appraisal and will be reflected in the Project Implementation Plan to be submitted in draft form prior to negotiation of IRFF.

The speed and magnitude of the planned infrastructure reconstruction activities raise serious capacity and sustainability challenges. This is particularly true for local and provincial governments. Their capacity has always been limited and was further eroded because of the tsunami. In addition, local governments will likely shoulder most of the responsibility for maintaining newly rebuilt assets and for developing new infrastructure after the end of BRR's mandate in June 2009. A number of steps – described in more details in Section XI and Annex 10 – have been taken to try and address those challenges:

- As mentioned above, TA programs have been designed to emphasize hands-on training of local government technical departments, as well as of BRR staff. Such TA is an important tool that will contribute to ensure the quality of infrastructure subprojects undertaken during BRR's mandate and to prepare local authorities for the post-BRR era.
- The overall incentive framework under which local government officials operate in the context of IRFF is geared toward building lasting institutional capacity at the local government level. For example, making IRFF resources available to finance well prepared local infrastructure

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<sup>3</sup> Three local governments in Aceh – those of Aceh Besar, Banda Aceh and Sabang – are currently receiving TA assistance from existing consulting arrangements for subprojects identification and design. Such assistance will end in January 2007 however, and a small fraction of IRFF funds will be used to ensure that those three local governments continue to benefit, beyond January 2007, from the type of TA made available, under IREP, to other local governments in Aceh and Nias.

subprojects is expected to prompt local governments to improve their ability to select and prepare such subprojects so as to gain access to IRFF financing.

- Mechanisms have been designed to ensure that local government officials develop a sense of ownership with respect to the infrastructure assets financed under IRFF. For example, new institutional arrangements are in place to give local governments a say in the design of annual investment plans, the program managers or saters responsible for preparing and implementing subprojects will be chosen by local governments and will generally be local government staff, and responsibilities for procurement and financial management will progressively be transferred to local governments as their capacity to handle such responsibilities increases.
- Finally, measures will be taken to ensure that appropriate institutional arrangements are put in place for the post June 2009 period. BRR and the GOI are committed to drafting a transition strategy specify those institutional arrangements at least one year before the scheduled expiration of BRR's mandate in June 2009. This transition strategy will, inter alia, propose institutional mechanisms aimed at facilitating exchanges of experience between all Aceh and Nias local governments involved in infrastructure reconstruction and development. In addition, an unallocated component of IRFF is currently held in reserve and could be used to extend the TA carried out under IREP beyond June 2009.

Finally, the PAD highlights the need to allocate sufficient resources to allow for thorough Bank supervision of this complex operation. During IRFF implementation, Bank staff will review Interim Financial Reports each quarter to assess financial management, procurement, and physical progress made in the preceding quarter and to agree with the procurement plan of the forthcoming quarter. This procurement plan will include subprojects to be undertaken in the next quarter along with the rationale for their inclusion. The Bank will also receive bi-annual monitoring reports covering environmental and safeguards issues. As part of the agreed Anti-Corruption Action Plan, BRR will regularly share with the Bank the findings of technical and financial audits and ensure that any suspected case of corruption related to IRFF is reported immediately to the Bank. Lastly, any changes to the Project Implementation Plan – and in particular to the main components of the Plan such as the Environmental and Social Safeguards Framework, the Financial Management Arrangements, the Procurement Plan and the Anti-Corruption Action Plan – will be made in agreement with the Bank (see Section XIII for more details on the Bank's review and supervision functions under IRFF).

## TECHNICAL REPORT

### I. BACKGROUND

The tsunami and earthquake that struck the Indian Ocean in December 2004 caused devastation on a horrific scale. In Indonesia, the disaster killed or left missing more than 230,000 people, and destroyed communities, infrastructure and livelihoods. The total reconstruction and development program for Aceh and Nias is estimated to cost between US\$6-9 billion<sup>4</sup> (2005-2009), making it the largest reconstruction program in the developing world. In addition to the physical damage, the disaster caused enormous destruction to the economy and loss of institutional capacity. While it appears that peace may finally have been achieved in Aceh between the government and the Free Aceh Movement, the neglect to infrastructure and human development from thirty years of conflict adds to the reconstruction challenges.

Following the disaster, the immediate need was to put in place humanitarian and disaster relief programs; these were widely supported and successfully implemented by local and national governments, as well as numerous agencies, NGOs and individuals. The people of Indonesia and the international community have since shifted from the initial emergency phase to the recovery phase. In April 2005, the Government of Indonesia (GOI) created a dedicated Rehabilitation and Reconstruction Agency - *Badan Rehabilitasi dan Rekonstruksi* (BRR) - to provide leadership and management across all aspects of recovery. Given the magnitude of the losses suffered and the number of organizations currently involved in reconstruction efforts, demands on the technical and coordination capacities of BRR as well as of local and provincial governments are enormous. The first reconstruction priority was the provision of housing – this program is well underway, with 45 percent of the overall rebuilding needs in progress. The second reconstruction priority – which has made less progress – is to rebuild and restore essential infrastructure services, such as transport, roads, macro and local level drainage, water supply and sanitation, power distribution, and solid waste. Overarching these demands are the BRR's policy goals of rebuilding to improved standards (i.e., building back better), strengthening local governments, and working with communities.

**Sector overview.** As of March 2006, approximately US\$4.7 billion had been allocated by GOI, NGOs and donors (including MDF) to specific rehabilitation projects and an estimated additional US\$3.7 billion had been committed but had not been allocated to specific projects. Of this total of US\$8.4 billion, US\$535 million comes from the MDF<sup>5</sup>. This total of US\$8.4 billion appears sufficient given overall funding needs to: (i) cover the original loss assessment across all sectors from the tsunami and earthquake of US\$4.9 billion; (ii) cover anticipated cost increases of US\$ 1.2 billion resulting from inflation; and (iii) build back better (US\$2.3 billion) according to the GOI's stated objective. However, BRR, donors' and NGOs' interests and focus have varied across sectors according to their comparative advantage and preference and this has resulted in some mismatch between available funds and financing needs. Infrastructure, in particular, currently shows a deficit of available funds for reconstruction of about US\$650 million.

Having suffered the most damage, the housing and social sectors have received the greatest attention in the post-tsunami reconstruction program in terms of the allocation of resources. The estimate of damage to the housing sector was US\$1.4 billion, with the demand for new houses now ranging from 93,000 to 120,000<sup>6</sup>. The housing program is moving rapidly (and generally in the absence of supporting infrastructure) – by the end of June 2006, an estimated 35,000 houses have been completed, with up to

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<sup>4</sup> *Aceh and Nias One Year After the Tsunami: The Recovery Effort and Way Forward*, December 2005

<sup>5</sup> *Aceh and Nias One Year After the Tsunami: The Recovery Effort and Way Forward*, December 2005

<sup>6</sup> Permanent Housing Brief, February 16, 2006, UN-HABITAT.

22,000 under construction. Ensuring quality of finished works and providing sufficient supporting infrastructure are the key sector priorities.

Damage to infrastructure has been substantial and progress slow. To the extent that both physical infrastructure and staffing were limited before the tsunami (for e.g., in the water and sanitation sector, there were no sewerage systems and less than 30 percent of the population provided with piped water), building back better will require substantially more investment than simply replacing what was lost. Sectoral funding gaps resulting from a mismatch between available funds and financing needs further strain reconstruction efforts. Lack of sufficient funding is particularly severe in the transport sector, and to a lesser extent in flood control and irrigation. The funding deficit in the transport sector is a critical issue as an efficient transport network is vital for the delivery of rehabilitation and reconstruction assistance and for overall economic development.

The progress of spatial and infrastructure development planning is mixed. At the sub-district level, numerous donors, NGOs, and the government have produced community mapping and development plans but hardly any infrastructure planning. These efforts have succeeded in involving communities in the planning process, articulating community priorities and vision, and creating the foundations for the reestablishment of land rights. However, the early approaches were not standardized and quality varies. Many community maps/village spatial plans were made before the release of post-tsunami aerial photography, not developed on accurate base maps, and lack topographic details – thus limiting their utility for implementation. At the district level, the availability of updated spatial and infrastructure development plans is limited.

**Role of the Aceh-Nias Reconstruction and Rehabilitation Agency (BRR).** BRR's primary mission was to develop standard operating procedures and to provide coordination, leadership, and quality control of the activities financed by the government or underway by donors and NGOs. The BRR has undergone continuous organizational and managerial strengthening since then. BRR is also strengthening its presence and coordination at the district and sub-district level through newly established regional offices. BRR has given priority to engaging district governments – the ultimate aim is to increase capacity of provincial and district authorities to allow a gradual shift of decision-making, management, and implementation responsibility from BRR to facilitate BRR's exit in 2009.

**BRR's Infrastructure Reconstruction Strategy.** To determine the allocation of remaining MDF resources and to provide a strategic approach to infrastructure design and management, BRR has outlined an Infrastructure Reconstruction Strategy. This strategy serves as a framework for rehabilitation tailored to addressing infrastructure needs at the district and provincial levels, in particular, infrastructure linking communities. The core approach is to engage local governments, in collaboration with affected communities, to prioritize and manage their own infrastructure needs within a framework of strong planning and oversight by BRR, with appropriate technical assistance (TA)<sup>7</sup>. BRR's medium-term strategy for the MDF comprises three main priorities:

- (i) Remaining MDF resources should be predominantly used for the reconstruction and development (i.e., building back better) of infrastructure, broadly defined, at the housing plot, community, and district/provincial levels.
- (ii) The provision of infrastructure should be closely matched with capacity building efforts for local and provincial governments through a *learning by doing* approach and community

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<sup>7</sup> In July 2005, the Multi Donor Fund (MDF) approved a technical support project to BRR for US\$14.7 million, which provides BRR with additional funding, to enable BRR to recruit consultants and advisors with the best skills and expertise available. TA provided by IREP/IRFF is distinct from this program, and from other TA provided to BRR, as it is specific to the implementation and supervision of infrastructure investments.

- participation for enhanced governance to prepare for the BRR's handover of recovery activities to local and provincial governments in 2009.
- (iii) Though the initial focus will be on the areas most damaged by the tsunami and earthquake (with a particular focus on Nias), infrastructure support and related capacity building should be gradually extended to districts of Aceh where years of conflict stunted economic and human development.

**Phasing of infrastructure support.** The BRR Infrastructure Reconstruction Strategy encompasses three phases: (i) the execution of the ongoing MDF-supported Immediate Action Plan (IAP) agreed upon in November 2005 to meet urgent infrastructure needs; (ii) the Infrastructure Reconstruction Enabling Program (IREP), which is providing technical assistance for the mobilization of human resources and technical support to BRR, provincial, and local governments; and (iii) the proposed Infrastructure Reconstruction Financing Facility (IRFF), which will finance local and provincial level infrastructure subprojects, provide targeted technical assistance and capacity building to local governments to plan, implement and strengthen implementation oversight of the infrastructure reconstruction program, and facilitate the transition of infrastructure program management to provincial and local governments.

The first phase, the IAP, addresses key infrastructure bottlenecks – existing and anticipated. BRR is implementing this program through four partner agencies, the World Food Program (WFP), United Nations Development Program (UNDP), Catholic Relief Services (CRS), and Muslim Aid. The projects covered by these agencies include sea delivery and logistics, ports, road and bridge repairs, and drainage and flood protection works, respectively. These projects lay some of the groundwork for the implementation of the second and third phases of the Infrastructure Reconstruction Strategy.

The second phase, MDF-funded Infrastructure Reconstruction Enabling Program (IREP) is providing technical assistance and additional human resource capacity over a three-year period to assist the BRR in implementing the proposed third phase of the strategy, which provides funding for investment to targeted infrastructure subprojects. This TA will provide direct support to BRR for the strategic planning, programming and implementation of infrastructure development and reconstruction. IREP will also provide TA to 9 local governments most severely affected (7 on the West Coast<sup>8</sup> and 2 on Nias Island<sup>9</sup>), and to the provincial governments of Aceh and Nias to strengthen their project preparation capacity across infrastructure sectors. IREP is designed to support the activities already undertaken by the government and by numerous agencies and donors. The local government and provincial level teams will build project management capacity, prepare infrastructure development plans, feasibility studies, detailed designs, comprehensive procurement planning and support, and will provide construction supervision for infrastructure development.

The proposed MDF-BRR co-financed Infrastructure Reconstruction Financing Facility (IRFF) is the third phase of the Infrastructure Reconstruction Strategy. It will provide an annual allocation of funds for the reconstruction of basic infrastructure to each of the disaster-affected districts, with additional oversight, monitoring, and quality control provisions. There is close strategic integration between IREP and IRFF as IRFF focuses to a large extent on financing the individual infrastructure projects (called subprojects in the rest of the report to distinguish them from the overall IRFF project itself) prepared with the IREP TA<sup>10</sup>.

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<sup>8</sup> Aceh Jaya, Aceh Barat, Nagan Raya, Aceh Barat Daya, Aceh Selatan, Aceh Singil, and Simeulue.

<sup>9</sup> Nias and Nias Selatan.

<sup>10</sup> IREP TA will be to identify, prepare, implement and supervise IRFF-financed subprojects. It may be noted however, that supporting IRFF is but a part of IREP TA's contribution to BRR's infrastructure reconstruction program; IREP TA will oversee infrastructure program management, planning, design, and construction management of adequate standards in the West Coast and Nias, as well as support BRR in overall coordination of the infrastructure reconstruction program.

**Rationale for MDF involvement.** The BRR's approach of utilizing available resources from the MDF in the context of its overall rehabilitation and reconstruction strategy will yield three distinct benefits: (i) MDF will provide an additional and needed US\$100 million to partially fill the infrastructure funding gaps that have emerged as a result of the misallocation of resources<sup>11</sup> among sectors and across local governments in Aceh and Nias, as well as due to inflation; (ii) the US\$100 million of MDF resources (of which US\$82 million will be allocated to financing infrastructure subprojects) will leverage US\$191 million of BRR's monies to ensure that the investments under preparation, benefiting from high quality technical assistance provided by IREP, will indeed be financed; and (iii) MDF resources will be used to strengthen the sustainability of infrastructure reconstruction and facilitate the continuation of infrastructure development beyond the end of BRR's mandate in June 2009 by financing (a) subproject implementation till IRFF's scheduled closing in June 2010; (b) the extension of TA provided by IREP to local and provincial governments beyond June 2009 to continue supporting the implementation and construction supervision of subprojects financed by IRFF; and (c) TA activities specifically designed to facilitate the transition to the post-BRR era.

## II. PROJECT DESCRIPTION

**Objectives.** The objective of the Infrastructure Reconstruction Financing Facility is to assist the province of Aceh and 12 local governments in Aceh and Nias to reconstruct/rehabilitate strategic infrastructure and extend key infrastructure services of adequate quality standards that meet the needs of communities where infrastructure was damaged by the tsunami of 2004 and the subsequent earthquake. BRR has devised a consultative planning process that considers local needs as well as the overall strategic priorities of the reconstruction program to develop Local Government Annual Investment Plans (LGIPs) and Provincial Government Annual Investment Plans (PGIPs) that contain a list of priority infrastructure subprojects to be undertaken. BRR is already receiving technical assistance from MDF under IREP in the strategic planning, programming and implementation of infrastructure development and reconstruction. The proposed IRFF will finance a subset of individual subprojects in the LGIPs and PGIPs totaling US\$273 million by utilizing \$82 million of MDF resources and \$191 million of BRR's funds. In order to provide adequate time to complete IRFF-financed subprojects by the scheduled completion date of January 2010, BRR plans to complete the allocation of US\$273 million to approved IRFF subprojects by April 30, 2008. In addition, MDF resources will be used to strengthen the sustainability of infrastructure reconstruction as mentioned above.

The key performance indicators for these development objectives are:

- (i) Proposals of infrastructure subprojects financed by IRFF will include a set of indicators, including use of infrastructure, quality, user satisfaction, costs and timeliness, that will be used to measure performance during subproject implementation and after subproject completion. Monitoring mechanisms to assess the level of compliance with subproject performance criteria will be put in place;
- (ii) Infrastructure subprojects financed by IRFF after the infrastructure development strategy<sup>12</sup> is drafted reflect the priorities laid out therein;

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<sup>11</sup> The mismatch between available funds and financing needs has arisen somewhat inadvertently as a result of donors and NGOs contributing resources to specific activities they see themselves best suited to deliver. Although BRR coordinates the post-tsunami recovery and reconstruction program, its ability to address the funding mismatch across sectors by reallocating resources is limited given that the activities that it coordinates would themselves need to reflect donors' and NGOs' preferences. I.e., donors would not like to see their contributions finance activities in a sector outside their area of expertise.

<sup>12</sup> BRR is benefiting from IREP support to create an overall strategic program for infrastructure recovery on the basis of individual sector plans highlighting needs and corresponding priority projects in affected areas. This

- (iii) Technical designs of infrastructure subprojects are sound and appropriate;
- (iv) Proper financial and safeguards measures are integrated into the preparation of infrastructure subprojects financed by IRFF;
- (v) Implementation of infrastructure subprojects financed by IRFF is adequately supervised;
- (vi) Performance and financial audit reports (in addition to external audits financed under IREP) of financial statements of infrastructure subprojects financed by IRFF are prepared;
- (vii) A progressively increasing proportion of projects is managed by local and provincial government staff over IRFF project cycle;
- (viii) A progressively increasing proportion of projects managed by local and provincial government staff over IRFF project cycle incorporates appropriate safeguards measures, financial management and procurement practices during project design and implementation.
- (ix) Maintenance of infrastructure subprojects reflects asset maintenance strategies developed by IPM/IREP consultants;
- (x) IPM/IREP consultants design institutional mechanisms according to local/provincial government capacity to sustain subproject implementation and supervision responsibilities of BRR after the completion of BRR's mandate;
- (xi) A comprehensive survey designed to assess the state of infrastructure service delivery in the 12 districts of Aceh and Nias benefiting from IRFF financing of individual subprojects will be conducted at the beginning and at the end of IRFF. Additionally, the survey will assess beneficiaries' satisfaction with infrastructure investments made in their respective communities as well as their quality at the end of IRFF.

**Project components.** The proposed IRFF, co-financed by MDF and BRR, consists of two main components that will be implemented over the January 2007 – January 2010 period<sup>13</sup>. A detailed description of the project components is provided in Annex 2.

- a) **Component 1 - Financing of Infrastructure Reconstruction and Rehabilitation Investments (US\$273.0 million)** will finance individual infrastructure reconstruction subprojects in 12 local governments – 9<sup>14</sup> of which are benefiting from IREP TA, and 3<sup>15</sup> of which are receiving technical advice from existing consulting arrangements, as well as strategic investments at the provincial level. Each individual infrastructure subproject will be co-financed by BRR and MDF, according to a 70:30 ratio. This component will provide resources for civil works and installed equipment in subprojects in the following sectors: roads, ports, water and sanitation, drainage, flood control, coastal protection and restoration of major irrigation canals.
- b) **Component 2 – Targeted Support to Infrastructure Subproject Planning, Design, Supervision, and Implementation Oversight (US\$3.0 million)**<sup>16</sup> will provide TA (i) to Aceh

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infrastructure development strategy will be reviewed every six months by, and will require the approval of, the Infrastructure Board of BRR.

<sup>13</sup> BRR's mandate to lead, coordinate, and manage post-tsunami reconstruction is scheduled to expire in June 2009. The IRFF project, scheduled to close in June 2010, will extend one year beyond the completion of BRR's mandate. This will provide adequate time, if needed, for subprojects financed by IRFF to be completed in line with post-BRR institutional arrangements, detailed in a transition strategy to be prepared by June 2008, and agreed by GOI and the Bank.

<sup>14</sup> Aceh Jaya, Aceh Barat, Nagan Raya, Aceh Barat Daya, Aceh Selatan, Aceh Singkil, and Simeulue in the West Coast and Nias and Nias Selatan in Nias.

<sup>15</sup> Aceh Besar, Banda Aceh, and Sabang.

<sup>16</sup> There will be no replication of TA funding between IREP, IRFF and other existing consulting arrangements. During appraisal, additional TA needs, similar to those addressed by IREP TA (including planning, design, and construction supervision) were identified for Banda Aceh, Aceh Besar and Sabang. TA activities in these districts were being supported by existing consulting arrangements funded by the French government, and were scheduled to

Besar, Banda Aceh and Sabang that are currently receiving TA from existing consulting arrangements for subproject identification and design (till January 2007) for the period January 2007 to January 2010<sup>17</sup> (US\$2 million). This component aims at strengthening the ability of the Aceh Besar, Banda Aceh and Sabang local governments to improve the provision of infrastructure in their respective jurisdictions by providing technical experts to assist them in planning and subproject identification, subproject design, tender documents, procurement, safeguards compliance, implementation, construction supervision, and monitoring; (ii) to support performance and financial audit (over and above external audit) of the project financial statements (US\$0.6 million); and (iii) to provide technical assistance for transition to a post-BRR timeframe and institutional arrangements beyond June 2009, including extension of TA provided under IREP, and capacity building and infrastructure asset maintenance programs for local and provincial governments (US\$0.4 million).

**Unallocated funds (US\$15.0 million).** In order to mitigate uncertainty in the implementation of this project, a portion of the project funds is not allocated to any specific component. These unallocated resources may be used for one or more of the following: (i) extending IREP TA (a) beyond June 2009 to continue supporting the implementation, construction supervision and performance monitoring of subprojects financed by IRFF, and (b) to support BRR's mandate of supervision, performance monitoring and quality assurance of the infrastructure reconstruction program; (ii) financing TA activities necessary to help local and provincial governments prepare for the transition to a post-BRR era by undertaking greater responsibility of infrastructure program management based on the IREP-financed BRR transition strategy, detailing institutional arrangements beyond the scheduled expiration of BRR's mandate agreed by GOI and the Bank by June 2008; and (iii) financing additional subprojects in the event the implementation of all subprojects proceeds as planned.

**Lessons learned and reflected in the project design.** Numerous lessons have been learned from review of reconstruction efforts to date<sup>18</sup>. The design of the project takes into account the following:

- *The need to balance local level planning and overall reconstruction needs.* One the one hand it is critical to design a subproject planning process originating at the decentralized, local level so that the investments financed respond to community needs and local government planning capacity is strengthened. Yet, to ensure coordination and efficient management of available resources, it is essential that infrastructure subprojects reflect the overall reconstruction needs and priorities outlined in the BRR infrastructure development strategy. This balance is achieved by requiring that IRFF-financed subprojects (i) be selected by local governments through a consultative process described in section IV below; and (ii) be confirmed by BRR.
- *The importance of speedy reconstruction while upholding the quality of construction.* The magnitude of infrastructure service disruption to communities in Aceh and Nias calls for quick implementation and completion of high quality reconstruction operations. IRFF addresses the

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end in January 2007. However, after appraisal, the French government announced its commitment to extending TA in Aceh Besar, Banda Aceh and Sabang. If and when a commitment of funds is made by the French government, an equivalent amount of funds for this TA will be put in the unallocated funds under IRFF.

<sup>17</sup> During IREP preparation it was anticipated that additional bilateral assistance would be available to extend this TA beyond January 2007. However, these resources were not secured. In addition, infrastructure reconstruction in Aceh Besar, Banda Aceh and Sabang is very complex and is beyond the resources and mandate of the IREP Infrastructure Program Management (IPM) consultants. Taken together, these factors warranted the inclusion of TA support in infrastructure reconstruction to Aceh Besar, Banda Aceh and Sabang in IRFF.

<sup>18</sup> Refer to December 2005 report *Aceh and Nias One Year After the Tsunami: The Recovery Effort and Way Forward*.

need for speed and quality in reconstruction by utilizing high quality expertise through IPM/IREP consultants who will support BRR and local/provincial governments to deliver infrastructure subprojects on an accelerated basis.

- *The need for local ownership of reconstruction efforts.* It is critical to ensure that local governments develop a sense of ownership with respect to the infrastructure subprojects financed by BRR so that they devote financial and technical resources to keep building and maintaining these infrastructure assets. IRFF addresses this issue in several ways. For instance, LGIPs and PGIPs, which include investments to be financed by BRR as well as by local governments and other stakeholders, will be developed by the local government themselves with support from BRR staff and IREP consultants. Further, project managers (or satkers) for BRR-financed projects will be designated by local governments and will generally be local government employees. In addition, all local infrastructure assets financed by BRR will legally belong to the respective local/provincial governments.
- *The need for transition of overall infrastructure reconstruction management from BRR to local and provincial governments so as to sustain reconstruction activity beyond the duration of BRR's mandate in June 2009.* Local and provincial government capacity in Aceh and Nias had been compromised over years of political strife and the tsunami further reduced government capacity. Cognizant of the risk that infrastructure reconstruction may breakdown in the absence of BRR post-June 2009, IRFF has built-in mitigating measures. BRR will undertake, with the help of IREP consultants, an assessment of local governments' capacity with a view to progressively transferring implementation responsibilities to local/provincial governments; IRFF will finance TA to support local governments' capacity enhancement, if needed. Further, IREP will assist the BRR/GOI to design institutional mechanisms detailed in a transition strategy, by June 2008 at the latest, to ensure that Government bodies are able to keep meeting the obligations of BRR beyond the scheduled expiration of its mandate in June 2009. IRFF will finance additional TA, as and when needed, to help local and provincial governments transition to the new post-BRR institutional arrangements.

**Alternatives considered and reasons for rejection.** Options for financing and implementing infrastructure subprojects to the level of quality envisioned under IRFF are limited in the context of Aceh and Nias. However, the following approaches were considered:

- *Project closing dates of June 2012 and June 2009.* The team considered structuring IRFF as a five year project with a closing date of June 2012 to provide sufficient time to complete infrastructure subprojects financed. However, such an arrangement would be contingent on (i) the extension of the MDTFANS, which is scheduled to close in June 30, 2010; (ii) the provision of funds by GOI to finance its share of IRFF subprojects after the scheduled completion of BRR's mandate; (iii) the preparation of a transition strategy by BRR/GOI with IREP support, acceptable to the Bank, that will help local governments prepare for the post-BRR period; and (iv) the restructuring of IRFF along the new institutional arrangements outlined in the transition strategy and modalities stipulated in the MDTFANS extension. Another alternative considered was to structure IRFF as a two year project with a closing date of June 2009 to be coterminous with the currently scheduled expiration of BRR's mandate. On balance, the team decided to structure IRFF as a three year project with a closing date of June 2010 to be coterminous with the MDTFANS. This would provide sufficient time for IRFF-financed subprojects to be completed, or at the very least, reach an advanced stage of implementation, that could be completed under the new institutional arrangements in the transition strategy using GOI resources.
- *No co-financing of individual infrastructure reconstruction subprojects.* The team considered using MDF resources to fully finance a subset of infrastructure subprojects prepared by BRR with IREP support. This alternative was rejected on the grounds that it would decrease the leverage of

MDF resources in two ways: (i) US\$100 million of MDF monies would not be sufficient to finance the subprojects generated by IREP, expected to be of a total magnitude of US\$300-400 million; and (ii) utilizing US\$100 million of MDF funds to completely finance a few subprojects as opposed to co-financing a larger number of investments, would decrease the leverage of MDF resources with respect to the quality and sustainability of BRR-financed investments as such investments would not benefit from the technical, economic, financial and safeguards measures discussed in Section V below and in Annex 4.

- *Co-financing individual infrastructure reconstruction subprojects funded from BRR/MDF resources with local governments.* Misalignment of the budgetary cycles and administrative procedures of BRR and local governments ruled out this alternative.
- *Using MDF resources to co-finance all the infrastructure subprojects financed by BRR.* The team considered using MDF resources to co-finance all the infrastructure subprojects financed by BRR to increase the leverage of MDF finances spent on infrastructure reconstruction. However, financing all of these subprojects under the proposed IRFF would result in spreading MDF resources too thinly across all of BRR-financed subprojects, some of which will not be subject to IREP quality control mechanisms.
- *Financing overall support to BRR without focusing solely on infrastructure.* Key to recovery in Aceh and Nias is the provision of water and sanitation, transport and other essential infrastructure. Other donors are focusing on support to social and other areas of BRR work, leaving infrastructure to be addressed by alternative sources.
- *Suggesting that the BRR use its own funds to procure consultants for additional TA.* BRR is allowed to contract international expertise using its own funds. However, this procurement method limits the salary to which the consultant is eligible, which hinders the hiring of top international experts. As infrastructure reconstruction progresses, highly specialized consulting services, not readily available from local expertise, will be required to respond to specific needs.
- *Execution of the project by the Bank.* The team considered Bank execution of the project to facilitate faster implementation. However, this alternative was rejected since it would dilute the long term development of ownership and capacity building of local government and institutions.

### III. PROJECT COSTS

IRFF will fund, among other things, individual infrastructure subprojects, each of which will be co-financed by BRR and MDF according to a 70:30 ratio starting on January 1, 2007. IRFF is therefore being processed under an accelerated schedule to ensure that project implementation can start before November 2006 when BRR's 2007 budget needs to be finalized and approved by Parliament.

The estimated costs of financing infrastructure subprojects and funding the technical assistance discussed above are displayed below in Table 1. The Infrastructure Reconstruction Financing Facility (IRFF) will combine US\$100 million of MDF and US\$191 million of BRR resources to finance individual infrastructure subprojects in 12 local governments of Aceh and Nias, provide targeted support to infrastructure subproject planning, design, supervision and implementation oversight, and set aside US\$15 million currently unallocated to specific project activities. The table below assumes that US\$273 million (of the total project cost of US\$291 million) will be used to fund infrastructure subprojects by combining US\$82 million of MDF and US\$191 million of BRR resources in a co-financing ratio of 30:70.

**Table 1: IRFF Costs and Proposed Sources of Funding**

<b>Component</b>	<b>MDF Request US\$m</b>	<b>BRR Co-financing US\$m</b>	<b>Local Gov't Co-financing US\$m</b>
1. Financing of Infrastructure Reconstruction and Rehabilitation Investments	82.0	191.0	Local support costs
2. Targeted Support to Infrastructure Subproject Planning, Design, Supervision, and Implementation Oversight (i) TA support to Aceh Besar, Banda Aceh and Sabang (ii) Transition to post-BRR timeframe (iii) Performance and financial audit (over and above external audit) of project financial statements	3.0	Local support costs	Local support costs
Unallocated	15.0		
<b>Total</b>	<b>100.0</b>	<b>191.0</b>	

#### **IV. IMPLEMENTATION ARRANGEMENTS AND INSTITUTIONAL DESIGN**

**Institutional support to infrastructure reconstruction.** IRFF will use the management structure set up for IREP. The Project Management Unit (PMU) established under IREP will be responsible for managing IRFF. BRR has appointed the Deputy of Infrastructure as Head of the PMU. Located in the PMU is the IREP Secretariat, responsible for daily work to support the functions of the PMU. A full-time Chief of the PMU Secretariat has been appointed to administer the Secretariat work program and staff. BRR will be responsible for equipping the Secretariat with qualified staff. The PMU reports to the Chief Operating Officer (COO) of BRR.

At the BRR level, the progress of the project will be monitored by the BRR Infrastructure Board (IB), which is comprised of the Chief Operating Officer and the Deputies of Infrastructure, Housing, Finance and Planning, and Institutional Development. The IB will provide overall guidance related to donor and sectoral coordination, and monitor progress of the reconstruction program. Detailed implementation arrangements for the project are provided in Annex 3.

Joint Secretariats comprising representatives from local governments and from decentralized BRR offices will be established in each of the 12 districts covered by the project. The Joint Secretariats, assisted by IREP consultants, will facilitate a mechanism of coordination and consultation among multiple stakeholders, including the local governments, BRR, and NGOs. Discussions at the Joint Secretariats will be aimed at guiding the local/provincial planning process, formulating Local Government Annual Investment Plans (LGIPs) and Provincial Government Annual Investment Plans (PGIPs), and identifying individual subprojects therein to be co-financed by IRFF using BRR/MDF resources.

**Planning and implementation of infrastructure reconstruction subprojects.** IRFF will finance individual infrastructure reconstruction subprojects in 12 local governments as well as strategic investments at the provincial level. Local and provincial governments, with support from BRR and IREP consultants will prepare Local Government Annual Investment Plans (LGIPs), and Provincial Government Annual Investment Plans (PGIPs). IRFF will fund some of the infrastructure subprojects contained in the LGIPs and PGIPs. To avoid delays in making progress on the 2007 investment plan, IREP-financed IPM consultants will review the projects already under preparation by BRR and other donors and identify subprojects for IRFF financing. All subprojects financed by IRFF will be required to meet eligibility criteria based on sector and geographic location, technical, economic and financial requirements, and environmental safeguards.

*Preparation and review of the Local and Provincial Government Annual Investment Plans.* The proposed project aims for *programmatically co-financing* of key local investments embedded in strategic local development investment plans prepared by local governments with the assistance of IREP-financed consultants. Existing and on-going donor assisted development and strategic planning efforts (for e.g., ADB's support of KAPs, and Government of France's support of local level infrastructure design) would also serve as inputs for IRFF funded projects. Local governments will work with the Joint Secretariats and IREP-financed consultants to prepare a Local Government Annual Investment Plan (LGIP) and Provincial Government Annual Investment Plan (PGIP) in which prioritized local investment needs will be grounded<sup>19</sup>.

Once the LGIPs & PGIPs are finalized, the Joint Secretariat and local government will send the LGIPs and PGIPs to the BRR PMU, through BRR's regional office, for discussion and confirmation of BRR's potential commitment to finance specific subprojects with IRFF funds in line with regional priorities. The BRR PMU will share the list of confirmed subprojects with the Bank every quarter as part of the Interim Financial Reports (IFRs; see section VI below) along with analyses justifying their confirmation. Each accepted sub-project would be subject to a documented appraisal process to ensure eligibility. As part of the IFR review process, the Bank will ensure that subprojects are fully consistent with, and meet the defined subproject eligibility criteria (set out in Annex 4), and that the required safeguards assessments are met (see Annex 8). The BRR PMU and the Bank will agree (through a Bank no objection letter, 'NOL') on a procurement plan (subproject list of IRFF funded projects derived from LGIPs and PGIPs) for eligible subprojects for the forthcoming quarter that will contain details of confirmed subprojects and an explanation of their inclusion in IRFF. Further, the Bank will require prior review of all International Competitive Bidding (ICB) goods and works contracts, all projects financed retroactively, the first three National Competitive Bidding (NCB) goods and works contracts, consultants contracts greater than US\$200,000, the first three contracts using Consultants Qualification Process (CQ) and all sole-source contracts (see Annex 6).

*Preparation and approval of individual subprojects.* All confirmed subprojects will be notified to the local governments. After agreement, an MOU between the BRR and local and provincial governments will include confirmation of the subprojects the BRR will finance in the LGIP/PGIPs through IRFF, as well as formal commitment by the local and provincial governments to allocate appropriate budgetary resources to maintain these investments on the basis of a maintenance plan. Operations and maintenance of all IRFF subprojects will be supported by detailed financial and maintenance assessments/plans developed by IREP technical assistance (West Coast, Nias, and Strategic Planning, Design, and Construction Supervision consultants).

Local governments, with the assistance of the IREP-financed consultants working at the district level, will be responsible for detailed subproject preparation, including preliminary design, analysis of alternatives, conducting feasibility studies (including required environmental and social studies), followed by detailed design and bidding documents<sup>20</sup>. Final subproject designs and tender documents will be submitted to the BRR PMU for review and tendering<sup>21</sup>. Once received by the BRR PMU for final clearance and

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<sup>19</sup> The LGIPs and PGIPs will be circulated to the MDF Steering Committee for informational purposes and posted on the BRR's webpage. The MDF will have the opportunity to comment on the plans during project supervision.

<sup>20</sup> Environmental studies (AMDAL, UKL/UPL) will be carried out in such a way as to inform the completed detailed designs. Therefore environmental mitigation should be integrated, as necessary, into finalized technical drawings and in the bill of quantities.

<sup>21</sup> BRR PMU and provincial governments will carry out procurement for the first year of the project. In later years, procurement will be decentralized to local and provincial governments on the basis of procurement capacity assessments conducted by IPM consultants. Further details regarding procurement arrangements are provided in Annex 6.

procurement, subprojects will be reviewed to ensure that they meet the technical, economic, financial, environmental and safeguards compliance criteria developed at the outset of the project. Subproject eligibility criteria are discussed in Annex 4, and their role in the local government planning process is presented in Annex 3.

*Subproject implementation.* It is expected that subprojects of approximately US\$150 million will be allocated during each of the 2007 and 2008 BRR budget cycles. Saters will be responsible for implementing individual subprojects and overseeing contractors with the support of IREP supervision consultants. These saters, traditionally work-groups established within an appointed line-ministry, are now organized by activities and sub-activities. Currently, saters function as work-groups to manage the implementation of a project or program. In 2007, these saters will be nominated by local governments and appointed by BRR. In later years, it is expected that saters will be nominated and appointed by local governments. Consultant teams will work alongside saters to assist in the procurement, implementation and supervision of infrastructure reconstruction. Saters will also be assisted by IREP consultants to manage the flow of subproject funds. In particular, the IREP supervision consultant will apprise the saters of the progress made by contractors, and put his/her signatures on the contractor's invoice on the basis of which saters will initiate payment.

**IRFF project financing and disbursement procedures.** BRR and KPPN (Regional Treasury Office) have established a very effective means of disbursing sater investment funds to contractors, other suppliers, and to saters to cover day-to-day operating expenses. The project will establish a Designated/Special Account (DA) (described in Section VI below and in Annex 7), and the KPPN will draw funds from the special account to meet project commitments as required. BRR and MDF will contribute to each subproject financed by IRFF according to a co-financing ratio of 70:30. KPPN will simply draw 30% of each claim's funding requirements from the Special Account and 70% from the BRR's approved budget (DIPA) resources.

As subprojects come on stream, contractors will be paid 20 percent of contract price (as stipulated in the contract) directly into their designated account on signing the contract. The advance will be secured by a bank guarantee as stipulated in the contract. To process the balance of the payments, the contractor will submit invoices, along with supporting documents, to the sater according to payment provisions included in the contract. The invoices submitted will be verified by, and bear the signatures of, the IREP/IRFF supervision consultant. Verification by IREP/IRFF supervision consultant will require his/her review and confirmation that the physical progress of works is in accordance with the contract and with the contractor's invoice. The BRR sater will not process invoices that do not have the IREP/IRFF supervision consultant's signatures attesting to his/her verification of the invoice. Saters will review the claim and confirm that it is in accordance with the contract, that supporting documents are complete, and that the claim is in accordance with the approved sater budget. When all documentation is complete the sater will prepare an SPM-LS, which will be signed and stamped by both the sater manager and the IREP/IRFF supervision consultant. The SPM-LS will then be forwarded by the sater to KPPN for processing and direct payment to the contractor's bank account less any retention for guarantees or advances provided for in the contract and for any taxation obligations. After checking that all supporting documents are in order and that the claim has been correctly authorized by both the sater and IREP/IRFF supervision consultant, KPPN will draw payment from the sater budget held by treasury and special account according to the agreed apportionment and pay this directly to the contractor's specified account. Details of the project financing procedures are presented in Annex 5.

**Local government participation in IRFF.** During project appraisal, the team considered co-financing individual infrastructure reconstruction subprojects funded from BRR/MDF resources with local governments. However, misalignment between the budgetary cycles of local governments and that of BRR, variance between the administrative procedures of local governments and those of BRR as well as

between different local governments themselves, and weak technical and institutional capacity of local governments would have made formal co-financing between BRR, MDF and local governments unduly challenging and complex. At the same time, strengthening the capacity and the incentives of local governments to prepare, implement and maintain infrastructure projects together with BRR and also after BRR's scheduled exit in June 2009 is a key priority. Accordingly, several steps have been taken to maximize local government involvement in the projects financed by IRFF:

- Both IREP and IRFF include TA components that emphasize **hands-on training of local government technical departments**, as well as of BRR staff. Such TA is an important tool that will contribute to ensure the quality of infrastructure subprojects undertaken during BRR's mandate and to prepare local authorities for the post-BRR era. These capacity building efforts will cover all aspects of subproject selection and implementation.
- The overall incentive framework put in place in the context of IRFF is geared toward **building lasting institutional capacity at the local government level**. In particular, making IRFF resources available to finance well prepared local infrastructure subprojects is expected to prompt local governments to improve their ability to select and prepare such subprojects so as to gain access to IRFF financing.
- Measures are taken to **ensure that local governments develop a sense of ownership with respect to IRFF-funded projects**. For example, Joint Secretariats, headed by the head of the local bappeda and comprising a number of local government staff, are being set up in each district to facilitate the process of selecting infrastructure subprojects. In addition, once subprojects are selected and approved for funding by BRR/MDF, project teams will be formed at the local government level to start subproject preparation and the key members of these project teams – in particular the satkers who manage subprojects – will be chosen by local governments and will generally be local government staff. Finally, BRR will undertake, with the help of IREP consultants, an assessment of local governments' capacity with a view to progressively transfer implementation responsibilities to those local governments able to carry out such responsibilities.
- In the context of IRFF, BRR and the GOI are committed to develop a **transition strategy**, by June 2008 at the latest, which will specify the institutional arrangements that will apply after June 2009 period, the scheduled expiry date of BRR's mandate. Such transition strategy will, inter alia, propose institutional mechanisms aimed at facilitating exchanges of experience between all Aceh and Nias local governments involved in infrastructure reconstruction and development. In addition, an unallocated component of IRFF is currently held in reserve and could be used to extend the TA carried out under IREP beyond June 2009.

## V. ELIGIBILITY OF SUBPROJECTS

In order to ensure that investments financed under the operation meet Bank and international standards for quality of investment and are sustainable, investments financed under the operation will be evaluated prior to tendering using simple eligibility criteria. During the initial stages of their engagement, the IPM consultants financed under the related IREP operation, will aid BRR in defining eligibility criteria and in disseminating them to local governments and district level consultant teams. These eligibility criteria aim to ensure that subprojects submitted for final approval by the BRR meet simple requirements for (i) sectoral and geographic inclusion in the proposed project; (ii) appropriate design of technical solutions; (iii) economic and financial viability, including ensuring that mechanisms are in place for operation and maintenance of IRFF-financed investment; and (iv) compliance with the agreed-upon safeguard approach as relates to environmental, social, and fiduciary safeguards in place under IRFF. Details of these eligibility criteria are provided in Annex 4.

## VI. FINANCIAL MANAGEMENT

The size of the proposed project, the number of subprojects to be undertaken, and the complexity of the overall coordination and implementation of the infrastructure reconstruction program assigned to a newly-established agency like BRR create specific financial management challenges. A variety of risk management measures addressing these challenges have been adopted and are discussed below. Additional information on financial management provisions is provided in Annex 7.

**Budgeting.** IRFF will follow a standard annual government budget mechanism. The budget authority (Satker) at the local level will work under BRR supervision and oversight. Project Management Unit (Satker) at local level will be appointed by BRR through fit and proper procedures. Satkers at the local level will report to BRR.

As with other government projects, funds under this project need be put in the government budget and follow existing government budgeting processes. Each individual infrastructure subproject will be co-financed by BRR and MDF according to a 70:30 ratio, and will be recorded as such in the budget documents.

**Accounting & Reporting.** The project will use government accounting software (SAI) to record project transactions. An additional feature of monitoring contract commitments in the accounting software has been developed and will be used in project implementation. A separate worksheet will be prepared to serve the reporting needs of the Bank outlined in the Interim Financial Reports (IFRs). Grant expenditures and activities will be reported to the Bank under the project IFR on a quarterly basis. Satkers at the local level will submit the project IFRs to PMU in Banda Aceh for report consolidation. The financial report may be prepared using a separate stand-alone spreadsheet. This would include information on procurement, physical progress of budgeted activities and financial sources and uses of funds. Formats for these will be agreed to before negotiations.

Quarterly IFRs should be received by the Bank no later than 30 days after the end of each quarter. To ensure consistency of the IFRs with GOI reporting, the aggregates in the financial reports will be reconciled periodically with the aggregates in the SAI and Special Account. All financial transactions should be properly recorded and supported by adequate evidence in accordance with Grant objectives. The audited annual financial statements should be made publicly available to ensure transparency.

**Internal Controls and Internal Audit.** The internal audit department will be responsible to review internal control of all Satkers that implement the project budget at the local level. The internal audit unit will recruit additional staff, if necessary, to supervise the project activities. The internal auditor will conduct a review on internal control system in the implementing Satker, including payment validation. Copies of these reports will be made available to the Bank upon request.

**External Audit.** BRR will prepare special purpose project financial statements annually in specified formats. The financial report will be based on the summary of financial transactions under this grant. The project financial report will be subject to a performance and financial audit by the Supreme Audit Institution (BPK), which may sub-contract this work to a reputable auditor acceptable to the Bank. A copy of the audited project financial statements, along with management letters issued by the auditors, if any, will be submitted to the Bank no later than six months after the end of the fiscal year.

Terms of Reference (TOR) for the project audit will be agreed by the Bank with the Recipient before negotiations. The audit report will include an opinion on the reliability of the project financial statements, including the validity and eligibility of transactions through dedicated special account used for channeling MDF funds. The audit reports will be made accessible to the public to ensure transparency.

**IRFF Disbursement Arrangements.** Applicable disbursement methods include: (i) Advance; and (ii) Direct payment. Advance method will be used to facilitate disbursements for eligible expenditures. A Designated Account (DA) denominated in US dollars will be opened in the Central Bank (BI) or a commercial bank acceptable to the Bank under the name of MoF. The management of the DA would be under the responsibility DG Treasury, MoF and thus the application for applying for an advance and reporting on uses of the advances to the DA would be prepared by PMU and submitted to the Bank through DG Treasury, MOF. The ceiling of the advance provided to a Designated Account (DA) is \$10,000,000. Application for applying for an advance and/or reporting on the uses of advances to the DA would be submitted, monthly or as required. Such an application would be supported by: (i) list payments for contracts under Bank's prior-review and records evidencing such expenditures, or (ii) statement of expenditures (SOEs) for all other expenses, and (iii) DA reconciliation statement.

Another acceptable method of withdrawing funds under this arrangement is the direct payment method, involving direct payments to suppliers for works, goods and services upon request form. The Disbursement Letter will stipulate the minimum application value for direct payment.

When the PMU has the capacity of producing timely quarterly Interim Financial Reports (IFRs), reporting the use of funds will be based on the IFR, and advance to the DA made for six month projected expenditures. Preparation and presentation of IFRs will be required regardless of the selected method of disbursement.

Retroactive financing will be provided under the project for up to 20% (i.e., US\$20,000,000) of the MDF grant amount to finance eligible expenditures for project activities incurred after June 20, 2006. The services, civil works, and goods to be eligible for retroactive financing should be contracted following World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004; and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004. All procurement contracts proposed under retroactive financing will be subject to the Bank's prior review.

**Supervision Plan.** Supervision of project financial management will be done on a risk-based approach at least once a year. The supervision will review the project's financial management system, including but not limited to accounting, reporting and internal control. The financial management supervision will be conducted by financial management specialist and Bank consultants.

## **VII. PROCUREMENT ARRANGEMENTS**

Procurement for the proposed project will be carried out in accordance with the World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004; "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004, and the provisions stipulated in the Grant Agreement. International Competitive Bidding (ICB) will be used for all works packages estimated to cost more than US\$5 million each and goods packages estimated to cost US\$200,000 each. National Competitive Bidding (NCB) will be used for all other packages. Since the minimum size of a subproject is US\$300,000 there will be no need for shopping. For each contract to be financed by the Grant, the different procurement methods or consultant selection methods, estimated costs, prior review requirements, and time frame will be agreed between the Grant Recipient (BRR) and reflected in the Procurement Plan. As mentioned above, retroactive financing will be provided under the project for up to 20% (i.e., US\$20,000,000) of the MDF grant amount to finance eligible expenditures for project activities incurred after June 20, 2006. All procurement contracts proposed under retroactive financing will be subject to the Bank's prior review.

In line with the project's emphasis on supporting every stage of the subproject cycle, including subproject identification, preparation of detailed design and tender documents, procurement, implementation and supervision, the current procurement plan reflects contracts for technical assistance. This will be updated once the subprojects are identified and prior to launching any procurement process for subprojects. Once the first set of subprojects are identified and reflected in the plan, the procurement plan will be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity in the different local governments. Details of the description of the various components and the proposed selection procedures are presented in Annex 6.

BRR has carried some procurement activities so far, mainly in the housing sector using direct award. It provides funds to local governments to carry procurement, but retains the prerogative to approve the final award of contracts. BRR has expressed its concern on the capacity, timeliness and quality of procurement at the local government level, particularly in certain cases where there has been suspicion of collusion. In addition, political pressures weaken the capacity of most local governments to undertake procurement. As a result, BRR has indicated its decision to centralize procurement with the participation of the concerned local governments. BRR is currently developing a structure for a new procurement unit and plans to staff it with qualified personnel to carry the procurement for funds provided by BRR. All procurement managers will have to be certified to carry procurement in accordance with the current national certification system. The BRR will also have access to a pool of experts and procurement certified civil servants who then can use on an on-call basis. Additionally BRR intends to install and use an e-procurement system. BRR is currently assessing the e-procurement system in the city of Sorabaya to determine the ease of its transferability for use in their procurement, including under this project. A Bank staff expert in e-procurement has assessed the current system in Sorabaya and found it to be acceptable for use, subject to recommendations that address weaknesses in the system.

IPM consultants will have a dedicated team of procurement specialists with international and national experience who will assist BRR in all procurement activities. The procurement services of the IPM will include supporting the BRR in directly carrying procurement for the first 12 months while in parallel assessing the procurement capacity at the local government level to determine the current benchmark, developing this capacity through a combination of training programs, on the job training, and gradual transfer of procurement responsibilities to the local governments in the last phase of the project. The BRR will request the Bank's no-objection to their decision to decentralize procurement to local governments, and will reflect this in a revised procurement plan. The BRR will still be responsible for all procurement in terms of preparing procurement plan, ensuring use of appropriate methods, following all applicable procurement procedures in managing the process and evaluating and awarding bids.

## **VIII. SAFEGUARD POLICIES**

Safeguard policies triggered by this project include environmental assessment, involuntary resettlement, and Indigenous Peoples. These policies are triggered by virtue of the fact that, taken together, IREP/IRFF will design and finance a range of infrastructure subprojects, and will therefore have had to consider a full range of safeguards issues as part of subproject preparation and detailed design. A safeguards framework for this project is attached as Annex 8. The environmental and social safeguards framework provides general policies and guidelines to serve the following objectives:

- Protect human health;
- Prevent environmental degradation as a result of either individual investments or their cumulative effects;
- Enhance positive environmental outcomes;

- Avoid or minimize land acquisition and involuntary resettlement, and where this can not be avoided, provide compensation at replacement value and assistance to rehabilitate livelihoods based on consultation with those affected;
- Avoid conflict among community members and strengthen community social cohesiveness.

The safeguard policies triggered include OP 4.01 on Environmental Assessment, OP 4.12 on Involuntary Resettlement and OP 4.10 on Indigenous Peoples.

<b>Safeguard Policies Triggered by the Project</b>	Yes	No
<a href="#">Environmental Assessment (OP/BP/GP 4.01)</a>	[x]	[ ]
Natural Habitats ( <a href="#">OP/BP 4.04</a> )	[ ]	[x]
Pest Management ( <a href="#">OP 4.09</a> )	[ ]	[x]
Cultural Property (OPN 11.03, being revised as OP 4.11)	[ ]	[x]
Involuntary Resettlement (OP/BP 4.12)	[x]	[ ]
Indigenous Peoples (OP 4.10)	[x]	[ ]
Forests ( <a href="#">OP/BP 4.36</a> )	[ ]	[x]
Safety of Dams ( <a href="#">OP/BP 4.37</a> )	[ ]	[x]
Projects in Disputed Areas ( <a href="#">OP/BP/GP 7.60</a> )	[ ]	[x]
Projects on International Waterways ( <a href="#">OP/BP/GP 7.50</a> )	[ ]	[x]

**Environmental issues.** Taken together, IREP and IRFF entail the procurement of services to support infrastructure reconstruction and programming of very significant MDF and BRR resources for Aceh and Nias. Consequently, the consultant teams that will be engaged under the project will need to have a good understanding of related environmental and social impacts and how such impacts can be mitigated via appropriate planning, design, and implementation measures.

Assessment of the impacts of infrastructure reconstruction first needs to be set within the context of existing environmental conditions, particularly along the West Coast and in Nias. Furthermore it should be recognized that existing conditions are being further impacted by the reconstruction process that has been underway since early 2005 – now increasing in scope and intensity. Many coastal areas have been severely damaged by the tsunami both in terms of marine and terrestrial environments. In many places coastlines have been physically altered, particularly the inter-tidal zones. Shallow coral reefs have been affected resulting from the large amounts of solid waste, silts and clays generated by the waves. In Nias, large tracts of coastal land have been lifted up and an estimated 250 ha of coral reefs are reported to have been destroyed. With the loss of sea defenses previously built up areas have been reclaimed by the tides leading to coastal inundation and the recreation of marshy areas juxtaposed with human settlement.

**Social issues.** In general, the infrastructure subprojects that will be designed and implemented with support from IREP/IRFF will entail replacement of pre-existing infrastructure. As a result, the level of associated social risks is likely to be limited. However, it is important for planning processes, including prioritization of infrastructure needs, to reflect community needs - specifically those of vulnerable groups, such as women, children, and the poorest in society.

In some cases, land acquisition and resettlement will be unavoidable, leading to a range of challenges associated with clarifying land titles and ensuring that adequate and timely compensation is provided. Thousands of people still remain missing after the tsunami while others still live in the camps/barracks or have moved to other regions. Although most intend to return to their holdings, the timing varies. Therefore, in many cases landowners are not available to discuss land acquisition issues leading to project delays or later conflicts during project implementation relating to disputed land claims. A further challenge is in dealing with the tenure rights defined under the customary and traditional codes,

particularly in Nias which is dominated by traditional tenure systems. For example, traditional codes do not clearly define rights for women to inherit land, and a challenge may be how to ensure that female heads of households retain rights to receive compensation.

Although the people of Aceh are a broadly homogeneous group, there are indigenous people living in Nias requiring the project to undertake specific measures to ensure that they are meaningfully engaged in consultation processes associated with the planning, design, and construction of proposed infrastructure.

**Safeguards approach.** A range of safeguards specialists will be hired by IREP and IRFF both for the IPM team, the province level team and geographically based consultant teams situated on the West Coast and in Nias. The safeguards team will initially conduct an environmental orientation study based on a pressure/state/response methodology in order to determine how overall infrastructure planning can best take account of environmental challenges. In order to ensure that investments financed under IRFF meet Bank and international standards for quality of investment and are sustainable in the medium term, all subprojects financed under the operation will be screened for compliance with environmental and other safeguard policies.

The Government of Indonesia's environmental review procedures, which include specific procedures for Aceh and Nias<sup>22</sup>, are broadly consistent with those of the World Bank, and will form the framework for the project's approach to environmental screening and mitigation. Subprojects being prepared, designed and implemented under IREP/IRFF (including any subprojects not prepared under IREP but submitted to IRFF) will first be subject to eligibility criteria at subproject identification stage (to be developed by BRR) in order to rapidly eliminate highly damaging or controversial proposals. Once sub-projects progress into formal project preparation, the World Bank and GOI formal social and environmental screening will be applied to determine what level of social and environmental review is required as follows:

- full environmental assessment (AMDAL) required;
- environmental management and monitoring plan (UKL/UPL) required;
- Land Acquisition and Resettlement Action Plan (LARAP) required;
- standard operating procedures (SOP) only.

All subprojects (being funded by IRFF) will be required to complete a standardized screening form providing basic information, according to infrastructure sub-sector (roads, irrigation, drainage, coastal defenses, etc.)<sup>23</sup>. Other key tasks to be undertaken are further detailed in Annex 8. These include principles for handling of land issues and other assets based on minimizing impacts on assets, informed consultation and use of market price for assets lost, as well as sensitivity to local culture. Annex 8A provides details for a framework for treatment of indigenous or isolated vulnerable people. Detailed operational procedures for implementation of the safeguards framework will be developed by the PMU/IPM team and integrated into the Project Implementation Plan (PIP), and a program of training delivered for BRR, local government, project staff, and contractors.

**Gender outreach strategy.** BRR has proposed special provisions in IREP/IRFF for empowering women throughout the IRFF project cycle, and anticipates improved quality of IRFF investments through this outreach strategy. The BRR's preliminary concept for engaging women and addressing gender considerations in IRFF are; (i) direct solicitation of inputs from women's groups during early review of

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<sup>22</sup> Ministry of Environment Decree No. 308/2005 on Implementation of Environmental Impact Assessment, Environmental Management Measures and Environmental Controlling Measures for Rehabilitation and Reconstruction Activities of Nanggroe Aceh Darussalam and Nias Islands of North Sumatra.

<sup>23</sup> GTZ is in process of preparing standard screening formats for discussion with Province Bapedalda. The project will review these formats as a basis for preparing appropriate internal screening procedures.

proposed project designs (particularly for water and sanitation, and market projects); (ii) obtaining women's inputs on investment prioritization through focus group discussions, or other means, and integrating these considerations into the selection process; (iii) ensuring women are represented and active in the district joint secretariat fora; and (iv) direct outreach to community stakeholders through local print media and community radio, to inform on IRFF progress, plans, and major decision. Once mobilized, the IPM Consultants will develop the gender component for IRFF, which the district based IREP consultants will be responsible for implementing. In the interim, BRR will continue to develop these gender outreach strategies, which will be refined and formally integrated into IRFF once IREP consultants being operations.

## IX. ANTI-CORRUPTION ACTION PLAN

An Anti-corruption Action Plan (ACAP) has been prepared for the infrastructure investments to be financed by IRFF. The implementation of this plan depends on strong support from the BRR through its PMU as well as the BRR's Anti-Corruption Unit (*Satuan Anti-Korupsi*, or SAK). Details of the action plan and the mechanisms to protect IRFF subprojects from corruption are provided in Annex 9.

BRR will establish a small Ethics Team that would include representatives from the SAK and from the Internal Audit unit of BRR<sup>24</sup>. This Ethics Team will work closely with the IPM consultants, and provide timely advice to the PMU on issues such as:

- Adapting and adopting procedures acceptable to the MDF and the government for hiring and managing consultants and contractors;
- Ensuring that parliament and civil society groups are properly informed and engaged within an appropriate "third-party" monitoring system.

The IRFF Anti Corruption Action Plan has six key elements, each of which is briefly discussed below. An additional element focusing on effective involvement of local parliaments at BRR's request is also included.

**Disclosure of information.** To encourage healthy competition between bidders, the PMU, with advice from the SAK and the Ethics Team, will ensure that information concerning all contracts as well as full audit and progress reports of subprojects is widely circulated. This will be done using established procedures (e.g., advertisements in newspapers, BRR's website [www.e-aceh-nias.org](http://www.e-aceh-nias.org), development-related newsletters), enhancing with additional measures when possible. To avoid misinformation circulating about the project, the PMU will ensure that groups interested in individual subprojects are kept up to date with progress during the procurement and implementation phases, *inter alia* by using an electronic mailing list and by sending information directly to key distribution hubs, such as NGO fora. The project will also use Public Accountability Meetings, hosted by the local government, to provide an opportunity for civil society to hear about the subprojects from related contractors and consultants in person at the beginning, middle and end of each subproject.

**Civil society oversight.** To broaden informal oversight coverage and further reduce the problems related to misinformation, the PMU will ensure that socialization of civil society oversight begins as soon as possible, so that civil society becomes aware of any forthcoming bidding and so that local governments can see that BRR fosters coordination with key external groups. These groups will include NGOs, religious groups, local parliament and higher education institutions. Both of the latter institutions should be encouraged to send representatives to witness the procurement process and comment on progress.

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<sup>24</sup> This team would greatly benefit from having access to a fulltime Advisor on operational aspects, including the MDF and government disbursement, procurement and financial management guidelines.

Public Accountability Meetings briefly discussed above will be used to engage with civil society groups, where participants can hear about subproject(s), including information on contracts and progress, and pose questions concerning, *inter alia*: timing, finance and quality issues. During subproject preparation, BRR, with assistance from the IPM and the Ethics Team, will develop plans for achieving effective third-party monitoring of procurement and implementation.

**Collusion mitigation.** Special attention will be given to the planning and preparation of procurement processes, as this may entail very different package types and sizes, different levels of responsibility (e.g. shared between BRR and local governments), and different local capacities in terms of process management and oversight (internal and external). As mentioned above, BRR will encourage representatives from civil society and, where possible, local parliament to act as observers of the key stages in procurement. The Ethics Team and the SAK will be fully consulted concerning the methods to be used for each location. At a minimum, the measures outlined in the procurement and financial management sections of the PIP must be closely followed at each stage and any deviation from the agreed rules must be carefully investigated with appropriate sanctions strictly applied.

**Mitigation of forgery and fraud.** Forgery and fraud risks will be minimized by adherence to fiduciary management practices. Measures undertaken will include strict payment validation procedures that will be rigorously enforced. Project filing/bookkeeping will be tightly controlled and subject to strict reviews. Internal and external audits will be held to ensure that fiduciary management is in accordance with the agreed procedures. Special attention will be given to aspects that have proven vulnerable in previous projects, such as “soft” categories like training, workshops and information dissemination. Internal audits will be carried out by BRR, and external audits by the Supreme Audit Board (BPK), which may outsource the task to a professional and reputed audit company acceptable to the Bank. IPM consultants will assist BRR in supervisory work, including routine and ad hoc reviews of other contracts, etc.

**Complaints handling.** A sufficiently independent and credible system for handling complaints is already available within the BRR that feeds into the SAK. The PMU will make full use of this system throughout the life of the program. The overall approach of the project is to support the SAK as an independent unit within the BRR, to carry out most anti-corruption activities for IREP/IRFF. To enhance SAK’s capacity, the IPM consultants have staff to support the SAK. However, SAK will continue to report directly to the BRR, and not the PMU, to maintain the integrity of the unit.

**Remedies and sanctions.** To the extent that this project will finance several individual infrastructure subprojects in an environment of weak institutions and local government capacity, there may be several cases of abuse during the implementation phase. The BRR will follow up on each case appropriately, taking into consideration the size and nature of the case as well as the level of evidence available. BRR may use its own sanctioning regime which includes blacklisting of companies. Depending on the case, sanctions may be imposed by on individual offenders, companies or other entities. If necessary, the BRR Anti-corruption Unit will activate and monitor the referral system to external authorities (e.g., the police/KPK) to gauge if legal and/or administrative sanctions are being effectively applied. The PMU will ensure that proven cases of corruption get high publicity so that they will act as a social (“name and shame”) deterrent.

**Effective involvement of the Local Parliament.** The PMU will ensure that the local parliament (DPRD) is actively involved from the beginning by insisting that they are properly involved in the strategic planning stage. It will also invite representatives from the relevant commission to observe the procurement process on the condition that conflict of interests is avoided. Later on, the PMU will ensure that DPRD are invited through relevant commission to all Accountability Meetings. All of these activities will require inputs from the Ethics Team and the IPM.

## **X. INFRASTRUCTURE SUBPROJECT PIPELINE**

The BRR has formulated a phased infrastructure program to reconstruct and provide essential economic services for Aceh and Nias. Several of the key multilateral and bilateral agencies, donors, and NGOs have been involved in supporting infrastructure reconstruction – the former involved in some of the larger-scale items, and the latter supporting housing reconstruction and social facility reconstruction. An initial pipeline of prioritized infrastructure programs and projects has been prepared by BRR for financing by different sources. Projects in the pipeline cover the ports and harbors, sea defense and macro-drainage, roads and transportation, water supply, sanitation and solid waste management, and urban and town essential municipal services sectors. Some of these projects may be potential candidates for MDF/BRR funding under IRFF. Criteria to select subprojects to receive funding under IRFF are set out in detail in Annex 4. The complete list of projects in the initial pipeline prepared by BRR is presented in Annex 11.

## **XI. TRANSITION STRATEGY AND SUSTAINABILITY**

Rebuilding infrastructure in Aceh and Nias so as to reverse the destruction caused by the tsunami, compensate for the under-development caused by years of political strife and unlock the medium to long term development potential of the province is a task of enormous magnitude. The risk that the efforts now underway might prove unsustainable is substantial. Compounding this risk is the expiration of BRR's mandate scheduled for June 2009, beyond which local and provincial governments will need to undertake greater responsibility for infrastructure reconstruction program management. BRR's exit in June 2009 and the need for new institutional arrangements to facilitate continued progress in infrastructure reconstruction require a well conceived transition strategy to prepare local and provincial governments for the post-BRR period. A number of steps in the context of both the IREP and the IRFF are being undertaken to ensure the sustainability of the reconstruction program for Aceh and Nias and to facilitate the transition of local and provincial governments beyond BRR's mandate. Each of these is briefly discussed below. Details about the efforts to enhance the sustainability of the infrastructure reconstruction program are provided in Annex 10.

**Technical assistance.** Both IREP and IRFF include TA components that emphasize hands-on training of local government technical departments as well as of BRR staff. Such TA is an important tool that will contribute to ensure the quality of infrastructure subprojects undertaken during BRR's mandate and to prepare local authorities for the post-BRR era. These capacity building efforts will cover all aspects of subproject selection and implementation, including subproject selection, preparing detailed design and tender documents safeguards compliance, procurement, subproject supervision, training for handover of databases and other development monitoring tools, anti-corruption measures and infrastructure asset maintenance.

**Ownership.** Steps will be taken to ensure that local governments develop a sense of ownership with respect to the infrastructure assets financed by BRR. For example, infrastructure investment plans that include subprojects to be financed by BRR/MDF resources as well as by local governments and other agencies will be developed through the Joint Secretariats by the local government themselves with support from BRR staff and in coordination with other relevant stakeholders. Once subprojects are selected and approved by BRR central for funding by BRR/MDF, project teams will be formed at the local government level to start subproject preparation. The key members of these project teams – in particular the satkers who manage subprojects – will generally be local government staff. In addition, BRR will undertake, with the help of IREP consultants, an assessment of local governments' capacity with a view to progressively transfer implementation responsibilities, including procurement and financial management, to those local governments able to carry out such responsibilities. The capacity building measures mentioned above are designed to enable transferring increasing levels of responsibilities to local governments over time.

**Building institutional capacity.** The overall incentive framework under which local government officials operate in the context of IRFF is geared toward building lasting institutional capacity. For example, making IRFF resources available to finance well prepared local infrastructure subprojects is expected to prompt local governments to improve their ability to select and prepare such subprojects so as to gain access to IRFF financing. During the IRFF cycle, it is anticipated that local governments will share some of the implementation responsibilities (procurement, financial management, etc) of IREP TA. This will be determined on a case-by-case basis after capacity assessments are conducted by IPM and the district/provincial based IREP TA, and with NOL from the Bank. In addition, a transition strategy – to be developed with the help of IREP consultants to help local governments prepare for the post-BRR period – will propose institutional mechanisms aimed at facilitating exchanges of experience between all Aceh and Nias local governments involved in infrastructure reconstruction and development.

**Post-BRR arrangements.** The capacity building measures described above are designed to help local governments work together with BRR to select, design and implement high quality infrastructure subprojects, and will help local governments implement infrastructure development programs on their own after the end of BRR’s mandate. Additional measures are specifically designed to ease the transition to the post-BRR period. For example, BRR with support from IREP consultants will develop institutional mechanisms, by June 2008 at the latest, for the post June 2009 period when its mandate is scheduled to expire. In addition, unallocated funds under IRFF are currently held in reserve to be used, for example, to extend the TA carried out under IREP beyond June 2009 if it proves desirable.

## XII. RISKS

Table 2 below outlines critical risks to the project, as well as proposed mitigation measures to be taken to minimize these risks.

**Table 2 – Critical risks and proposed mitigation measures**

<b>RISK</b>	<b>RATING</b>	<b>MITIGATION</b>	<b>RATING AFTER MITIGATION</b>
<b>Misuse of and failure to account for project funds</b>	H	Outsourcing of accounting and reporting functions. Public disclosure of audit report and anti-corruption initiatives as outlined in the Anti-corruption Action Plan.	M
<b>Ineffective audit functions</b>	H	Inclusions of an independent audit as part of the FM component. FM consultants apply professional best practices to implementation.	M
<b>Political involvement in funds flow process</b>	S	An independent financial management team will be supplied as part of the IPM team to monitor fiduciary arrangements.	M
<b>Lack of involvement and support of key government agencies</b>	S	The Infrastructure Board of BRR will be engaged to ensure the appropriate commitment of BRR and the relevant LGs.	M
<b>Inadequate capacity of the executing agency</b>	S	TA consultants will provide the required capacity. BRR will establish a PMU staffed by experienced technical staff, administrative staff, procurement and financial management staff/accountants.	M
<b>Limited availability of foreign and local TA consultants</b>	M	All consultants will be procured using standard Bank procedures. Maximum coverage will be given to advertisements requesting interest from consultants.	N

<b>Consultant teams do not meet performance requirements</b>	S	Use of procurement advisors will ensure good quality consultants are selected. The Bank will support BRR in closely monitoring performance of consultants through intensive supervision. The TORs of the consultants have clauses included that mandate replacement of underperforming staff; also as part of the contract, consultants must sign an integrity clause.	M
<b>Local governments unable to supply co-financing for compensation of land acquisition</b>	H	If local governments are unable to mobilize funding to co-finance land acquisition for infrastructure works, BRR will provide the additional financing.	S
<b>Weak procurement environment and collusive practices in past projects</b>	H	All packages funded on a retroactive basis will be subject to prior review. To ensure transparency in the procurement process, enhanced procurement procedures are included in the Anti-Corruption Action Plan. Procurement training activities and a capacity assessment will also be conducted with local and provincial governments with IPM assistance.	S
<b>Low capacity of local and provincial governments to provide experienced, qualified staff to work with consultant teams</b>	H	The project will create incentives for active participation of local and provincial government staff by increasing their ability to manage subprojects through capacity building activities for subproject selection and management.	S
<b>Low capacity of the local governments to operate, and maintain new/rebuilt infrastructure</b>	H	The project design includes significant institutional strengthening to promote sustainable management, operations, and maintenance by the PU staff.	S
<b>Infrastructure contracts will not be executed to standards and costs as designed</b>	S	Improved bid documents and tightened control of quantities and quality by consultants.	M
<b>All subprojects financed by IRFF will not be fully implemented by the time the project closes in June 2010</b>	H	TA provided under IREP will facilitate adequate pace of implementation of IRFF-financed subprojects by supporting subproject identification, preparation, implementation and construction supervision. In addition, the following provisions aim to achieve timely completion of IRFF-financed subprojects: (i) development of a transition strategy detailing post-BRR institutional arrangements agreed by GOI and the Bank by June 2008; (ii) provision of funds by IRFF to extend TA under IREP after IREP closes in June 2009; and (iii) restructuring of IRFF after January 2010 to fund expenditures related to IRFF-financed subprojects along the post-BRR institutional arrangements outlined in the transition strategy.	S

<b>Transition of responsibility to local and provincial governments for maintenance of infrastructure proves unsustainable after BRR's mandate ends</b>	H	IREP is designed to help build capacity of local and provincial government staff to bring about improvements in the planning and maintenance of infrastructure. The consultants will gradually shift responsibility to local government staff to manage infrastructure subprojects during the course of IREP/IRFF. Steps will be taken to ensure that local governments develop a sense of ownership with respect to the infrastructure assets financed by BRR. BRR/GOI, with support from IREP consultants, will develop a transition strategy detailing post-BRR institutional arrangements agreed by GOI and the Bank by June 2008. IRFF will finance TA, as and when needed, to support local and provincial governments transition to the new post-BRR institutional arrangements.	S
<b>Capacity of the Bank to meet its responsibilities with respect to review and supervision of subprojects</b>	S	It is expected that IRFF will finance 100 to 200 subprojects across several infrastructure subsectors over the duration of the project. Each of these will require Bank review of procurement, financial management, and safeguards and anti-corruption measures, as well as their respective technical reviews. In addition, the Bank will be required to monitor the quality of design and implementation. The Bank will assess its staffing needs and allocate adequate resources to ensure the constitution of a strong team that can shoulder its responsibilities towards subprojects financed.	M
<b>OVERALL RISK LEVEL</b>	<b>H</b>		<b>S</b>

Risk Rating - H (High Risk), S (Substantial Risk), M (Modest Risk), N (Negligible or Low Risk)

### XIII. MONITORING AND EVALUATION

Monitoring and evaluation (M&E) of IRFF projects will be carried out by IREP district and provincial level TA, and coordinated by IPM consultants. The M&E framework will be developed by the IPM consultants and reviewed by the Bank during supervision. Each subproject proposal will include monitoring indicators and data collection indicators. The framework will include roles and responsibilities of the PMU and IREP consultants. M&E for safeguards will be conducted under the same framework, and will be overseen by the IPM safeguards coordinator<sup>25</sup>.

### XIV. BANK REVIEW AND SUPERVISION

The proposed IRFF is structured as a programmatic operation, with multiple subprojects being prepared, implemented and their construction supervised over the next three years<sup>26</sup>. The Bank, as partner agency under the MDF legal framework, will be responsible for project supervision of the project on behalf of the MDF. In such capacity, the Bank will have the following review and supervision functions during implementation of IRFF:

<sup>25</sup> IRFF documents will include a covenant for the BRR to submit, within six months of IPM mobilization, a draft M&E framework to the Bank for review.

<sup>26</sup> Although IRFF's implementation period is January 2007-January 2010, the disbursement schedule will span two and a half years between January 2007-June 2009, to be coterminous with the currently scheduled completion of BRR's mandate. If subprojects are not completed by June 2009, they can be financed by IRFF till June 2010 (when the project is scheduled to close) in line with post-BRR institutional arrangements, detailed in a transition strategy to be prepared by June 2008, and agreed by GOI and the Bank.

**Finalization of Project Implementation Plan (PIP).** The PIP will guide project implementation and will list all project-related policies and procedures. The PIP will contain, among other things, specific accounting and reporting procedures for all organizations involved in project implementation, preparation of Interim Financial Reports (IFRs), and details of procurement, environmental and safeguards compliance procedures. In addition, the document will include details of the eligibility criteria formulated by IPM consultants that will help identify subprojects to be financed by IRFF. A draft of the PIP will be agreed with the Bank prior to negotiations. Any further changes to the PIP will be made in agreement with the Bank.

**Interim Financial Reports (IFRs).** During implementation, Bank staff will review IFRs each quarter to assess financial management, procurement, and physical progress made in the preceding quarter as well as agree with the procurement plan of the forthcoming quarter. This procurement plan will include subprojects to be undertaken in the next quarter along with the rationale for their inclusion. Quarterly IFRs should be received by the Bank no later than 30 days after the each of each quarter. To facilitate project supervision, the Bank will schedule its supervision missions in line with the submission of the IFRs. The format of the IFRs will be agreed by BRR and the Bank at negotiations.

**Procurement review.** During implementation, Bank staff will review and monitor procurement in IRFF subprojects through the following: (i) IPM will support BRR and provincial governments in carrying procurement for the first 12 months, and in parallel, assess the procurement capacity at the local government level to determine the current benchmark, develop this capacity through training programs, and facilitate a gradual transfer of procurement responsibilities to the local governments. BRR may delegate procurement responsibilities to local governments during implementation in agreement with the Bank; and (ii) as displayed in the procurement arrangement details in Annex 6 detailing the Procurement Plan and Assessment, all TA contracts will be subject to prior review by the Bank. As mentioned above, the Bank will review procurement over the preceding quarter as well as the procurement plan for the forthcoming quarter submitted along with quarterly IFRs. In addition to the regular prior review supervision and a review of quarterly IFRs to be carried out from Bank offices, annual supervision missions will visit the field to carry out post review of procurement actions on a yearly basis.

**Environmental review.** An environmental and social safeguards framework was agreed to at appraisal, and is outlined in Annex 8. Formal Bank review will be required at three stages: (i) completion of required environmental and social studies (AMDALs, UKL/UPL and LARAP) during sub-project preparation; (ii) integration of study results into DD/TDs prior to sub-project approval; and (iii) completion of land acquisition and resettlement monitoring form prior to contracting of work. During construction supervision, the Bank will receive bi-annual monitoring reports covering environmental and safeguards issues.

**Anti-corruption.** The Anti-corruption Action Plan will be part of the PIP prepared by BRR and agreed with the Bank prior to negotiation. During implementation, Bank staff will monitor the six elements of the anti-corruption action plan (elaborated in Annex 9). Aide Memoirs will clearly state progress in relation to the Anti-Corruption Action Plan. Any changes to the Anti-Corruption Action Plan will be made in agreement with the Bank. Bank supervision may be enhanced by support from an External Supervision Team (EST), which advises the Bank's internal Anti-Corruption committee for Indonesia in relation to infrastructure development, to help identify the risks of fraud and corruption at an early stage, and bring these to the attention of the Bank and Government institutions for further processing. In particular, the EST may aid Bank supervision by identifying and tracking indicators of corruption, and carrying out subproject site checks at strategic times between formal supervision missions. The EST may also assist the Bank's supervision team in designing complaint handling processes as well as mechanisms for coordination with other institutions including BPK and SAK. These inputs in no way reduce the need for the BRR to monitor the project implementation through the agreed mechanisms. BRR will regularly

share with the Bank the findings of technical and financial audits, to be held during (interim audits) and after (post audits) each year for a significant sample of subprojects. The BRR will also ensure that any suspected cases of corruption related to this project be reported immediately to the Bank.

#### XV. POLICY EXCEPTIONS AND READINESS

**Grant conditions and covenants.** Standard World Bank conditions and covenants apply. The following actions will be taken prior to negotiation:

- BRR submission of shortlist of FM Consulting firms
- Terms of Reference (TOR) for project audit and Financial report format to be agreed between BRR and the Bank
- Draft Project Implementation Plan acceptable to the Bank to be adopted by BRR
- Anti-Corruption Action Plan, Environmental and Social Safeguards Framework and Procurement acceptable to the Bank to be adopted by BRR

The following action(s) will be taken prior to effectiveness:

- BRR signing of contract with FM Consulting firm

In addition to standard implementation actions, the following actions will be taken during implementation and will be reflected in the Grant Agreement:

- **Finalization of PIP.** BRR will review/revise the PIP at least once every six months with the IPM consultants, the first such review to be completed by the earlier of two months after the date of mobilization by the IPM Consultants or November 1, 2006.
- **Approval of Subprojects.** BRR will submit a quarterly list of proposed subprojects and supporting documentation to the Bank, for review by no later than each January 31, April 30, July 31 and October 31 in each year .
- **Transition to post-BRR phase beyond June 2009.** BRR/GOI will submit a draft transition strategy to the Bank by June 30, 2008 for its review and comments and will submit the final transition strategy to the Bank by September 30, 2008.
- **Subproject Financing.** GOI will ensure that adequate financing and institutional support will be provided to complete projects beyond the scheduled expiration of BRR's mandate in June 2009.
- **Audit Arrangements.** BRR will appoint BPK as external auditor for this project and BPK may sub-contract work to private audit firms acceptable to the Bank; such contracts should be completed no later than 6 months after signing of the Grant Agreement.