



Peer Review of the Audit Board of the Republic of Indonesia



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Preface

It is with great pleasure that I offer the Audit Board of the Republic of Indonesia (BPK) the final results of the Peer Review 2009. BPK, like the Netherlands Court of Audit, is a Supreme Audit Institution. It is dedicated to safeguarding good governance by ensuring the transparency and accountability of the public sector of the Republic of Indonesia. To function as a Supreme Audit Institution it must safeguard its independence. Independence requires responsibility, a responsibility to be transparent and accountable. That is why we, as members of the International Organisation of Supreme Audit Institutions (INTOSAI), conduct Peer Reviews to assess the quality of our institutions. However a uniform model for conducting Peer Reviews of Supreme Audit Institutions is not yet available. At present INTOSAI's Capacity Building Committee is preparing a Checklist of Possible Peer Review Issues. For our Peer Review of the BPK we could use checklists already developed by the Asian and African Organisation of Supreme Audit Institutions (ASOSAI and AFROSAI).

This Peer Review marks an important point in the history of BPK. BPK has transformed its organisation into a modern Supreme Audit Institution with legally embedded independence, a strong mandate and qualified staff to realise its tasks and objectives. Our Peer Review found that BPK had laid strong foundations to function as a Supreme Audit Institution. We believe that BPK has played an important role in enhancing the transparency and accountability of the Indonesian public sector. We are confident that it will continue to do so. We hope our suggestions will be of value to further improve the functioning of BPK and the benefits of its activities for the Indonesian population: its most important stakeholder.

I would like to express my gratitude to the current Board for its cooperation and friendship and I wish to welcome the new Board as members of our community and hope for a continuation of our cooperation and friendship in the period to come. On behalf of the Peer Review team I would also like to express our great appreciation for the warm hospitality and full support given by the Audit Board and its staff during this Peer Review.

Saskia J. Stuiveling
President of the Netherlands Court of Audit
The Hague, July 2009

Part I

Conclusions, recommendations and response

I About this Peer Review

This report presents the results of the Peer Review of the Audit Board of the Republic of Indonesia (BPK) as performed by the Netherlands Court of Audit in 2009.

The Peer Review team conducted a review of:

- 1 BPK's quality control system to assess whether or not it had been designed and implemented in the organisational structure so as to support the aims of providing adequate assurance that BPK (a) has applied and complied with the State Finance Audit Standard (SPKN) and (b) has adequately applied and complied with auditing policies and procedures.
- 2 BPK's progress and on-going efforts to implement the recommendations given by the previous peer reviewer, the Auditor General of New Zealand.

Quality controls were reviewed at institutional level and at engagement level. In total 14 individual audit engagements were selected for review.

The criteria used to assess quality assurance and quality control at BPK are set out in the following documents:

- INTOSAI'S LIMA and Mexico Declaration;
- INTOSAI standards and guidelines;
- AFROSAI standards and guidelines;
- ASOSAI standards and guidelines;
- BPK's own standards and guidelines.

In addition to analysing translated documents and interviewing several units (core and support units), we reviewed eight financial audits, three performance audits and three special purpose audits.

In part I of this report we present our conclusions and recommendations for further improvement. Part 2 of this report contains the findings of the Peer Review. Findings on quality assurance and quality control at entity level are described in chapter 1. The results of the review of selected audits are reported in chapter 2. The follow-up to the Peer Review performed by the Auditor General of New Zealand is considered in chapter 3.

2 Conclusions and recommendations for further improvement

BPK has put in an impressive amount of work. Since 2004 it has laid strong foundations to function as a Supreme Audit Institution. It has opened 33 regional offices and recruited new staff. BPK has also developed a multi-year strategy based on key performance indicators for internal and external objectives. Although the Peer Review team has made many recommendations (meant for further improvement) the overall conclusion is clearly very positive.

Besides organisational and policy improvements, we have identified necessary improvements in the strategic planning and focus of BPK's activities. We believe BPK should exploit the momentum of the upcoming changes in the Board's composition and the finalisation of its current strategic period to implement these improvements in close cooperation with its relevant stakeholders, being parliament and government at both national and local level.

In this chapter we set out our findings with regard to the entity level, engagement level and the follow-up to the previous Peer Review. Section 2.1 contains the main conclusions of the Peer Review. The strategic improvements we believe are necessary for the coming period are presented in section 2.2. Conclusions and recommendations regarding the key factors of BPK's Quality Management System identified by the Peer Review team are clustered and reported in section 2.3.

2.1 Where is BPK now?

We conclude that BPK has laid strong foundations to function as a Supreme Audit Institution. It has put in an impressive amount of work since 2004.

We found that BPK's role as a BPK is now secure because nearly all crucial elements of Law No. 15 2006 have been effectuated. In practice, however, BPK has encountered one main obstacle to carrying out its mandate, namely its limited access to information on the Taxation Office's revenues. This situation means that the Audit Board's Law No. 15 is not complied with. It also goes against INTOSAI's Lima Declaration 1977 as confirmed in the Mexico Declaration 2007.¹ INTOSAI stated in principle 4 that unrestricted access to information is necessary for the proper discharge of the statutory responsibilities of SAIs.

We also found that the audit manual framework, consisting of rules and regulations, manuals and guidelines, complies with international standards. Moreover, a quality control system is in place and a quality assurance system has been designed.

We further found that the responsibilities of all actors were clear and that the right checks and balances were in place in the audit process. The audits reviewed had been performed in compliance with BPK's audit manual framework. All quality control elements identified by the BPK were evident in the audit process reviewed.

¹
INTOSAI (2007), *Mexico Declaration on SAI Independence* (ISSAI 10).

Furthermore, we found that the work performed by the selected audit teams provided reasonable assurance to express an opinion. The auditors interviewed had a very good knowledge of their audit subject, audit objective and audit methodology. They followed internal guidelines and were able to provide the supporting audit documentation.

Finally, we found that BPK had followed up the recommendations made by the Auditor General of New Zealand.

2.2 Where should BPK be heading?

2.2.1 Political environment of BPK

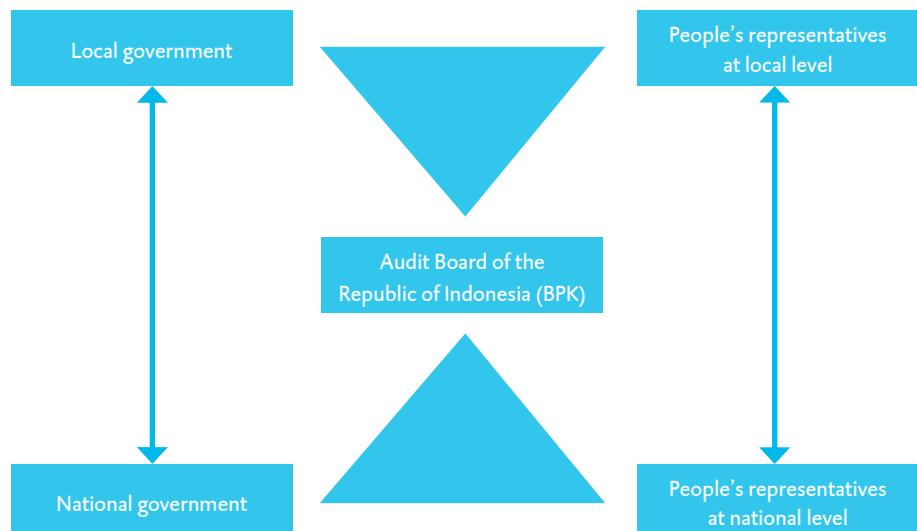
2009 will see changes in BPK's political environment: the 2009 general elections will produce a new parliament and a new government. Moreover, the composition of BPK will change as seven of the nine Board members end their term and are replaced by new members. These changes need to be properly managed by the Audit Board and its staff to secure the achievements reached so far and to exploit the momentum for further improvement in its performance as a Supreme Audit Institution.

2.2.2 Accountability and transparency risks

Besides the political changes and renewal of the Audit Board, three main risks have been identified with regard to the accountability and transparency of the public sector in the Republic of Indonesia. These risks need to be addressed in the next strategic period:

- 1 BPK's limited access to information on revenues and foreign aid;
- 2 weak financial management in central and local government;
- 3 the persistence of fraud and corruption in government and society.

To be able to address these risks, BPK should formulate a strategic plan that can be implemented in the political environment in which it operates. Cooperation and communication with people's representatives at national and local level and government at national and local level are essential. Only then can these issues, which are a problem for the whole of the Republic of Indonesia, truly be resolved. The relevant political environment can be visualised as follows:



Below, we suggest how BPK could address the three risks in its political environment, consisting of the interaction between people's representatives, government and BPK.

Risk 1: Limited access contrary to international rules and practices

As noted in section 2.1 BPK has encountered a serious obstacle to its carrying out its mandate, namely its limited access to information on the Taxation Office's revenues.

In addition, BPK has been excluded from auditing foreign-funded projects because the government and donors/creditors agreed to use an internal government agency (BPKP).

BPK has already taken up these two issues of limited access. BPK raised the issue of access to revenues with the Constitutional Court. The Court has not granted BPK full access to the revenues of the Republic of Indonesia. Nevertheless, there seems to be an opening at the Ministry of Finance, which has allowed BPK some access to its information for its audit. With regard to auditing foreign-funded projects, the lack of access to foreign-funded projects is contrary to the standard practice at many bilateral and multilateral donors. BPK has discussed access with government and foreign donors but without any concrete result.

We recommend that BPK give the highest priority to the full implementation of its mandate with regard to revenues and foreign funds and start an open and constructive dialogue with the Minister of Finance, foreign donors and parliament.

Risk 2: Weak financial management

At present, financial management in all layers of government is weak. BPK has already started several activities to raise government awareness and to set out a route for improvement by demanding action plans from national and local government that lead to appropriate financial management in due course. BPK has a role to play as external auditor but it is not responsible for financial management. The improvement of public financial management should be a joint effort by government and the people's representatives at national and local level and by BPK.

At present, there is no strong interest in parliament to address public financial management and BPK's audit findings. We believe BPK's effectiveness as a SAI could be strongly enhanced through the appointment of a Public Accounts Committee in parliament. Furthermore, a Public Accounts Committee could play a crucial role in enhancing public financial management in the Republic of Indonesia.

We recommend that BPK develops a common strategy together with government (including internal control and audit units) and the people's representatives to raise public financial management to a structurally adequate level within a realistic but ambitious timeframe. We also recommend that BPK coordinate all action plans of lower tiers of government.

We recommend that BPK retain a strong focus on financial auditing by selecting important elements of public financial management, such as the internal audit function, asset management, revolving funds and contract management.

Furthermore, we consider the appointment of a Public Accounts Committee of crucial importance and therefore recommend that BPK actively promote the appointment of such a committee.

Risk 3: Fraud and corruption

At present, Indonesian society is still troubled by fraud and corruption. Although BPK has put a lot of effort into setting up and conducting investigative audits, we believe BPK's effectiveness lies not so much in detecting fraud and corruption but in preventing its occurrence by analysing the causes and effects of fraud and corruption: how does it happen and how should it be made impossible?

We recommend that BPK focus more on the causes and effects of fraud and corruption and not solely on the misconduct of individuals. We suggest that BPK use its investigative audit results in combination with international and national knowledge to identify trends and the underlying structure that facilitates fraud and corruption. We also suggest that BPK exchange knowledge and experience with SAIs from other countries in the region that have comparable problems. This would further improve its approach to combating corruption and sharing its own valuable experience.²

2.2.3 New strategic focus ('umbrella')

Given the vast audit field and the limitations on BPK's audit capacity, a well-balanced strategy is required. The multi-year strategy BPK has developed is a good basis to set the agenda for public discussions.

We believe BPK's next strategic plan should be based on the five-year government planning cycle. This would enable a more structured evaluation of the government's performance at the end of its term. The start of the new Board coincides with the start of the new government and provides an opportunity to tailor BPK's planning to that of the new government and to optimise its influence. To enhance the impact of its audits, BPK should focus its multi-year strategy on a limited number of major policy issues over a period of several years (for instance education, health, infrastructure, security or the environment). These issues can then serve as a framework for the annual audit selections.

Starting with a description of expected outcomes, themes and sectors of its mandate, BPK could define its multi-year audit plan (its 'umbrella') by specifying objectives it would like to attain. Such objectives would guide BPK during its annual selection of audits or other activities. The success of government policies is hard to measure by means of a single audit but a cluster of interrelated audits can give better proof of policy success or failure. BPK could develop less capacity-consuming interventions to increase its coverage of the audit field. Findings and recommendations from one audit (case study) could be used, for example, to make recommendations in similar situations or at similar entities. The system of key performance indicators that BPK has developed and implemented is a helpful instrument to ensure the realisation of this strategy.

²

The Netherlands Court of Audit issued a study report, 'Signals of Fraud', on 11 March 2008. This report is based on experiences in the Netherlands, Europe and a number of international cases. The report contains information on vulnerable activities/processes, red flags (circumstances that increase the risk of fraud) and indications of fraud.

To secure the achieved results and give the new Board members a flying start, we believe the Audit Board and its staff should give the new Board members the ‘red carpet treatment’. It would comprise a familiarisation course for the newly elected members and provide information on the Audit Board itself, technical aspects and products. The new members should have an opportunity to observe Board meetings and the way the members work with each other. A coach could be appointed to accompany the new members and offer them guidance during this familiarisation phase.

We recommend that BPK develop a multi-year strategy based on a limited number of topics that are aligned with the new government policy programme. The strategy should address the three risks we identified earlier (limited access to information, weak financial management and fraud and corruption).

We suggest that the current Board provide the newly elected Board members with a familiarisation course to enable them to make a flying start. We also recommend that the Board ensure that the new members incorporate this report’s recommendations in the new strategy and annual working programmes.

2.3 Conclusions and recommendations on key factors of BPK’s Quality Management System

BPK’s Quality Management System is based on internationally accepted standards. BPK’s quality control is supported by the following key factors:

- 1 Independence and Mandate;
- 2 Leadership and Internal Governance;
- 3 Human Resources Management;
- 4 Audit Standards and Guidelines;
- 5 Institutional Support;
- 6 Continuous Improvement;
- 7 External Stakeholder Relations;
- 8 Results;
- 9 Audit Engagement Performance.

The Peer Review team reviewed the design and implementation of BPK’s quality control system and came to the following clustering of conclusions and recommendations. The detailed findings for each key factor are presented in part 2 of this report.

2.3.1 Reporting

The quality of audit reports is a key factor in the effectiveness of a Supreme Audit Institution. The reports we reviewed were very long, contained many findings and referred in most cases to shortcomings only, not to causes and effects.

Possible improvements

The auditors should have a better understanding of the scope of financial audit in comparison with performance audit. Some financial audit objectives could also be defined as performance audit objectives. Assessing internal control systems and

compliance with laws and regulations, for instance, has some aspects of performance audit. The utility of BPK's reports to its stakeholders would be improved if the causes and effects of findings and opinions were clarified.

BPK should provide more historical analyses of its findings and recommendations and also the response to them. Monitoring the follow-up to recommendations could be more effective. BPK should pay more attention to the impact of its recommendations and not only to compliance with recommendations. This would also make it possible to learn from the effectiveness of recommendations made.

To increase the effectiveness of its reports, we recommend that BPK report more concise with a strong focus on causes, effects and solutions and not merely on findings. Furthermore, we recommend that BPK enhance the attractiveness of its reports by using communication experts and more visualisations to present its analysis and conclusions.

In view of the Peer Review team's findings, BPK's auditors should broaden their understanding, views and skills to disclose issues and develop audit reports. They need to look behind the financial figures and clarify to parliament and auditees the causes and effects of the findings. Attention should be paid to their ability to monitor and understand the environment of BPK and to use that knowledge for assessing relevant risks and for designing and conducting audits.

2.3.2 Communication

BPK uses a communication mix and has already launched its own website, has held consultative meetings, public dialogues, stakeholder surveys and has provided annual awards to auditees who demonstrated substantial transparency and accountability improvements. BPK recently organised a two-month TV series to provide an explanation of several audit reports to the general public.

We also found that BPK is very active within the community of SAIS (INTOSAI, ASOSAI and bilateral contacts). Although we realise the added value of international contacts for auditing cross-border issues, capacity building and sharing of knowledge and experience, we also see a risk regarding the burden of an active international role of BPK for its scarce staff capacity. At present, BPK does not have a strategy endorsed by the Board that focuses its international activities in relation to its national strategic goals.

We recommend the fast approval of BPK's international relations strategy once its development is completed in order to focus its international activities.

Besides technical guidelines we recommend that BPK develop effective scenarios for responses/ interventions to counter auditees' resistance to change. One example is selecting the right moment to publish reports so that they have the highest impact. Although this is not possible for the annual financial audits, it will improve the effectiveness of special purpose audits and performance audits.

We recommend that BPK build up a strategic network of relevant stakeholders at international, national and regional level.

Although not required by law, we recommend that BPK develop and issue an annual report on BPK's performance and financial management. This annual report could serve as an example for transparency and accountability in the public sector of the Republic of Indonesia.

2.3.3 Continuous improvement

Quality control and quality assurance are preconditions for continuous improvement. BPK has fulfilled the basic requirements for quality assurance by means of several instruments. To be effective, however, the role and function of all actors and instruments must be clear. An overall vision, description of the actors and the relationship between the instruments will help to ensure continuous improvement.

We recommend the development of a description of the vision, tasks, actors and relationship between the instruments necessary for quality assurance.

Quality assurance (ITAMA)

The combination of internal audit/inspection tasks with quality assurance tasks in one unit (ITAMA) does not improve the quality assurance environment. The combination of what is seen as punishing and learning at the same time should be discouraged.

We recommend that BPK separate the inspection task from quality assurance. Moreover, we recommend that BPK define the role of ITAMA in more detail in relation to:

- the evaluation unit (EPP);
- internal review teams;
- hot review teams in the audit units.

BPK recently took the first steps to prepare project charters to clarify each function's use as a quality assurance instrument. We recommend that ITAMA be able to use the findings (errors) of the other units' summarising/verifying activities. Furthermore, we recommend that only ITAMA should report relevant findings and lessons to the management of BPK.

Quality control activities need experienced auditors

It is essential that only very experienced auditors with a certain authority and teaching skills are placed in ITAMA. It would then become an honour to work for ITAMA. The current ITAMA staff should be clearly informed about their role, tasks and required performance as soon as possible. They should also enjoy the support of BPK's senior management and have sufficient budget to do the job. A sufficient number of senior auditors should join the QA inspectorate every ten years for a period of three years.

We recommend that the Board and management give their full support to the development of ITAMA and ensure there are enough experienced auditors within ITAMA to assess the quality of the work done by BPK's auditors.

From procedural controls to substance

We are positive about the multi-year strategy ITAMA presented. In the initial years, ITAMA does not pay attention to the strategic and technical quality of audit reports but concentrates on compliance with procedures. ITAMA started its quality assurance work in 2008 by considering the existence and completeness of audit working papers. Although formalities are important they do not have the highest added value or learning effect for BPK. Quality assurance should seek best practices (what went wrong and what went right?) and suggest improvements to the team involved or management on such aspects as training, manuals and line control.

We recommend that the strategy be revised so that more qualitative assessments of BPK audits and products can be started in the near future rather than wait another two years. Step by step ITAMA must develop a strategy to generate added value for BPK. What should it learn first and what afterwards?

2.3.4 Human Resources Management (HRM)

The quality of the people who work at BPK forms the backbone of BPK's performance. Strong leadership is necessary to put the professional skills of BPK's staff to its optimal use. BPK is therefore a very important aspect of quality control at entity level. Although it might be a slow process, improving staff quality needs BPK's full attention in the coming years. The BPK unit should have a stronger relationship with the line managers to convince them of the urgency of using all BPK instruments.

We recommend that BPK create more awareness amongst managers regarding the importance of human resources management and the available HRM policies and instruments. Furthermore, we recommend that BPK maximise the potential of its operational flexibility and ability to promote and reward talented people. Finally, we recommend that BPK involve line management in selecting new staff and putting the right person in the right place.

Feedback and good performance need to be rewarded

BPK's current staff classification and remuneration system is in general still based on its former ranks and qualification periods system rather than on staff performance. A strong performance appraisal cycle concentrating on the relation between manager and employee is needed in which feedback in both directions is a must. Results of the appraisals must be discussed at a higher lever to get a better picture of developments in a particular unit.

We recommend that more attention be paid to good performance, feedback between manager and employee in both directions and selective rewards.

Professionalism and knowledge

ASOSAI supports our opinion that professionals should be appointed to positions where they are needed. This would make BPK less dependent on external specialists and consultants. The prevailing opinion at BPK is that by law it can recruit only auditors, even for non-audit positions. In our opinion this is a misinterpretation.

We recommend that the present uncertainties in BPK's recruitment rules be evaluated.

Staff rotation is important to exchange experiences and remain dispassionate. BPK has decided to assess its entire staff. We wonder whether it would be better to wait until the individual performance measurement system is ready so that both attitude and performance can be measured simultaneously.

Given the three-year compulsory rotation and the recent opening of the new regional offices, we recommend that not all staff be changed at once as institutional knowledge would be lost.

Coaching and development of skills

BPK should be aware that auditors need frequent guidance and coaching from their managers as well as training. Managers, however, also need extra training and attention to keep pace with developments that affect their role and attitude. Managers should give guidance and draw on the creativity and knowledge of their personnel because a lot of their potential is currently unused.

We recommend that the skills managers need be assessed and managers be offered specific training in how to work with professionals.

Given the importance of coaching new employees, we recommend that a form of mentorship be introduced.

2.3.5 Audit standards/Guidelines

BPK's list of audit manuals and guidelines is comprehensive. General principles are defined and more specific criteria and approaches are set out in guidelines for the various phases of the audit process (planning, fieldwork, reporting, follow-up and evaluation).

With regard to financial audit we concluded that the general audit approach complies with international standards. Some guidelines are being developed, however, that could be quite useful to BPK's auditors at this moment (for instance technical guidelines on audit risk and sampling).

With regard to performance audit we concluded that the approach complies with international standards but there is some room to improve the manual's practical value to the auditors. BPK only recently introduced performance auditing and has met some difficulties. In the appendix we offer some suggestions regarding performance audits. A manual alone is not enough. It takes time to develop an audit programme because it is a creative process that requires straightforward definitions of the audit objective and design. The auditor must continually ask himself how he can have the greatest impact with the least effort. It is important to make clear what the audit subject is. Is it the performance (compliance or efficiency) of an entity, a system, a process or is it the effectiveness of policy?

We recommend that more awareness be developed of the complexity of performance audit and the diversity of the types of audit that can be performed under the general heading of performance audit. To this end, BPK could develop courses on public administration and policy analysis with universities and public entities. A carefully performed performance audit of the effectiveness of policy, moreover, takes time: it cannot be completed in a couple of days.

BPK's Board approved the manual for special purpose audits in February 2009. The manual complies with international standards. However, we found that it does not clarify what type of audit should be used when or explain the procedural differences between the three types of special purpose audit. Recommendations should be made in the report, except in the case of investigative audits. As mentioned above, BPK would have more added value if it combined all audit findings, analysed them and drew conclusions and made recommendations on the underlying system.

On the whole, we conclude that the most essential documents, including State Finance Audit Standard (SPKN), are formally implemented and are in full force. We are positive about the specific technical guidelines developed for specific topics such as the rehabilitation of forest and land, hospital waste, air pollution, etc. Additional manuals are in the process of formal implementation.

2.3.6 Code of Ethics/integrity

Independence from the entities audited is important at all levels of BPK. This is stated in general terms in the Code of Ethics the Board adopted on 21 August 2007. BPK has trained senior auditors and internalised the Code of Ethics. In every audit engagement, the auditors must sign a statement of independence and BPK has established an Honorary Council of Code of Ethics to enforce the Code. To keep the Code of Ethics alive, BPK should periodically reiterate its values and principles in various ways for both newcomers and established employees and for both senior and junior staff. In addition to a Code of Ethics, a self-assessment method for SAIs could improve awareness among BPK's personnel of their own integrity risks.

We recommend that BPK reiterate its values and principles periodically and use the Intosaint tool to assess its own integrity. This could also facilitate the introduction and use of this tool at BPK to help its auditees perform self-assessments.

Breaches of integrity

Given the high integrity risks in the Republic of Indonesia, registering and monitoring breaches should be part of BPK's management information system. Such an overview could also be used for learning purposes.

We recommend introduction of the central registration of breaches of integrity within BPK.

2.3.7 Institutional support

Apart from good HRM, there must be sufficient institutional support in the form of financial resources, infrastructure and technology.

Management control

The central management control system could be improved by introducing the position of controller to monitor the orderliness of budget spending and other key performance indicators such as the development of direct hours relative to indirect hours (like a modern Chief Financial Officer who makes use of financial and non-financial information).

Inspection tasks that are currently performed by ITAMA could also be a responsibility of the controller. A controller could help improve institutional support by analysing management information on key performance indicators and informing management when action is needed.

We recommend that a controller be appointed within BPK.

We recommend that a new target ratio be set for direct versus indirect working hours spent on auditing and that compliance with it be monitored. A standard would enable BPK to improve its resource management and mitigate the risks of inefficiencies.

Information technology

BPK's IT system is developed and is improving. However, it is still not stable, works slowly and suffers from viruses. IT personnel complain about their lack of involvement in strategic discussions at BPK. A steering committee could improve communication between the Board and the IT department. The IT issue needs more attention in the next strategic period.

To assess the level of IT support for the business processes (IT business alignment) and the steps necessary to improve this support, we recommend the use of the IT Self-assessment tool.

3 Response of BPK

3.1 Introduction and the Importance of the Peer Review

First of all, the Audit Board of the Republic of Indonesia (BPK) would like to express its gratitude to the Netherlands Court of Audit for the excellent review of BPK's quality control and assurance. The peer review is very important for BPK's endeavour to fulfil its mandate on the Constitution, to comply with the Law Number 15 Year 2006 concerning BPK as well as with auditing standards, and to provide reasonable assurance for BPK's stakeholders with regard to enhancing transparency and assuring accountability of the Indonesian public sector.

BPK has taken significant efforts in upgrading the Indonesian public sector auditing. First, BPK restored its independence in terms of organisation, finance, personnel, and audit reports as secured by the Law Number 15/2006 concerning BPK. Second, the Constitution and Law Number 15/2006 gives mandate to BPK to audit all activities of the state at the three levels of government in Indonesia: central, provincial and sub-provincial, as well as state owned enterprises, quasi-government agencies and affiliated institutions. Third, BPK leads by example in upholding professionalism, integrity, transparency and accountability by establishing a council of honour and ethics, providing BPK's financial reports which were audited by independent public accountant firms appointed by Parliament, and being reviewed by independent supreme audit institutions members of INTOSAI, which was approved by Parliament.

In spite of those efforts, BPK has also taken important initiatives, which are beyond the call of its duty. First, BPK required all audited entities to submit their management representation letter. Second, BPK encouraged the government to adopt the treasury single account. Third, BPK clarified the roles, functions, and responsibilities of state institutions at all levels of government, including schools, hospitals, airports, ports, community trusts, foundations, state-owned enterprises, and business activities linked to the military and police. Fourth, BPK required all audited entities to prepare action plans for improving their transparency and accountability. Fifth, BPK arranged public dialogues to discuss and to solve problems regarding transparency and accountability. The public dialogues were attended by all high officials of audited entities such as ministries, governors, and mayors, members of central and local parliaments, as well as academician and public figures. Sixth, BPK encouraged and proposed the establishment of a public account committee within Parliament.

3.2 BPK's Commitment on Quality Controls and Assurance

Regarding the quality control and assurance in public sector auditing, BPK has been paying more attention and taken some relevant and significant efforts. First, BPK followed-up previous peer review recommendations given by the Office of Auditor General of New Zealand (OAG-NZ). Second, BPK developed a quality assurance guideline, approved in March 2009. Third, BPK has committed and participated actively in an ASOSAI-IDI project on quality assurance. Fourth, BPK invited the

Netherlands Court of Audit as a member of INTOSAI to perform this peer review. All above efforts confirm BPK's commitment to have sound and effective quality control and quality assurance.

3.3 BPK's Appreciation on Peer Review Conclusions and Recommendations

We are pleased that the Netherlands Courts of Audit reached the overall very positive conclusion on BPK's quality control and assurance. We value the Netherlands Court of Audit's recognition of BPK's endeavour to build its quality controls and assurance as well as to improve government transparency and accountability. In addition, we are satisfied that the Netherlands Court of Audit reminded changes in the BPK's political environment with regard to new parliament and government as results of recent general elections. Moreover, we are also grateful for the identification of three main risks consisting of information access limitation, weak financial management in central and local government, and the persistence of fraud and corruption in government and society. These three risks have been challenging BPK for playing its roles in improving transparency and accountability of the Indonesian public sector.

We also appreciate the Netherlands Court of Audit's constructive recommendations for BPK's further improvement. Therefore, we will develop an action plan to carry out the recommendations, including aligning BPK's current bureaucratic reform and BPK next strategic plan with the recommendations.

3.4 BPK's Immediate Action Plan

In line with our initiative to require BPK's audited entities to provide an action plan to respond to BPK's audit reports, we will develop an action plan within two months after BPK receives the final peer review report. The action plan consists of our relevant activities to follow up the Netherlands Court of Audit's recommendations together with clear time schedule to address the weaknesses disclosed on the peer review report. The action plan and its subsequent implementation will be communicated to the Netherlands Court of Audit and also reported to Parliament.

3.5 BPK's Next Strategic Plan

BPK's current strategic plan will end in 2010. We think that it is the best time for us to develop our next strategic plan not only by considering the results of assessment of the current strategic plan implementation, but also by incorporating the peer review report and recommendations. For instance, the next strategic plan has to be based on central and local government medium-term development plans, thus BPK has a structured approach to assess the effectiveness of development plans at the end of their terms. In addition, the strategic plan has to take into account various factors such as changes in the BPK's upcoming political environment and the three main risks regarding transparency and accountability identified on the peer review report. Furthermore, the next strategic planning will be used as a guide to make annual selection of BPK's audit plans and to prepare relevant supporting resources.

3.6 BPK's Bureaucratic Reform

BPK has currently been implementing a bureaucratic reform since 2004 as a part of Indonesian bureaucratic reform. The BPK's bureaucratic reform consists of four strategic programs namely human resources, business processes, institutional development, and infrastructures including the information technology. So far, the BPK's bureaucratic reform has been recognised as the most successful program of the Indonesian bureaucratic reform, although there is still room for improvement, some of which have been identified by the Peer Review Team.

Many areas in bureaucratic reform have inter-relation and inter-section with the peer review recommendations. Therefore, we will incorporate the recommendations into our bureaucratic reform programmes and ensure the alignment of the revised bureaucratic reform programmes with our immediate action plan and the next strategic plan.

3.7 The Red Carpet Treatment

The peer review report as well as the necessary actions mentioned above is important for not only the current BPK members and management, but also BPK new members. Therefore, an induction programme for BPK new members will be prepared and provided, including communication of the peer review report and our follow up actions. We are very grateful that the Netherlands Court of Audit reminded us with the 'red carpet treatment'.

3.8 Closing Remark

Finally, on behalf of all BPK members, management and staff, I thank the Netherlands Court of Audit, especially the Peer Review Team, for its competence, professionalism, and constructive approach to this important engagement. We hope our relationship will be strengthened in the future, not only in monitoring recommendations of the peer review but also in improving our capacities and qualities.

Jakarta, July 2009
The Audit Board of the Republic of Indonesia
Chairman,

Prof. Dr. Anwar Nasution, MPA

Part II

Findings

I Quality control at institutional level

I.1 Quality Management System requirements

According to ASOSAI, a SAI should have a Quality Management System designed to provide ‘reasonable assurance’ in the light of the likelihood and magnitude of potential risks, that it conducts audits, both regularity and performance, in accordance with applicable legislative requirements, rules and regulations, audit standards, policy manuals, guidelines and procedures. Such a Quality Management System supports, maintains and improves a SAI’s role, function and responsibility to fulfil its mandate appropriately. All elements must be linked to each other so that the right choices can be made in a Quality Control System. Quality control is supported by the following key factors:

- Independence and Mandate;
- Leadership and Internal Governance;
- Human Resources Management;
- Audit Standards and Guidelines;
- Institutional Support;
- Continuous Improvement;
- External Stakeholder Relations;
- Results;
- Audit engagement performance.

We set out our findings on each key element in the following sections.

I.2 Independence and mandate

SAI’s generally recognise eight core principles that contribute to independence. The principles were first set in the Lima Declaration and are confirmed in the Mexico Declaration (ISSAI 10). The Peer Review team assessed BPK’s compliance with the Mexico Declaration on the basis of applicable laws.

The independence of BPK is clearly defined in Art. 23 E (1) of the Constitution 1945 of the Republic of Indonesia and section 2 of Law No. 15 Year 2006. Its mandate is further specified in the following laws:

- Law of State Finance (Law No. 17 2003);
- Law of State Treasury (Law No. 1 2004);
- Law of Audit of State Financial Management and Responsibility (Law No. 15 2004);
- New BPK Law (Law No. 15 2006).

I.2.1 Audit function in the Republic of Indonesia

The enactment of the Law of State Finance clearly separates the functions of internal control and external auditor in public sector audit in Indonesia. Government Regulation No. 60 2008 emphasises BPKP’s function as internal control unit, in contrast with BPK’s function as the only Supreme Audit Institution of the Republic of Indonesia to audit state finances.

With reference to the Auditor General of New Zealand's recommendation in 2004, BPK's role as a SAI is now secured. Nevertheless, further arrangements with internal control units such as BPKP and Bawasdas are needed to clarify each other's roles and responsibilities. BPK will be able to perform its specific role as a SAI if it can fully rely on the quality of their reports. From our fact-finding we learned that financial management at the ministries and especially at local government level is still far from adequate. According to BPK this is due to a lack of qualified personnel (knowledge of financial management and accounting).

1.2.2 Mandate

Introduction of the New BPK Law No. 15 2006 was the final step in a duly prepared legislative process towards a free and independent BPK with authority to provide the House of Representatives (DPR), the Regional Representative Councils (DPD) and the regional Houses of Representatives (DPRD) with the results of audits of state financial management and accountability. Its government-wide mandate covers central/regional government, other state institutions, Bank Indonesia, state owned enterprises, regionally owned enterprises, public service agencies, foundations, institutions or other agencies required due to the nature of their respective duties. To enforce its constitutional mandate under Law No. 15 2006, BPK needs to expand and improve its institutional capacity. In the past three years, BPK has established new regional offices and recruited graduates from a variety of educational backgrounds, applying a competitive selection process to optimise the quality, integrity and dedication of new employees. BPK has flexibility to recruit new staff and place and promote staff. To ensure professionalism and high quality oversight, BPK has recruited experts and high-ranking officials from other institutions. BPK has also enhanced the capability of its staff through various education and training courses at the BPK Training Centre.

1.2.3 BPK's budget

BPK's budget is allocated to a separate heading in the state Budget. The annual budget is based on BPK's audit and support activities plan. It is discussed by BPK's Secretary General with a relevant parliamentary committee, the Ministry of Finance and the National Planning Agency/ Bappenas (in accordance with the mechanism provided for in Law 17 2003 of State Finance). Only in budget execution does BPK have to follow a government mechanism. In consequence, BPK has to submit a payment order to the government treasury to execute the budget.

1.2.4 Access to all necessary documentation and information

As far as we can determine BPK complies with the principles of the Mexico Declaration. In accordance with Principle 8, for instance, BPK has financial and managerial autonomy and sufficient human, material and monetary resources. There are three major deficiencies regarding Principle 4 though. According to Principle 4, SAIs should have adequate powers to obtain timely, unfettered, direct, and free access to all the necessary documents and information, for the proper discharge of their statutory responsibilities. In the same spirit section 9 of Law No. 15 2006 formally grants BPK unrestricted access to information and the right and obligation to report the results of its audit work. This includes its right to audit the regularity and effectiveness of levying state revenue or other income without any restriction. We found that BPK does not have unrestricted access to all documents and information necessary to audit (1) state tax revenue and (2) administrative fees charged by the Supreme Court. However, we do not consider BPK responsible for this situation. It has taken these issues to Court and held

discussions with the House of Representatives, so far without success. BPK should continue to seek publicity, support from parliament, public opinion and other SAIs. It should emphasise its right of unrestricted access to the taxation system and any other organisation in the Republic of Indonesia that can impose levies or imposts in order to assess their regularity and effectiveness. Small, negotiated steps to gain access to the Taxation Office might create trust and perhaps an opening to break the impasse. A step was recently taken to access a limited amount of financial information on income tax receipts and tax receivables. We consider this a good start on the winding road to full access to the Taxation Office. A following step could be access to the files of registered taxpayers without looking into their tax returns. The other deficiency BPK faces is (3) the fact that BPK has limited access to conduct financial audits of foreign-funded projects because government and creditors agreed to use an internal government agency (BPKP).

BPK has already taken these issues of limited access to the Constitutional Court and discussed them with creditors. BPK has so far failed in the Constitutional Court but its discussion with creditors is still in process. Nonetheless, BPK has started a limited audit of tax revenues.

Regarding audit limitation on the Supreme Court and foreign funded projects BPK informed us, that:

- There was a new legislation about Supreme Court passed in January 2009, which gives bpk access to all data necessary regarding administrative fees charged.
- On June 12, 2009, the Directorate General of Debt Management of the Ministry of Finance informed the World Bank that they have no objection to the initiative of the possibility of requesting bpk to audit some selected foreign-funded projects.

1.3 Leadership and Internal Governance

Considering the vast geographical and functional area of BPK's mandate, leadership and internal governance are vital to quality assurance.

The QCS elements of leadership and internal governance comprise:

- a Leadership and Direction;
- b Strategic & Operational Planning;
- c Oversight and Accountability;
- d Code of Ethics;
- e Internal Control (see Continuous Improvement);
- f Quality Assurance (see Continuous Improvement).

a Leadership and Direction

The Board sets the organisational direction of all BPK's units and auditors. BPK has developed a multi-year strategy based on key performance indicators for internal and external objectives. On the introduction of New Law No. 15 2006 BPK had difficulty initiating the necessary activities for the changes it required. In mid-2007 a new approach by the Principle Directorate of Planning, Evaluation, Research and Development (R&D) and Training gave BPK's leadership a stronger grip on this process. The use of a Balanced Score Card system based on key performance indicators to monitor the progress and performance of each unit seems to becoming more

accepted and effective. Supported by senior management and the planning and evaluation, R&D and training units, the Board takes decisions and sets achievement indicators for deliverables and high professional standards. BPK's training centre is well organised and has a clear structure focusing on the transfer of knowledge to auditors. BPK must be aware that as well as training, auditors need frequent guidance and coaching by their managers. Managers, however, also need extra training and attention to keep pace with new developments that affect their role and attitude. More informal horizontal and vertical, top-down and bottom-up communication is part of such modernisation. It will increase knowledge-sharing and raise awareness of BPK's strategy, vision and priorities throughout the organisation. Management will in turn have more insight into what is happening on the shop floor.

b Strategic & Operational Planning

All BPK's units and auditors are involved in the selection of audit objects and topics, risk assessment, investigative audits, manuals and measures to assure audit policy implementation. BPK's strategic plan is part of the desired long-term achievement. BPK has developed key performance indicators to make the strategy specific and measurable. BPK's strategic plan 2006-2010 focused mainly on improving the organisation. This plan proved successful. Now that the final stage of this strategic period is in sight the next strategic plan should concentrate on the direction in which BPK would like to take its assurance products in the next five years.

While preparing the new strategic plan BPK should ask *what changes are needed in central government to improve the delivery of public services*. BPK must therefore:

- be aware of what is happening around bpk in society and the public sector;
- know what parliament wants and can understand;
- introduce focus through strategic planning;
- not only identify problems but also help to solve them.

The Peer Review team of the Auditor General of New Zealand recommended in 2004 that BPK should have a strategic audit planning process in place that:

- identifies key issues across the public sector by means of environmental scanning;
- identifies key issues within sectors, for example the health or local government sectors;
- identifies the key risks;
- outlines a range of audit interventions to address these risks;
- compares audit interventions on some kind of risk and pay off basis;
- presents this information in a coherent, credible and logical form;
- forms the basis for bpk's work programme;
- communicates this information to auditors.

ASOSAI requires auditing standards, policies and procedures to be designed to ensure that a SAI undertakes audit work that is within its audit jurisdiction and authority and manages the risks involved in performing that work in an efficient and effective manner, including any risks that may be involved in gaining access to the records for carrying out the audit work. The Peer Review team observed the well organised development and rollout of manuals and guidelines in the organisation.

Besides technical guidelines BPK must develop effective scenarios for various reactions/-interventions to counter resistance from auditees. Interventions should be tailored to have optimal effect in each case. BPK's claim to unlimited access to the Taxation Office, for example, can be supported by combined activities in the field of publicity, reports, negotiations and suggestions for less-threatening small-scale audit activities.

The Peer Review team found three high strategic risks in the Republic of Indonesia:

- 1 limited access to revenues of the Taxation Office and Supreme Court;
- 2 weak financial management;
- 3 fraud and corruption.

1 Limited access to revenues of the Taxation Office and Supreme Court.

ASOSAI's guideline underlines BPK's realistic claim to unlimited access to the Taxation Office and any other organisation in the Republic of Indonesia that can impose levies or taxes in order to audit their regularity and effectiveness. Although the new BPK law is clear about BPK's unlimited authority, BPK's access to the Taxation Office is in fact severely limited. As a result there is a serious risk regarding the lawful collection of taxes in the Republic of Indonesia. We have already considered this in section 1.2. At staff level, BPK and the Ministry of Finance reached agreement on access to information from the Taxation Office on request. The Board decided to go to Court to get a judicial decision on its legal mandate to audit the Taxation Office. The Court did not give the desired judgement but the Minister of Finance agreed to provide information to BPK. Negotiations between BPK and the Ministry of Finance led to an instruction from the Minister of Finance to provide BPK with information on accounts receivable and income tax. BPK therefore has limited access to the Taxation Office. BPK's staff said access depended on whether or not the persons in charge at the Ministry of Finance and the Taxation Office used tax law to prevent BPK auditing. Publicity and support as well as good relations with the Ministry of Finance and the Taxation Office will be crucial to resolve this issue. The same applies to the dispute about access to the Supreme Court's revenues.

2 Weak financial management

The second high risk with a permanent character to BPK is weak financial management in all layers of government. BPK should wonder whether its wish to focus more on performance audits is justified given the present state of financial management and regularity in government.

According to the Board and staff (see also half-year reports) public sector financial management in Indonesia is improving as the number of disclaimer opinions is decreasing and the number of qualified and unqualified opinions is increasing (figures are presented in the table in appendix III). The Board and staff have discussed the improvement of financial management with local governments. More than 50% of local government entities (295 out of 475) have prepared an action plan to improve financial management so that unqualified opinions are given.

As well as an opinion, more attention should be paid to management and efficiency. If this leads to explanations of the findings' causes and effects, BPK's audits would have higher learning content.

3 Fraud and corruption

Corruption is the third high risk and has been an almost ineradicable phenomenon in the government of the Republic of Indonesia since time immemorial. Supplementary

audits to expose unnecessary bureaucracy (a major cause of corruption) would help reduce corruption (for instance at authorities that issue permits or decide on the purchase of valuable goods). Corruption cases must be prosecuted only in close cooperation with the police, the Office of the Attorney General and KPK. For learning purposes BPK could seek international support from comparable countries to analyse its approach to fighting corruption.

BPK currently cooperates with the police and Attorney General on the basis of protocols. BPK will organise a conference on its role in curbing/fighting corruption. The Board asked the Peer Review team what it should do regarding fraud and corruption. We replied that BPK should not focus solely on incidents (conduct of individuals) but also on their causes and effects. It should ask how they were possible, what the consequences were and how they could be prevented in the future.

c Oversight and Accountability

BPK has to provide its annual financial statements, which are audited by an independent auditor e.g. a public accounting firm appointed by the parliament. Regarding this requirement, the 2006 and 2007 BPK's financial statements were audited by an accounting firm and obtained qualified and unqualified opinions respectively.

BPK's Secretary General submitted a performance report.

BPK does not issue an annual report on its performance and developments in the past year because it is not required to do so by law. Such a report, however, might help create transparency about the development of BPK's performance over the years. This could create more goodwill among the general public. BPK's slogan 'Leading by example' can be put into practice if it voluntarily issues annual reports. BPK can be an example to other governmental institutions and contribute to good governance. Annual reports can also include statements by the Board that its members do not hold other positions and/or details of their personal administrative costs.

d Code of Ethics

In compliance with INTOSAI standards 1998, BPK has developed a comprehensive Code of Ethics for Board members and auditors. An advisory council enforces the Code. BPK has taken the initiative to ensure that all its auditors are familiar with the values and principles. Moreover, independence and integrity are two of BPK's core competences for auditors. To keep the Code alive, BPK must reiterate these values and principles again and again and in many ways for both newcomers and established staff and for both senior and junior staff. In addition to a Code of Ethics a self-assessment method for SAIs could improve awareness among BPK's personnel of their own integrity risks.

To prevent corruption and fraud a tool called IntosAINT could be helpful. IntosAINT is a method for audit offices in the field to assess their own integrity (prevention of corruption and fraud). It is based on the SAINT instrument designed and successfully used in the Netherlands. IntosAINT is presented at a workshop for employees at strategic positions in the organisation. It gives insight into the organisation's general and specific vulnerabilities, the maturity of the Integrity Control System and remaining risks. The results are presented to management together with suggestions for improvement.

Intosaint was designed specifically for national audit organisations but could easily be adapted for use by auditees. Parts of the content of the self-assessment workshop are also suitable for use in audits. For instance the inventory of vulnerabilities can be the basis for risk analysis and the Integrity Control System can be used as a standards framework for good integrity policy.

e/f Internal Control/Quality Assurance

These subjects are discussed under the heading 'Continuous Improvement'.

1.4 Human Resources management³

BPK's mandate covers a vast range of auditees and stakeholders. To fulfil its mandate BPK needs sufficient well-educated and well-trained personnel to perform timely audits of the quality required by ASOSAI. Principle 8 of the Mexico Declaration underlines SAIs' financial and *managerial/administrative autonomy* and the availability of appropriate human, material, and monetary resources. Regarding BPK's own employment conditions, the 2004 Peer Review report of the Auditor General of New Zealand states: 'Ideally, part of any audit sector and or legislative reform will be to give BPK greater, if not complete, control over its management of human resources, in order to give it greater operational flexibility and the ability to promote and reward its talented people.'

New Law No. 15 2006 section 9 (g) gave BPK such flexibility. BPK should try to make optimal use of it. BPK has successfully recruited a lot of young personnel since 2007. The review team noted that quality improvement among BPK's older personnel did not have the same priority. BPK's existing staff classification and remuneration system, however, is in general still based on its former ranking and qualification periods system rather than staff performance. Although it might be a slow process, improving the quality of personnel needs BPK's full attention the coming years.

In paragraph 3.2 of the *Guidelines on Audit Quality Management Systems* (ASOSAI, 2004) ASOSAI states, 'Generally, strategies of human resources management should be designed to create a diverse workforce with knowledge, skills, and abilities needed to support the achievement of the SAI's vision, mission, the core values and the strategic goals.' In paragraph 3.10 ASOSAI continues, 'Recruit multidisciplinary persons with suitable qualifications and experience. It should include professionals qualified in their fields and bring a rich mix of academic disciplines and experience.'

At BPK, however, critical specialist functions are held by auditors. We found many of them in support units such as HRM, training, R&D and finance. The ASOSAI guidelines support our opinion that professionals should be appointed to positions where they are needed. This would make BPK less dependent on external specialists or consultants. The prevailing opinion at BPK is that by law it can recruit only auditors, even for non-audit positions. In our opinion this is a misinterpretation of section 34 (3) of Law No. 15 2006, which states, 'In performing audit duties BPK shall employ auditors'. Experts, however, can be recruited under section 9 (1) (g). Since there is a difference in remuneration between the audit sector and the support sector, moreover, support units do not attract ambitious auditors. These units, however, fulfil a very important role in the field of R&D and Quality Control and Assurance. In the long term, support staff will not come up to expectations.

³
In appendix V we look into greater detail at our suggestions to improve HRM.

1.4.1 HRM instruments

BPk's staff has increased substantially and its mandate has expanded significantly. BPk's HRM unit has developed a variety of modern instruments such as:

- a national placement policy based on educational background;
- bpk-sponsored studies;
- a periodic rotation policy between regional offices and head office;
- a promotion system based on civil service criteria, competence evaluation, education, experience and input about actual performance;
- a career development programme in which there is equal opportunity to work in audit and non-audit units.

As noted above, BPk's existing staff classification and remuneration system is in general still based on its former ranking and qualification periods system rather than on employee performance. A major success is that promotion is no longer based on seniority. Further negotiations with the Ministry of Civil Servant Empowerment are taking place to modernise BPk's employment conditions. BPk has already enhanced its potential flexibility by allowing early retirement in combination with early pension/a golden handshake. Since many BPk instruments are relatively new the measures and other provisions for ensuring stable and qualified personnel are not fully in place and effective yet.

Managers are expected to provide guidance and challenge the creativity and knowledge of their personnel. A lot of potential is currently unused. Coaching new employees is very important. Furthermore, a strong performance appraisal cycle concentrating on the manager/ employee relationship is needed whereby feedback in both directions is a must. Appraisal results must be discussed at a higher lever to gain a better picture of developments in a particular unit. Group sessions about the targets set in each unit's Balance Score Card will create more awareness and motivation for the direction in which the unit has to go.

BPk has decided to assess its entire staff. Echelons II to IV will be assessed first. We wonder whether it would be better to wait until the individual performance measurement system is ready so that attitude can be measured together with performance. We are curious about the criteria (integrity, knowledge and behaviour) to be used. The process will be outsourced almost fully to external consultants. We consider this sub-optimal. External consultants are less aware of the specific skills and history of each staff member. HRM should at least be involved in the assessment project. BPk has responded that its HRM now has trained internal assessors. According to BPk's staff everyone will be assessed and then receive extra training, take early retirement or be ordered to stay at home with loss of pay. We noticed that higher echelons seem to be more conservative than lower ones and that they generally do not maximise the potential of their juniors and audit results. We wonder what action BPk will take if this is confirmed by the assessments.

1.4.2 Personnel directly/indirectly involved in audit

According to information supplied by the Human Resources Bureau the ratio of BPk's support staff to staff directly involved in audit is almost 40/60. Although there is no general target figure for this ratio it might be rewarding to evaluate the actual need for such a percentage of support staff. We admit that there is no clear line between direct and indirect activities but we can imagine that given BPk's many challenges the current ratio is not optimal.

For a well-balanced personnel mix BPK needs more insight not only into the staff's educational background but also into their potential and practical experience. Knowledge about their employability at the right level and right place in BPK is also very important. It would prevent personnel being employed sub-optimally at the expense of BPK's primary process: audit.

BPK's HRM unit states that it cannot solve this situation owing to the staff's strong legal position based on governmental regulations (creating a lifetime employment guarantee). Whereas BPK law no. 15 2006 gives BPK strong independence (section 2), section 9 (g) and (h) allows BPK to renew/tailor its employment conditions to its present needs.

1.4.3 New personnel assessment

For recruitment purposes the Ministry of Civil Servant Empowerment determines the formation; however, BPK has its own recruitment method. It is free to determine the maximum age and educational background of candidates. BPK hires a consultancy firm to conduct recruitment. This firm has expertise and competence to measure a candidate's profile, for example by conducting a TPA test (equivalent to GMAT/ Graduate Management Admission Test). The HRM unit also considers the consultancy firm to be more objective and independent. The method used has been enhanced year by year. In the past two years, central staff has played a role in interviewing candidates. The Peer Review team recommends reducing the extent of outsourcing of recruitment activities step by step to avoid overdependence on consultants. Moreover, HRM will otherwise not gain experience to perform this task. Independence inside BPK should be safeguarded by compliance with the Code of Ethics. Furthermore, HRM should organise a thorough check of the qualifications of accountants that sign reports and determine whether delegation by Board members is appropriate.

1.4.4 Assessment Centre

BPK's assessment procedures aim to compare individual competences with required competences. Since 2004 the HRM unit has recruited new civil servants by using an Academic Potency test of their language capabilities and psychological status. In 2007 BPK started to perform competence tests of 578 senior auditors for the position of Team Leader, followed in 2008 by an assessment of 480 auditors on the standard competences for Team Member and Team Leader. In total, 1,058 (66%) out of 1,598 auditors without a permanent position were tested.

BPK is currently developing an Assessment Centre funded by the Asian Development Bank (ADB) with the use of specialists to provide objective input about the competence profiles of candidates. The centre is supposed to have a staff of 100 permanent positions and senior auditors. An Assessment Centre is a valuable instrument for a SAI the size of BPK.

1.4.5 Rewards/punishments

ASOSAI states in paragraph 3.1⁴ that 'People are the most valuable assets of an audit institution. Sound human resources management should provide employees a rewarding and professional environment, as well as maintaining and enhancing the capabilities of the people.' BPK's HRM unit and training facilities contribute to the fulfilment of this statement.

Although standard procedures to reward employee achievement *are yet to be written* into BPK's performance management system, extraordinary achievement as determined by the Employment Adviser Official is rewarded with a special rise in grade level. Along with the rise in grade level, the employee is promoted to a higher position.

In addition, BPK has a system of honour symbols to reward employees for dedication. The honour symbols, in the form of 'Satya Lencana medals', are awarded in accordance with Law No. 4 1959 on the general stipulation of the honour symbols.

Employees who break the law, stipulations or regulations on civil servants or the BPK Code of Ethics in the conduct of their duties are punished accordingly. The punishment procedure is consistent with the applicable regulation on discipline.

We noted that there is a system of rewards and punishments. The very low number of applications indicates that management rarely uses it in practice. A fraction of the auditors were punished. Some managers did not punish offending auditors in 2007. There might also be a registration problem. Given the high integrity risks in the Republic of Indonesia, registering and monitoring violations should be part of BPK's management information system in order to gain an overview and for learning purposes. Although the Code of Ethics has been rolled out it should be kept alive by repeating its message. Rewards are generally in the form of faster career development. Under the reward and punishment system five persons were rewarded in 2007. This also indicates that the instrument is relatively unknown. We noted some cases of placing audit personnel in support positions as a kind of reward. To reward personnel we recommend a system of promotion, bonuses or other benefits within existing career paths. It is important not to wait any longer in formalising BPK's performance management system.

1.4.6 Staff rotation

ASOSAI recommends providing opportunities to gain work experience at other public or private bodies or overseas audit offices – in particular by establishing reciprocal exchange arrangements with SAI officials in other ASOSAI countries (adapted from ANAO practice). In addition to seconding SAI staff to other bodies to acquire and share knowledge and experience and gain insights into the operation of peers, SAIs may offer temporary assignments to staff from other bodies and legislative secretariats to enhance their awareness and understanding of an SAI's role and responsibilities. To date, BPK has made limited use of these opportunities (mainly other SAIs from the United States of America, Australia, New Zealand and France).

All auditors should rotate position every three years. We also received signals that the increase in young officers in combination with high mobility prevents the build-up of institutional memory and expertise.

1.4.7 Training

According to ASOSAI:⁵

- '3.15 A SAI should establish a training function with its responsibility to develop, establish and monitor training policy, conduct annual need assessment, plan and schedule training activities. The SAI should maintain an inventory of skills of personnel to assist in planning of audits as well as to identify professional development needs.'
- '3.16 Training should be a continuing process and should be adapted to the needs of the SAIs so that employees can continuously upgrade them and be in tune with

⁵
Guidelines on Audit Quality
Management Systems
(ASOSAI, 2004).

the latest technological developments and changes in audit methodologies, techniques and tools.’

BPK’s training is well organised in a clear structure directed at the transfer of knowledge. To modernise the attitude of BPK’s personnel a fundamental change must be made, starting with less control and domination and more personal motivation and responsibility for each employee with a view to development and results (professionalisation). Normally there should be a standard range of courses that every auditor is obliged to take (including an introduction course). In the next step, specific courses can be given to meet personal needs. Each BPK auditor has to complete at least 80 training hours to enhance their professional audit competences. We would remind BPK not to overlook its staff’s personal development. SAI personnel should be encouraged to prepare individual development plans in consultation with their performance managers in order to identify a handful of specific competences that address individual needs. Approved plans should be action-oriented.

Auditors should be capable of and responsible for determining their own training and development needs. Their managers must provide them with the necessary opportunities.

1.5 Audit Standards and Guidelines

From 1995 until 2006 BPK used the Government Audit Standard (Standar Audit Pemerintahan, SAP) as guidance for its operation and duties. In line with the development of audit theory and the principles of good governance, which insist on transparency and accountability, BPK felt that SAP was out of date. In January 2007, BPK therefore published BPK Regulation No. 1 2007 concerning the State Finance Audit Standard (SPKN). SPKN will be continuously monitored and updated to keep up with current developments.

SPKN lays down professional requirements for auditors, audit quality and audit reports. Its aim is to be the quality benchmark for auditors and audit organisations investigating the management and accountability of state finance. It is binding on BPK and institutions that conduct state finance audits for or on behalf of BPK.

Besides SPKN (State Finance Audit Standard) as guidance for auditors and audits, BPK now also has an Audit Management Guideline (PMP) on the management of and accountability for state finance. It contains audit procedures that must be performed to satisfy SPKN’s requirements. The procedures are linked to the stages of an audit: Audit Planning Phase, Audit Execution Phase, Reporting Phase, Monitoring Phase and Evaluation Phase.

The first edition of PMP (published in 2002) was made obsolete by the development of the BPK organisation and new regulations. BPK therefore revised PMP in 2008.

The Peer Review team took stock of BPK’s list of audit manuals and guidelines to establish what procedures provide reasonable assurance that audits are performed in accordance with professional standards and regulatory and legal requirements. The list is comprehensive. The primary documents, including SPKN, have been formally implemented and are in full force. Additional manuals are in the process of formal implementation. In addition to general documentation BPK produces many thematic guidelines and manuals for specific audit objects.

Board member I Gusti Agung Made Rai, for instance, shares 40 years of his experience in the auditing sector in his book *Performance Audit for the Public Sector, Concept, Technique and Case study*. It is an essential reference work for newcomers who want to understand the essence of BPK's performance audits.

The table below shows the overall framework for the audit methodology and the status of the different parts. The dark fields have been finalised and accepted by the Board.

1945 constitution			
State finance audit laws and regulations			
General Manual	SPKN (7/3/2007)	PMP (19/2/2008)	Code of Ethics (21/8/2007)
Audit Guidelines	100 financial audit (19/5/2008)	200 performance audit (5/6/2008)	300 special purpose audit (27/2/2009)
	400 quality assurance system (25/3/2009)		
	500 audit report		
	600 audit documentation		
Technical Guidance	100.001 Understanding and evaluation internal control of financial audit	200.001 Determining Key Area	301.000 Investigative audit for indication of corruption (24/12/2008)
	100.002 Understanding and evaluation of audit risk	200.002 Determining criteria	302.001 Hospital waste RSUP/ RSUD (31/7/2008)
	100.003 Audit materiality (30/5/2008)	201.000 Rehabilitation of forest and land (31/7/2008)	302.002 Audit of air pollution control (31/7/2008)
	100.004 Sampling method		303.000 Goods and services procurement audit
	101.000 LKPP and LKPL audit (31/8/2007)		304.000 Electricity subsidies audit
	102.000 LKPD audit (21/9/2007)		305 Food subsidies audit
	103.000 Central bank audit		306.000 PNBP PAD
	400.001 audit reviews		
	601.000 electronic format of audit working paper		

The manuals are appropriate and explain the different types of audit. They define general principles and set more specific criteria and approaches for the phases in the audit process (planning, fieldwork, reporting, follow-up and evaluation).

We compared the audit methodology with international auditing standards and concluded that it was compliant.

Experience based knowledge sharing and group discussion are held in order to enhance the understanding of certain newly guidelines/guidance.

We concluded that the general approach to financial audit complies with international standards. Some guidelines are being developed, however, that could be quite useful to BPKS auditors (for instance technical guidelines on audit risk and sampling).

We concluded that the performance audit manual complies with international standards but there is some room for improvement to make it more useful to the auditors.

BPK's Board approved the special purpose audit manual in February 2009. The manual complies with international standards. However, we found that it does not adequately clarify what type of audit should be used when or the procedural differences between the three types of special purpose audit. Recommendations have to be made in all audit reports except investigative audit reports. As mentioned above, BPK would generate more added value if it combined all audit findings, analysed them, drew conclusions and made recommendations on underlying systems.

1.6 Institutional support

1.6.1 Financial resources

ASOSAI promotes optimal budget execution to procure and provide the infrastructure and material support required for the various functions. BPK's budget has been increased significantly after a long period of shortages. Remarkably, BPK seems unable to spend its entire budget. In 2007 Headquarters did not spend 36%, Training Centre 12% and Regional Offices 10% of their budgets. In 2008 the budget underspend averaged 15%. Budget spending starts late in the year. According to BPK, budget underspend was due to reorganisation and the cancellation, suspension or delay of programmes. In some cases budget holders started preparing projects too late. Regional offices sometimes lack experience on how to manage a budget. A better central management control system headed by a controller who regularly monitors orderly budget spending and provides advice would be helpful. This is an important element of BPK's accountability because BPK will decide on the audit units' 2010 audit work, staffing and funding in mid-2009.

1.6.2 Infrastructure

A SAI should have sufficient infrastructure (office buildings, working space, furniture and fittings, electricity and water supply, training facilities, library, etc.) to enable its staff to perform their duties satisfactorily. Generally, BPK has invested a great deal in sufficient infrastructure.

1.6.3 Technology

Technology (telecommunication, IT: internet, intranet, general office support software, information and decision-making systems, software for audit planning, documentation and reporting, etc.) should function efficiently and effectively. BPK's IT system is developed and is improving. However, its IT network is still unstable, works slowly and suffers from viruses. IT personnel complain about their lack of involvement in strategic discussions at BPK.

To assess the level of IT support for the business processes (IT business alignment) and the necessary steps to improve this support we recommend a tool called IT Self-assessment.

The method has been designed for use by Supreme Audit Institutions (SAIs) and is based on COBIT,⁶ the widely accepted framework for managing and auditing IT.

The assessment considers two domains:

- 1 The business processes (users). Which are the 10 to 15 key business processes to achieve the SAI's goals? What is the importance of IT support for these processes? What is the quality of the present IT support?
- 2 The 34 COBIT processes (IT department). Which are the most important IT processes? What are the maturity levels of these IT processes?

IT self-assessment should take the form of a workshop and be undertaken by a group of 6 to 8 persons from different disciplines within the SAI: a mixture of users, IT staff and managers. The necessary time varies from 1 to 1.5 days.

The group needs the guidance of a moderator. He or she will introduce the group to the method and provide guidance on COBIT and on the maturity levels.

1.6.4 Electronic Working Papers/Teammate

An interview with the IT unit revealed that BPK is developing its own Teammate application with introduction planned for 2010. This contradicts a Board statement that BPK will buy Teammate as soon as funds are available. This seems to be proof of the weakness in BPK's strategic decision-making on IT.

1.6.5 Support services

Support services include secretarial assistance, security, transport, etc. As stated above, the number of support staff needs serious evaluation.

1.7 Continuous improvement

The quality of a SAI's interventions should be continuously assessed in terms of their impact on the SAI's environment (relevant stakeholders such as auditees and related institutions). The review team assessed what quality controls were in place and, subject to the scope of the Peer Review, the monitoring of the follow-up to BPK's conclusions and recommendations to ensure that lessons are learned.

Many people are involved in quality control activities in or between the management layers. Formalities and technicalities are subject to appropriate verification. The focus on results is limited to the audit assignment and is basically correct. However, the utility of BPK's reports to its stakeholders could be improved by clarifying the causes and effects findings and opinions.

1.7.1 Strategic quality of audits

Hot reviews pay hardly any attention to the strategic quality of BPK's assurance products. The EPP unit makes handy summaries for BPK's half-year report but it is not manned by communication specialists. Their timing is also important. Half-year publications have advantages and disadvantages, especially for performance and special purpose audits. BPK can sometimes act too early or too late to influence its stakeholders. Auditors have difficulty putting the audit message across. Findings and

⁶ COBIT – Control Objectives for Information and related Technology. This is a widely known and generally accepted framework for managing and auditing IT. For more information see <http://www.isaca.org>.

opinions are rarely expressed as consequences and impact on society and causes are rarely investigated. Auditors tend to focus on internal control weaknesses and report on assets but forget, for example, food supply risks because state-owned farmland might be lost. BPK should provide more historical analyses of findings, recommendations and solutions. According to staff, this information was recently included in BPK's half-year report.

1.7.2 Impact audits

Under the law, public entities must follow-up BPK's recommendations within 60 days and report on the follow-up. What follow-up means has not been defined: an action plan or full implementation of the necessary corrective measures? BPK takes account of the time auditees need to implement measures. If measures need more time BPK states that the recommendation has been followed-up but not finished and explains why not. The follow-up is scored in three categories: not followed-up, followed-up, followed-up but not finished.

The follow-up to recommendations could be monitored more effectively. BPK should pay more attention to the impact of its recommendations, not only to compliance with recommendations. This would also make it possible to learn from the effectiveness of recommendations.

According to staff, the results of audit findings are presented in DPR (by the Chairman of BPK) or in local parliaments (by the Head of Regional Office).

Parliament (DPR) generally has only a limited interest in BPK's reports (according to staff). Regional parliaments, also, show little interest in them because they are too technical and there are no sanctions for local governments: they can continue business as usual despite BPK's findings/opinion.

To enhance the impact of its reports, BPK should permanently seek new ways to inform parliaments and the general public about its audits and role. BPK recently organised a two-month TV series to provide an explanation of several of its audit reports.

1.7.3 Overly strict separation of audit types

BPK strongly believes that anything other than financial statements belongs to performance or special purpose audits. This narrow view prevents auditors commenting on the causes and impact on society of their financial audit findings.

1.7.4 Quality controls

Echelon I and all central and regional audit offices hold a coordination meeting in Jakarta twice a year. During the meeting, manuals and guidelines are explained and a work plan is discussed for the next period.

A helpdesk and reporting team have been installed for each Auditorate. Principal auditors permanently monitor and review their audit teams.

Furthermore, internal review teams have been appointed at several regional and central audit offices to perform hot reviews of audit reports.

1.7.5 Quality Assurance

The combination of internal audit/inspection tasks with quality assurance tasks in ITAMA does not improve the quality assurance environment. The combination of what is seen as punishing and learning at the same time should be discouraged. ITAMA does not consider the strategic and technical quality of audit reports, only compliance with procedures. This approach does not have any learning benefit for BPK.

We recommend that an implementation plan be drawn up to define ITAMA's role in relation to:

- Evaluation unit (EPP);
- internal review teams;
- hot review teams in the audit units.

BPK recently took the first steps to prepare project charters to clarify each function's use as a quality assurance instrument.

ITAMA should be able to use the findings (errors) of those other units' summarising/verifying activities. Only ITAMA reports relevant findings and lessons to the management of BPK. Quality assurance should look for best practices (what went wrong and what went right?) and suggest improvements to the team involved or management on such aspects as training, manuals and line control. Step by step BPK must develop a strategy based on added value: What should it learn first and what later? For learning purposes, a deep review could first be carried out of, for instance, methodology, followed up later by recommendations and conclusions. Furthermore, very experienced auditors with a certain authority and teaching skills should be placed in ITAMA, so that it becomes an honour to work for it. ITAMA's current staff should be clearly informed about their role, tasks and required performance as soon as possible, enjoy the support of BPK's senior management and have sufficient budget to do the job. According to the Board, BPK recently started to recruit experienced auditors for ITAMA.

Two units evaluate audit reports (cold reviews). Both suffer from lack of adequate capacity and poor communication. In semester II of 2007, the 33-man staff of the Evaluation unit (EPP) evaluated 821 final reports (LHP) containing 7,052 findings. They found that 3.4% of the 821 final reports did not comply with BPK's internal criteria. The findings should improve accuracy and the logical relation between findings and recommendations, prevent misinterpretation and increase compliance with auditing standards (SPKN). EPP produces half-yearly compilations of extracts from reports submitted to parliament. Files are not reviewed. However, the Principal Inspectorate supervises administrative support, discipline and audit activities at Auditorates at Headquarter and regional offices. It also performs quality assurance by reviewing the technical quality of a small selection of audits using audit files. These reviews are designed to increase internal learning. As BPK's new QA manual has almost been adopted this is the right moment to streamline QA activities in a single unit. This will enhance the production and quality of QA activities, which is necessary in view of the extra workload coming from regional offices. Furthermore, we recommend that the aforementioned inspection of administrative matters be separated from audit QA activities because they do not improve the QA environment. We noticed that auditors are barely interested in a QA inspection function owing to its negative image.

1.8 External stakeholder relations

The review team assessed the quality controls in place and BPK's ability to gather information from its main stakeholders with regard to risk assessment, audit object, topic selection and evaluation of the effects of assurance products.

BPK's stakeholders are not named in laws and regulations. But, by studying and analysing the laws (BPK and audit Laws), BPK has identified its stakeholders as:

- a parliaments (DPR central and DPRD local);
- b regional representative councils (DPD);
- c governments (central and local governments);
- d Attorney General's Office, Police Department, and Anti-Corruption Commission;
- e management of state-owned enterprises and other audited entities;
- f international organisations or institutions such as INTOSAI, ASOSAI, World Bank, Asian Development Bank, and other SAIS;
- g the public, including the media.

The question is whether BPK's communication strategy achieves its goals. BPK has developed a communication strategy but has not yet formally adopted it. BPK has approached its many stakeholders mainly through presentations of its reports and summaries. It also organises consultative fora with parliaments, coordination and follow-up meetings and press conferences. In 2009 a weekly TV magazine was broadcast for two months to make the results of specific audits accessible to the public. Given the huge challenge facing the Republic of Indonesia to improve its widely decentralised administration and financial management, BPK should prioritise its stakeholder relations and issues, preferably selecting high-risk issues in its own country and the Southeast Asia region.

In addition, we believe BPK's effectiveness can be enhanced through the appointment of a Public Accounts Committee in parliament to act as a focal point for BPK and its audit results. A Public Accounts Committee could also support BPK's efforts to enhance financial management in the Republic of Indonesia.

1.9 Results (impact assessment)

The Peer Review team reviewed a selection of 14 audits conducted by BPK in 2007-2008 to assess the performance of quality controls. The results are presented in the next chapter. The selection covered BPK's three audit types: eight financial audits, three performance audits and three special purpose audits.

Presentations given by the audit teams on their approach, supported by documents, gave us a general impression of the effectiveness of BPK's quality control system. The results also enabled us to focus our review on institutional issues by interviewing specific units within BPK.

2 Individual audit at engagement level

2.1 Introduction

To assess the adequacy of quality controls at individual engagement level the Peer Review team selected fourteen audits divided over the three types of audits (financial audit, performance audit and special purpose audit). We reviewed eight financial audits, three performance audits and three special purpose audits. We performed the following activities for our assessment:

- Assessment of the audit manual and guidelines;
- Familiarisation with the performance of the audit by means of a presentation by the audit team to gain a brief overview of its audit activities, audit results and quality control measures within the three main stages of the audit (planning, fieldwork and reporting).
- Interviews with the responsible audit team during and after the presentation.
- A review of the audit files, selected key documents and translations to analyse performance in more detail.

In the next section (2.2) we describe our findings concerning financial audit, followed by performance audit (2.3) and special purpose audit (3.4).

2.2 Financial audit

2.2.1 General conditions

Financial audit methodology

To perform a financial audit in accordance with BPK's rules the auditor needs to be acquainted with:

- State finance audit standard (SPKN);
- Financial audit implementation guidelines;
- Technical guidelines on audits of financial reports (central government, ministries, government agencies and regional government).

BPK's financial audit methodology complies with international standards issued by IFAC, INTOSAI and ASOSAI. The manual follows the three steps of auditing (planning, fieldwork and reporting); each step is worked out in detail. The planning phase is divided into 10 steps from understanding the audit objective and audit expectation to setting the audit programme and individual working programme. The field phase is divided into seven steps from analytical tests to reporting audit findings to the auditee. The reporting phase consists of five steps from compiling the draft audit report to reporting the audit result and compiling the final draft.

Responsibilities, checks and balances

All the actors' responsibilities are clearly described. The right checks and balances are in place in the design. Supervision is part of the process and the files showed us that it is effective. Supervision is performed at different levels. Reviews are also performed by the actors that perform quality checks.

Audit performance and documentation

The audits performed comply with BPK's manual and guidelines. The elements of quality control as identified by BPK were all evident in the audit process. The following elements of quality control are in place:

- clear rules;
- mandate and individual engagement;
- worked out working papers;
- supervision and internal review;
- communication of findings with the entity audited.

The working papers we reviewed were sufficient to prepare the right audit activities. The files were also systematically structured and gave a good view of the audit procedures, the audit findings and evaluation of the findings. We found evidence of internal control activities, such as signatures of the reviewers during the successive steps of the audit performance.

Professionals and knowledge

The auditors involved in the selected audits showed good knowledge of their audit subject and objective. They followed internal guidelines and showed the documentation of the audit. They also took various (update) courses last year.

Independence of auditors

Measures are in place to ensure the auditors' independence. Auditors are obliged to sign a form, for instance, declaring that they are independent. Besides these procedural controls, BPK also identifies risks concerning payments by the auditee to cover BPK's costs, such as transport and food costs, and takes action in such situations. Auditees are not allowed to pay BPK's audit costs.

2.2.2 Planning financial audit

The planning of all the financial audits we reviewed followed the steps required in the planning process. We have some remarks on the following elements:

- system based approach;
- risk assessment;
- assessment of the internal control environment;
- materiality;
- sampling.

System based approach

In general, BPK's approach is system based. Routine activities are performed as stated in the manual and working papers. There is room for improvement, however. To some extent, the steps in the planning phase are seen as distinct rather than interrelated elements. At key moments in a system based approach using risk analysis it is important to go back to an earlier step. For instance, if tests of controls conclude that assessment of the internal control risk was too negative, the model can be adapted ($ACR=IHR*ICR*DR$) and fewer substantive tests need to be performed. We noted that a technical guideline for audit risk is being prepared.

Risk assessment

BPK is aware of the need to have a risk assessment manual. A technical guideline for audit risk assessment is in preparation. For the selected audits reviewed at engagement

level, specific risk analyses have been performed without such a guideline. Nevertheless, we were impressed by the way BPK's auditors worked out their risk analyses. They performed a structured risk analysis and identified the main risks.

Assessment of the internal control environment

BPK uses COSO or comparable models to assess the auditee's internal control. We noticed that in some cases the questionnaire was sent to the auditee to fill in. It became quite clear from talks that the team was aware that this would give too positive a view of reality and told us what the real situation was. They took this into account in the audit. We advised them to make the evaluation more qualitative and use their own judgement next time and to document this in the working papers. In other cases we found that the model was used too instrumentally. They answered the questions but didn't give an overall analysis and conclusion on the key elements of the COSO model. It should be understood that the COSO model is intended primarily for an entity's management to make a kind of self-assessment and implement controls to mitigate risks to the organisation's objective and goals. The auditors can also use the model of course but they must be aware that it has another function for them: to become better acquainted with the entity performance of internal control and develop an appropriate audit programme. Furthermore, the auditor needs to be creative and think further than solely, *What is the meaning of this element of the coso model and why is it important?*

We found that auditors looked upon the question *Why didn't they recognise some elements of integrity risk?* as being more appropriate to performance audit. We also found this during talks with other teams. We agree that some focus by using the COSO model is necessary but there is usually a relationship between performance and financial audit. Broadening the scope can help improve a financial audit's effectiveness and strengthen the message of a financial audit.

Materiality and sampling

The audit team starts by defining materiality to calculate the planning materiality for each account. After this step the auditors select samples on the basis of professional judgement. No statistical methods are used but high risks are selected. In one high-risk case substantive testing was performed on 48% of the total financial amount. This is similar to the 20/80 rule (auditing 20% of the population can check 80% of the total amount) but it is not entirely system based. In one case the materiality was changed after a year. This situation reflects BPK's guidelines. Materiality can be higher if the auditee has shown some improvement (in the specific case there had been improvement and materiality was raised from 0.5% to 1%). This change, however, had no effect on the number of substantive tests. The fact that the opinion still contained a disclaimer and the change had no effect on the level of compliance or number of substantive tests made this decision open to question. BPK will address this issue when the technical guidelines on audit risk and sampling method are completed.

2.2.3 Fieldwork

In the section on general conditions we described some general findings of the Peer Review of the fieldwork. In general we are positive about the fieldwork performed by the audit teams we reviewed. They followed the guidelines and used the working papers.

The difficulties faced by BPK's auditors are:

- too little time available to perform the audit;
- IT systems are not always reliable;
- lack of qualified internal auditors at the ministries makes cooperation and reliance on the work of internal auditors difficult;
- shortcomings in the financial management of entities.

2.2.4 Reporting

The number of unqualified opinions remained low in 2006, 2007 and 2008, whereas the number of disclaimers declined in favour of qualified and adverse opinions. The development and progress of opinions is shown in the following table.

Figures and content of opinions given by BPK				
	2006	2007	2008	Remarks
Financial audit, ministers				
a Unqualified (emphasis of matter) opinion	6	17	34	positive development
b Qualified Opinion	39	31	30	
c Disclaimer opinion	37	34	18	
d Adverse Opinion	0	1	0	
<i>Total opinions given by bpk</i>	82	83	82	
Financial audit, local government				
a Unqualified (emphasis of matter) opinion	3	4	0	positive development
b Qualified Opinion	326	283	30	
c Disclaimer opinion	102	120	4	
d Adverse Opinion	28	59	5	
<i>Total opinions given by bpk</i>	459	466	397	
Financial statements other than central and local government				
- To be received according to regulation	158	170	168	serious
- Actually received (on time)	17	10	4	problem
Financial audit, BPK				
a Unqualified (emphasis of matter) opinion	10	3	3	no conclusion possible
b Qualified Opinion	3	1	1	
c Disclaimer opinion	3	6	0	
d Adverse Opinion	1	0	0	
<i>Total opinions given by bpk</i>	17	10	4	

Attention should be paid to minor inaccuracies in the opinions. The teams used the formats in the guidelines. A uniform tool should be available to evaluate BPK's opinions. We reviewed only a few opinions but think it would be useful to have different audit teams discuss the evaluation and conclusions on the audit findings. Let teams present their findings and evaluations to each other to express an audit opinion. It is not necessary to arrange workshops on all the audit opinions given, but to select a few different types of opinion (unqualified, qualified, disclaimer and adverse). People will learn from each other and opinions will improve. A BPK-wide comparison of opinions would also be useful to identify differences. We understand that a working group discusses all opinions with the auditors. We think this would be a very effective control measure and that other auditors and even ITAMA could use the outcome.

7
There are less financial statements in 2008 because the rest of entities are being audited by BPK.

It became clear from the interviews that the quality of internal audit at ministries and regional government is still problematic. BPK faces a challenge to change this situation and establish close cooperation among all actors in the field. But it will make BPK's role as a Supreme Audit Institution far easier in the future and allow it to spend more time on performance audits.

Reasonable assurance

Although there are opportunities for improvement (finishing the missing technical guidelines and working in accordance with them), we consider the audits we reviewed to be adequate. It is not very difficult to draw this conclusion because most of the opinions were disclaimers or qualified and there was one adverse opinion. It became clear that internal control (accounting and financial management) at the governmental entities was weak. The situation would be more complex and difficult if the systems, including the inspectorate, were better and the trend was towards more unqualified opinions.

The financial audit reports contain much information but are also very long and difficult to read for non-financial experts. The summary is also written very technically. To give an example:

One of the main problems addressed by the audit team is the valuation of fixed assets. This is a serious problem but it is quite technically reported. For parliament and others with a lack of financial expertise the consequence is not clear and they will probably take no action. We recommend helping the stakeholders by making clear that this means that the balance sheet gives a far too positive picture of the quality of, for instance, fixed assets. If the equipment is obsolete either (1) it has no value and it cannot be sold, or (2) the equipment cannot be used in operations and needs replacement or maintenance. This key message needs to be quite clearly reported in the summary of the audit report.

2.3 Performance audit

Step-by-step, BPK wants to increase the number of performance audits in the coming years. BPK conducted 22 performance audits in 2007 and 2008. As part of its audit manual framework, it has developed an Implementation Guidance document on performance audit that was approved on 5 June 2008. The performance audits in 2007 and 2008 were conducted before the Implementation Guidance was formally adopted and distributed to BPK's auditors.

To assess the quality of the Implementation Guidance and the selected performance audits we used criteria from INTOSAI and ASOSAI's performance audit guidelines. We also used our own experience and manuals as a reference to review the quality of the Performance Audit Implementation Guidance and the selected audits. To assess whether the Implementation Guidance complied with applicable laws and regulations we used criteria from Act No. 15 2004 on State Finance Management and Accountability Audit, Act No. 15 2006 on the Audit Board of the Republic of Indonesia, BPK Regulation No 1 2007 on State Finance Audit Standard, BPK Decree No. 1/K/I-XIII, 2/2/2008, on Audit Management Guidance, BPK Chairman Decree No. 34/ K/I-VIII, 3/6/2007, on BPK's Organisation Structure, BPK Decree No, 39/K/I-VIII, 3/7/2007, on Organisation and BPK's Investigator Work Order.

2.3.1 Main findings

Our main finding was that the Performance Audit Implementation Guidance complied with applicable laws and regulations. It also agreed with INTOSAI and ASOSAI guidelines. The Implementation Guidance provides auditors with a clear step-by-step approach from planning to reporting. It clearly states the relationship between the various activities in the audit process and the documents used to report findings, conclusions and recommendations and establish an audit trail. The Implementation Guidance provides and secures a systematic approach that enables uniformity and quality control measures to function properly. The Implementation Guidance provides general information on what performance auditing is and its aims. It also gives a brief description of important concepts such as economy, efficiency and effectiveness, illustrated with examples. The Implementation Guidance describes the basic competences that performance auditors should have. Even though the selected performance audits were conducted before the Implementation Guidance had been formally adopted, they complied with the requirements of the Implementation Guidance.

However, we believe the Implementation Guidance should be further improved with regard to the scope, methodology and challenges of performance auditing to better support BPK's auditors when conducting performance audits. This support is needed in our opinion because performance auditing is a relatively new activity not only for the auditors but also for BPK's management and Board. Our review of the selected performance audits found that the auditors used the financial audit methodology and the audit design and fieldwork focused on compliance rather than achievement of policy goals. Supervision, quality controls and quality assurances also did not encourage the auditors to focus on the performance of government and on the final impact on the Indonesian population. In appendix IV we look in greater detail at our suggestions to improve the Implementation Guidance further.

In the following sections we present more detailed findings regarding general conditions, planning, fieldwork and reporting of performance audits.

2.3.2 General conditions

The Implementation Guidance describes and illustrates the objective of performance auditing, important concepts such as economy, efficiency and effectiveness and techniques for data collection. We found that the descriptions did not provide enough information and knowledge for the auditors to conduct a performance audit. The descriptions of economy, efficiency and effectiveness, for instance, provided too many examples from the private sector and did not provide sufficient insight into how the concepts were applied in the public sector. The information on data collecting techniques was also insufficient to learn how to use these techniques in practice and what their advantages and disadvantages are.

The auditors we interviewed had good analytical skills and understood their auditees. On the other hand they had difficulty automatically identifying all causes and effects of their findings and relating their findings to the objectives of the government and final beneficiaries (Indonesian population) even though we believe they have the potential to do so. We also found that the auditors we interviewed were creative in the conduct

of their audits and presentation of their findings. This creativity was not used to its full potential in the reporting phase.

The selection of audit team members was clearly thought out in terms of skills and knowledge needed. During our interviews the teams raised concerns about the regular movement of auditors between audit projects and between regional offices and headquarters. This high turnover of auditors led to difficulties executing the audit and to loss of knowledge about the auditee and key areas of the audit.

2.3.3 Audit planning

We found that the scope of the selected performance audits was limited mainly to compliance. The current Implementation Guidance focuses strongly on identifying risks in the internal control system and ‘cheating risks’; both risks are derived from the financial audit methodology. The selected audits and Implementation Guidance pay too little attention to the problems facing the Republic of Indonesia and its population and the measures taken by public entities to solve them. We believe this relationship should be a focal point to define the problem and key areas of the audit. We also found a strong bias in the selected audits and the Implementation Guidance towards entities rather than policies. We believe the focus on internal control, ‘cheating’ and entities limits the scope of performance audits and thus prevents auditors assessing the economy, efficiency and effectiveness of government measures. It also limits the added value of performance audits to parliament and government.

We would also stress that designing and conducting the fieldwork for a good performance audit takes time. We therefore recommend that BPK reserve sufficient time especially for this phase as capacity has to be built up (30 days is not enough).

2.3.4 Audit implementation

We found that the BPK auditors we interviewed do not automatically analyse the causes and effects of their findings. This is evident in the audit reports, in which audit findings are described but not causes and effects. Reporting only findings reduces the added value and impact of performance audits. We believe an analysis of causes and effects enhances the learning process of the public entity(ies) concerned and focuses parliament’s attention on the measures that should be taken. The Implementation Guidance pays little attention to how causes and effects can be analysed.

2.3.5 Reporting

As stated above, we found that the selected audit reports consider the main findings but not their causes and effects. We also found that the reports consist of many pages in which it is difficult to find the message that the auditor wants to communicate to the audience. There is no logical structure of findings, causes, effects and measures to prevent repetition. The Implementation Guidance does not provide sufficient information or guidance on the reporting of audit findings, conclusions and recommendations.

2.3.6 Quality control

The working papers we reviewed are sufficient to prepare appropriate audit activities. Files were systematically structured and gave a good view of audit procedures, audit findings and evaluation of findings and we were able to find evidence of internal control, such as signatures of the reviewers in the successive steps of the audit.

We also found that quality controls focused more on procedures and did not lead to a broader scope in performance auditing than in compliance auditing.

Performance audits

Performance audits are not about the performance of agencies but about solutions to social problems in the Republic of Indonesia by its government. They attempt to answer the question: What should be solved by whom for whom? BPK recognises that performance auditing is still in its infancy: staff has to gain experience.

The Peer Review team's comments on weaknesses in performance audit reports are repeated by ANAO. In response BPK has started sending its auditors to Australia to take a special training programme on performance auditing. According to BPK's staff, BPK has selected a number of themes (e.g. epidemics) for its performance/special purpose audits. BPK has already worked on special themes such as education funds (all regional offices conducted an audit and an overall audit report was published on this theme).

2.4 Special purpose audits

The conduct of special purpose audits is provided for in BPK Law No. 15. BPK conducted 970 special purpose audits in the period 2007-2008, excluding investigative audits that are not publicly disclosed for reasons of confidentiality. The number of special purpose audits was even higher than the number of financial audits in the same period.

As part of its audit manual framework, BPK has developed a Special Purpose Audit Manual that was formally approved in February 2009. The special purpose audits conducted in 2007 and 2008 were conducted before the manual was formally adopted and distributed to BPK's auditors.

We used criteria in IFAC, INTOSAI and ASOSAI standards and guidelines to assess whether the Special Purpose Audit Manual complied with international standards. To assess whether the manual complies with applicable laws and regulations we used criteria from:

Act No. 15 2004 on State Finance Management and Accountability Audit, Act No. 15 2006 on the Audit Board of the Republic of Indonesia, BPK Regulation No. 1 2007 on State Finance Audit Standard, BPK Decree No. 1/K/1-XIII, 2/2/2008, on Audit Management Guidance, BPK Chairman Decree No. 34/ K/1-VIII, 3/6/2007, on BPK's Organisation Structure, and BPK Decree No. 39/K/1-VIII, 3/7/2007, on Organisation and BPK's Investigator Work Order.

We also selected three special purpose audits for our review. We interviewed the investigative audit unit that has been set up especially for investigative audits. Owing to the confidentiality of the investigative audits we did not review specific reports or related files (working papers).

2.4.1 Main findings

We found that the Special Purpose Audit Manual complies with international standards and applicable laws and regulations. The manual provides a step-by-step approach for auditors to select the type of special purpose audit and carry out the planning, fieldwork and reporting phases. It also explains the relationship between the various activities in the audit process and the documents used to report findings, conclusions and recommendations and to establish an audit trail. The manual provides and secures a systematic approach that enables uniformity and quality control measures to function properly. It also provides guidance for special purpose audits such as how to deal with confidential information.

However, we found that the manual does not adequately clarify what type of audit should be used when. Owing to the amount of information the manual contains it is also difficult to obtain a clear understanding of the procedural differences between the three types of special purpose audit. We recommend that the manual be restructured to provide planning, fieldwork and reporting information by type of special purpose audit in separate chapters.

The Special Purpose Audit Manual states in point 13 (B), Determine Type of Audit, 'in special purpose audits, for example investigative audits, the auditor should not make recommendations.' We believe this restriction limits the added value of special purpose audits: recommendations are important learning tools and prevent the repetition of negative findings (e.g. misconduct).

The auditors we interviewed had good analytical skills and understood their audit subject and objective.

2.4.2 Investigative audits

General conditions

A technical guideline will be developed for investigative audits as part of BPK's audit manual framework. This technical guideline will also help auditors outside the investigative audit unit conduct investigative audits. The investigative audit unit distinguishes the following steps in its Standard Operating Procedure: case selection, fieldwork and reporting. Owing to the audit object, the investigative audit unit takes special measures to select cases, gather information, evaluate findings and report findings. The steps and measures taken seem logical and adequate for the purpose of investigative audits.

The investigative audit unit formally consists of 17 auditors (as at 31 January 2009), 10 of whom have a special certificate from the Association of Fraud Investigators, and one support officer. In practice, only eight auditors can participate in investigative audits fulltime. Other auditors have been and will be trained in order to increase the number who can participate in investigative audits. Owing to the risks inherent in the fieldwork and the type of audit, the head of the investigative audit unit recruits staff not only for their analytical skills but also for their attitude: they should be suspicious, investigative, analytical and risk seekers. The investigative audit unit is facing a number of difficulties. Even though investigative audits are a priority within BPK, they have no formal structure and no structural capacity or budget is reserved for them in

BPK's annual plan. Moreover, it is difficult to retain investigative auditors, to recruit new ones and to involve auditors from other units in investigative audits.

Planning

Investigative audits are initiated in response to signs of fraud and corruption and therefore have a different, more ad hoc planning structure than financial and performance audits, which have an annual cycle. The signs come from BPK's other audits and external parties (whistleblowers, the Anti-Corruption Commission (KPK), the Police Force and the Office of the Attorney General).

Audit implementation

Investigative audits need different information sources than BPK's other audits. To secure the necessary information and exchange knowledge and expertise, BPK has agreed MoUs and protocols with the Anti-Corruption Commission, the Police Force, the Office of the Attorney General and the Financial Intelligence Unit.

Reporting

If the investigative audit unit has to deal with a complex case, it seeks advice from BPK's legal unit.

The requirements for investigative audit reports are agreed and set jointly with the end users: the Police Force, Office of the Attorney General and Anti-Corruption Commission.

Investigative audits report findings to end users only and do not consider the causes of the findings or solutions to prevent repetition of fraud. ASOSAI's Quality Management Framework (paragraph 4.146) states that 'Reports on irregularities may be prepared irrespective of a qualification of the auditor's opinion. By their nature, they tend to contain significant criticisms, but in order to be constructive they should also address future remedial actions by incorporating statements by the audited entity or by the auditor, including conclusions or recommendations.' According to the investigative audit unit the lack of recommendations reflects the main concern of an investigative audit: can it stand up in court? However, the investigative audit unit recognises the lack of recommendations and solutions and would like to include them in its reports.

Quality control and assurance

The internal audit unit has not yet asked the investigative audit unit for access to its audit files; investigative audits have therefore not been reviewed by ITAMA.

3 Follow up to the New Zealand Peer Review

BPK has addressed most of the points made in the recommendations of the Auditor General of New Zealand. BPK has all recommended legal, organisational and technical facilities at its disposal. It must familiarise itself with all these facilities to make optimal use of them. The added value of reports and management letters needs improvement.

1 Unclear and ambiguous mandate

In summary, the Constitution and legislation of the Republic of Indonesia today provide a strong basis for BPK's independence from the executive power and its auditees; detailed rules protect the security of tenure and legal immunity of the Board in the normal discharge of its duties; BPK's mandate covers all state finance entities in the Republic of Indonesia and it has full discretion in the discharge of its duties as a SAI. In the field of public sector audit, BPK has established all planned 33 regional offices; it has recruited graduates from various educational backgrounds (based on competitive selection) and experts to enhance capability to comply with international standards and increased its staff by 130% over the past five years; its budget increased by almost 635% over the same period. At the same time human resources training increased by two-thirds.

2 Shortcoming in legislation

BPK's enabling legislation comprises its enlarged mandate to audit central and decentralised governmental institutions and state-owned enterprises, supported by enhanced independence by having its Board appointed by parliament and its self-proposed funding determined by parliament. The mandate is clearly defined in:

- State Financial Law (No. 17 2003);
- State Treasury Law (No. 1 2004);
- State Finance Management and Accountability Audit Law (No. 15 2004);
- New BPK law (No. 15 2006).

3 Lack of (modern) auditing standards

BPK has implemented BPK Regulation No. 1 2007 on the State Finance Audit Standard (SPKN) and Audit Management Guidelines (PMP; BPK Decision No. 1/K/1/XII, 2/2/2008).

4 Unclear audit methodology

BPK subsequently published audit manuals and guidelines and several manuals and guidelines are still under production.

5 Need to establish audit and accounting technical capability to deal with new developments

BPK issued Decision No. 39/K/1-VIII, 3/7/2007, which gave the R&D department the power to meet BPK's need for technical capability in accounting and auditing areas. Education and training programmes have also been developed for auditors.

6 Shortcomings in Human Resources Capacity

BPK has recruited many graduates with an accounting background and allocated them to every audit unit. Required hours of education and training programmes are available

for auditors. BPK has some flexibility in the design of its staff remuneration system based on former ranks and qualifications.

7 Shortcomings in specialist resources and follow-up actions to fight Corruption, Collusion and Nepotism

BPK has formed a special unit for investigative audits and signed a cooperation agreement with the police, Attorney General and Anti-Corruption Commission on follow-up actions. The numbers of audit reports, findings and finding amounts are increasing.

8 Unclear Quality Assurance and Internal Audit system

Quality Assurance guidelines have been developed. A Board decision (No. 39/K/I-VIII, 3/7/2007) gives the Principal Inspectorate a clear mandate and internal control powers. The Principal Inspectorate must report to the Vice-Chairman.

9 Failure in delivering Audit Planning and planning how to respond to the New State Finance Law on accrual accounting

BPK has developed a strategic plan that considers changes in its environment and its mandate and cascades into its annual working plan. It strengthened its R&D function to develop a Financial Audit Guideline in anticipation of the introduction of accrual accounting.

10 Implementation of electronic working papers and portable pcs

BPK is developing an electronic working paper management system; some audits already use the system. In the meantime, 48% of auditors have laptops.

11 Lack of education and training needs assessment and renewal

BPK's Training Centre has identified knowledge needs and considered them in the training plan.

12 BPK must face the challenges of accrual accounting to fulfil its mandate and set reporting standards for public entities

BPK has arranged accrual accounting training courses. Although introduction by public entities has been postponed, BPK should anticipate accrual accounting by setting reporting standards.

BPK has assessed the public sector's willingness to adopt accrual accounting in the near future. By letter of 25 February 2009, it informed the Ministry of Finance what kind of aspects must be taken into account for the introduction of accrual accounting.

13 Lack of practice management systems for resource planning, time keeping, audit tracking and document management

The SDM system has been developed to monitor data on all BPK's personnel; furthermore, an Entity Data System and an Audit Management System have been introduced to support audit planning. A document management system is not yet available.

14 Low added value of BPK reporting and management letters

BPK's added value is a matter of concern. If BPK selects relevant issues in the Republic of Indonesia for its audits and presents the results to its target groups in an attractive way, their added value will increase. The Peer Review team made several suggestions in this respect.

Appendix I

Methodology used in the Peer Review 2009 of the Audit Board of the Republic of Indonesia

This report presents the findings, conclusions and recommendations of the Peer Review of BPK conducted in the period December 2008-June 2009. During this period we gathered information from various sources to honour the request of BPK as made in the Cooperative Agreement formally signed on 5 February 2009 by the Audit Board of the Republic of Indonesia (Appendix I1). Our first objective was to review the design and implementation of BPK's quality control system. The Peer Review should cover all aspects of BPK's Quality Control System (QCS) including quality controls at institutional level and at individual audit or engagement level. Our second objective was to review the progress made following up the first Peer Review performed by the SAI of New Zealand in 2004.

The criteria used for the assessment of quality assurance and quality control of BPK are set out in the following documents:

- LIMA Declaration and Mexico Declaration;
- INTOSAI standards;
- ASOSAI standards;
- BPK's own standards.

The review team, consisting of Roy Ferouge (team leader), Ton Kok and Egbert Jongmsma, conducted two missions to the Headquarters of BPK in Jakarta: one in January and one in May/June. During these two missions the Peer Review team interviewed BPK's Board and management and representatives of audit teams and relevant support units at BPK. With regard to reviewing quality controls at engagement level, we not only interviewed audit teams but also reviewed their audit files. We further reviewed relevant documentation on BPK's independence and mandate, the audit process itself (e.g. manuals and guidelines), BPK's quality control system and support functions such as HRM, IT, Finance, PR and Communication.

A draft of the final report was discussed by representatives of BPK and the review team in June 2009. The final draft report was made available to BPK's Chairman in July 2009 for verification purposes. The final report was presented to BPK on 18 August 2009 by the President of the Netherlands Court of Audit.

The Peer Review team would like to emphasise that its Peer Review work has been conducted on the basis of translated documents (not originals).

Appendix II

Overview of audits reviewed

The table below lists the audits we selected for our Peer Review.

Financials audits	
1	Financial statements, Papua province 2007
2	Financial statements, Ministry of Energy and Mineral Resources 2007
3	Financial statements, Ministry of Agriculture 2007
4	Financial statements, Ministry of Education 2007
5	Financial statements, Ministry of Defence 2007
6	Financial statements, Provincial Government of Riau 2007
7	Financial statements, Provincial Government of Bali 2007
8	Financial statements, Provincial Government of East Kalimantan 2007
Performance audits	
9	Rehabilitation and construction of the economy and business sector at brr nad-nias in 2005 and 2006
10	Pharmacy logistic management effectiveness at Fatmawati hospital
11	Effectiveness of Health Service Activities in Public Health Agency of West Nusa Tenggara for the fiscal year 2007 in Mataram.
Special purpose audit	
12	Investigate audit: yppi/bi fund flow case (fraud, etc.)
13	Management of government accountants
14	Cash management

Appendix III

General information BPK

1 Number of employees	4987
- number of auditors	
- number of auditors who are formally authorised to express an opinion on financial statement (registered accountant)	3095
	1065
2 Number of entities subject to audit mandate	719
Central Government	1
Ministries	34
Agencies	40
Provinces	33
Municipalities	348
Cities	85
Special purposes entities:	
- State own enterprise	161
- Other entities (in central government)	10
- Other	7

3 Financial figures			
Entity	Expenditures 2008 (x1 billion rp) (audited)	Revenues 2008 (x1 billion rp) (audited)	Opinion given by BPK (yes or no)
Ministry	985,731	981,609	Y
Local government			
- Propinsi	2,852.95	2,953.66	Y
- Kabupaten	9,143.11	9,009.64	Y
- Kota	-	-	Y
Specific entities			
- State-owned enterprises	2,555.44	2,497.29	Y (Not all)
- Other	29,234.72	45,428.53	Y

History of BPK's mandate

The 2002 amendment of the 1945 Constitution of the Republic of Indonesia by the People's Consultative Assembly (MPR) changed BPK's position and role. The amendment provides for a free and autonomous BPK, the submission of audit reports to DPR, DPDs and DPRD, and audit recommendations to be followed up by the agencies and/or Board in accordance with the regulation. Board members are no longer appointed by the President. They are chosen by the House of Representatives after consideration by the Regional Representative Council. BPK has also played an active role in supporting the government by being the subject expert in publishing a package of three regulations, namely Law No. 17 2003 on State Finance, Law No. 1 2004 on the State Treasury and Law No. 15 2004 on State Finance Management and Accountability Audit, enabling BPK to play a larger role in supporting the government's effort to improve the management of state finances and make them more efficient, economic, effective, transparent and accountable by In light of the state objectives of national justice and prosperity, as mandated in the Preamble of the 1945 Constitution of the Republic of Indonesia, BPK did not think Law No. 5 1973 on the Audit Board of the Republic of Indonesia contributed to the development of government at either central or local level. The House of Representatives and government therefore enacted Law No. 15 2006 on the Audit Board of the Republic of Indonesia.

To fulfil its constitutional mandate under Law No. 15 2006, BPK needs to expand and improve its institutional capacity. In the past three years, it has established new regional offices and recruited graduates from various educational backgrounds, applying a competitive selection process to optimise the quality, integrity and dedication of new employees. BPK has the flexibility to recruit, place and promote staff. To ensure professionalism and high quality oversight, BPK has recruited experts and high-ranking officials from other institutions. It has also enhanced the capability of its staff through various education and training courses at the BPK Training Centre.

Appendix IV

Suggestions for further improvements in the Performance Auditing Implementation Guidance

Introduction

Based on the results of our Peer Review 2009 (see section 3.3.1) we believe that the guidance provided to performance auditors should be further improved. In our opinion better guidance is needed because performance auditing is a relatively new activity not only for the auditors but also for BPK's management and Board. Our review of the selected performance audits found that auditors used the financial audit methodology and their audit design and fieldwork focused on compliance instead of the achievement of policy goals. Supervision, quality controls and quality assurance do not encourage auditors to focus on government performance or the final impact on the Indonesian population. We found that BPK's audit teams and support units, such as R&D and Quality Assurance, have inadequate knowledge and experience of performance audits.

We recommend that BPK further improve its Performance Audit Implementation Guidance as formally adopted on 5 June 2008, with regard to scope, methodology and performance auditing challenges. We also recommend that BPK gain knowledge and experience on a step-by-step basis by means of a limited number of audits or a limited number of topics. We suggest that this step-by-step approach be taken by auditors, R&D, Quality Assurance and possibly others from outside BPK with knowledge of performance auditing and/or policy analysis. We recommend that BPK earmark sufficient days to implement such a step-by-step approach as performance audits are complicated and are new to the staff.

In this appendix we consider our recommendations to further improve the Implementation Guidance in greater detail, considering the following elements of the Implementation Guidance: general conditions, planning, fieldwork and reporting.

General conditions

The Implementation Guidance defines and illustrates the concepts of economy, efficiency and effectiveness. We believe that the definition and illustrations are more relevant to the private sector than the public sector.

Economy, efficiency and effectiveness are measured by quality, price, output and outcome. Quality, price, output and outcome are less straightforward in the public sector than in the private sector, which makes measuring them very complex. Auditors should be aware of the complexity and should be helped to design audits that can deal with it. We therefore suggest providing auditors with fitting descriptions of economy, efficiency and effectiveness in the public sector based on examples from audit or policy practice. In addition to a fitting description, we recommend that BPK provide more information on how economy, efficiency and effectiveness can be measured. We suggest including a thorough explanation of the evidence-collecting techniques used in the social sciences. We make reference to chapter 4 of the fifth ASOSAI Research Project, Performance Auditing Guidelines document, October 2000, for more information on these techniques.

Audit planning

We suggest that problem identification be focused more on societal problems in Indonesia and the measures the President and his ministers are taking to combat them. Performance auditing should investigate the ability of public entities to deliver goods and services to the Indonesian public. At a higher level, this should be done in the Board's strategic planning process and trickle down to the development of the annual audit working programme and individual audit plans. The contribution of each audit to BPK's strategic objectives would then be clear.

Focusing on societal problems and policy areas that address them instead of focusing on public entities provides an opportunity to gain an insight into the complexity of policy implementation in Indonesia. The complexity is due to the many public entities at various levels of government that play a role in the implementation process and to Indonesia's vast population and geography. Clarifying that complexity could be of added value to BPK's stakeholders.

Like the problem definition, key area determination should be focused more on the relationship between societal problems and the measures taken by public entities to tackle them. The current Implementation Guidance focuses strongly on identifying internal control risks and cheating risks, both of which are derived from the financial audit methodology. We believe that a focus on internal control and cheating limits the scope of a performance audit to compliance and evaluation of the internal control system, thus preventing auditors from assessing the economy, efficiency and effectiveness of government measures. This is illustrated in appendices 4.1, 4.2 and 4.3, which provide checklists for the COSO model and the evaluation of regulatory compliance.

We recommend that the Implementation Guidance include basic information on how to analyse policy theory and policy measures and instruments. We believe performance audits should evaluate the economy, efficiency and effectiveness of policy measures and instruments. Weaknesses in the internal control system (the causes) could then explain why measures and instruments have not led to acceptable performance by public entities. When selecting the key area, check whether other institutions (such as internal audit/control units, universities, etc.) have already evaluated the economy, efficiency and/or effectiveness of the key area in order to determine the added value of an audit by BPK.

With regard to setting the audit scope and audit criteria we recommend that more attention be paid to the difficulty of assessing economy, efficiency and effectiveness (see also our suggestions in chapter 2 regarding the Implementation Guidance). The examples provided in chapter 2 are taken chiefly from the private sector. It is more challenging to assess the quality, price, output and outcome of policy measures in the public sector. We think it would help if BPK's auditors were aware of this before they decided on the audit objective and audit criteria. Furthermore, we think consideration should be given to the reliability and kind of evidence that must be collected to evaluate economy, efficiency and effectiveness. This is important to assess the feasibility of the audit objective. See chapter 5 of the fifth ASOSAI Research Project, Performance Auditing Guidelines document, October 2000, for some interesting thoughts.

We would also note that BPK's Board and management should be aware of their role in encouraging auditors to audit performance by focusing on societal problems and the policy measures taken to tackle them.

Audit implementation

The Implementation Guidance clearly states that after evidence is gathered it should be evaluated against the audit criteria set in the audit design. Auditors should then analyse the causes and effects of the evaluation's findings. Findings could indicate underperformance if the outcome is less than expected or good practice if it exceeds expectations. We recommend that more information be provided on identifying the causes and effects of audit findings because this determines an audit's impact. It stimulates a learning process for the relevant public entity(ies) and focuses parliament's attention on the measures that should be taken. In our opinion, identifying causes and effects is not only an important activity it is also a difficult one requiring a deep knowledge of the audited key area in terms of the policy (theory) used, the organisation and execution of policy implementation and external factors that can influence the economy, efficiency and effectiveness of policy measures.

Furthermore, identifying the causes and effects of audit findings lays a solid base to formulate recommendations that help solve a problem if the findings are negative or recognise good practice if they are positive. Chapter 4 of the fifth ASOSAI Research Project, Performance Auditing Guidelines document, October 2000, provides more information on identifying the causes and effects of audit findings.

Reporting

An audit report is a SAI's main formal instrument to share audit results with the auditee, parliament, public and other stakeholders. In addition to this accountability function, an audit report is an incentive to encourage public entities to improve their performance. The report should therefore convey a strong and clear message to its intended audience. The message should consist of an analysis (performance evaluation), conclusions and recommendations. On the basis of the performance audit reports we reviewed, we recommend that the Implementation Guidance or a separate guidance document pay more attention to the reporting of audit findings, conclusions and recommendations. The performance reports we reviewed lacked a logically structured presentation of findings, effects and causes and recommendations to prevent repetition. We would also suggest that more attention be paid to formulating specific and realistic recommendations that auditees can implement.

Furthermore, we recommend that BPK's guidance documents consider not only the formal reporting of findings but also other instruments that can communicate the message of its audits (e.g. interviews, presentations, articles, conferences and meetings). These instruments could be used to further enhance the audit's impact and encourage the learning process at public entities.

Appendix V

Human Resources Management

Introduction

Based on the results of our Peer Review 2009 (see section 2.4) we believe that BPK's Human Resources Management should be further improved with regard to recruitment and placement, retention, training and capacity building, performance assessment and management and career development in order to have a well-educated and well-trained staff that can support or perform audits on a timely basis and to the required quality.

BPK's staff is its key asset for it to fulfil its obligations, tasks and objectives. To secure this effectiveness BPK must manage its staff well. Given BPK's new tasks and ambitions and the arrival of many new auditors, we believe it is the right moment to adopt the basic principles of professional human resources management and create awareness of the staff and management attitudes necessary to support these principles. We believe that managing professionals should be based on a coaching concept of leadership, opportunity to develop professionals and awareness of individual responsibility. We also believe BPK should enhance control over its human resources management by claiming its legal right to formulate its own employment conditions and its own functional and remuneration schemes to increase its operational flexibility and ability to promote and reward talented people.

In this appendix we consider our recommendations to further improve Human Resources Management in greater detail, considering the following elements: recruitment and placement, retention, training and capacity building, performance assessment, and management and career development.

Recruitment

BPK recruited many new members of staff in 2007 and 2008 to carry out its new obligations and tasks. We are impressed by the number of staff BPK was able to recruit in a relatively short period. BPK has increased its staff by 130% over the past five years. BPK relied heavily on external assistance in the recruitment process. We see this as a high risk because it makes BPK dependent on the external assessment of its staff. This could easily lead to the recruitment of unsuitable personnel because external parties generally do not have a good understanding of what it takes to be a good auditor. From our interviews with units, we understand that management was not fully involved in setting criteria for the new staff or in final decision-making. Since BPK's staff contracts do not feature a trial period, BPK is unable to test the recruited staff on the job and decide not to continue contracts if staff are unsuitable as auditors. We therefore suggest that BPK include a trial period or temporary contract option in the new employment framework that we recommend it develop.

Furthermore, it seems that BPK has recruited staff for audit positions only. We believe that support functions are important to a properly functioning SAI. Support positions should be filled by professionals in the respective fields (e.g. HRM, IT, Legal, Finance). At the moment, crucial positions in support units are held by auditors, who generally lack the educational background, professional experience and skills necessary to fulfil

these critical functions properly. According to BPK, it is not allowed to recruit specialised staff for support functions. We therefore suggest that BPK include the ability to recruit professionals in support positions in the new employment framework that we recommend it develop.

Placement

The right person in the right place is a prerequisite for an effective SAI. On the basis of our interviews we believe that existing staff have not been sufficiently involved in designing the new HRM policies. Although we appreciate that BPK has put a lot of effort into recruiting new staff, we believe that the right person in the right place is also a valid and important principle for existing staff, particularly as BPK's staff requirements have been affected by recent legal and regulatory changes and changes in the audit profession itself (e.g. introduction of operational, performance and IT audits). We therefore suggest that BPK pay appropriate attention to existing staff in the development of its HRM policies.

BPK has a policy of rotating its personnel. We found that the policy is neither clear nor clearly communicated to staff. This leads to uncertainty. We also learned from our interviews that staff turnover is high and that there is a high risk of many auditors leaving at the same time, especially at the new regional offices. This leads to loss of knowledge and experience of auditees and of policy areas relevant to audit. We suggest that the instruments to place the right person in the right place be matched to the rotation policy and the policy be communicated clearly to all members of staff so that they know what is expected of them. We also suggest that BPK ensure that staff rotates between headquarters and regional offices and between audit and quality assurance. We also believe that BPK could enhance its own capacity building and that of the public sector of the Republic of Indonesia if rotation were possible and actively used between BPK and other public entities. This would also enhance awareness and understanding of BPK's role and responsibilities.

Furthermore, we found that the ratio of BPK's support staff to its direct audit staff is almost fifty/fifty. Although there are no general targets for this ratio it might be rewarding to evaluate the actual need for such a high percentage of support staff. We recognise that there is no clear line between direct and indirect activities but we believe a fifty/fifty ratio is not optimal given the many challenges facing BPK. We therefore suggest that BPK decide on an acceptable ratio of support staff to direct audit staff and monitor compliance with it. For a well-balanced personnel mix, BPK needs more insight not only into the educational level of its employees but also into their potential and practical experience.

Finally, we suggest that BPK organise a thorough check of the qualifications of accountants that sign reports and whether delegation by Board members is correct.

Retention

BPK has taken a number of measures to enhance staff retention, one being higher salaries. We found that there is a difference in remuneration between audit directorates and support units. We also found that support units are not attractive to ambitious auditors. We consider this to be a risk to the quality of important support functions such as Research & Development, Quality Control and Quality Assurance.

We suggest that BPK address this risk and take measures to improve the quality of staff in Research & Development, Quality Control and Quality Assurance.

Training and capacity building

BPK's training function is well organised and is placed in a clear structure that focuses on the transfer of knowledge. As stated above, we believe BPK's HRM policies should be built on principles of professional human resources management: a coaching concept of leadership, opportunity to develop professionals and awareness of individual responsibility. We believe that a change is needed towards less control and domination and more personal motivation and responsibility for career development and performance. We suggest that BPK encourage its employees to prepare individual career development plans to identify a handful of specific competences that address individual needs. The plans should be discussed and agreed upon with the responsible manager and should be action-oriented. BPK should facilitate the implementation of individual career plans by offering training opportunities that meet the needs identified in the career plan.

Training and education should enhance the skills and knowledge of BPK's employees and thus the skills and knowledge of BPK as a whole. To benefit in full from training and education, employees must be willing and able to use their newly acquired skills and knowledge in practice in order to develop themselves further. We concluded from our interviews that training and education efforts are wasted because employees are not encouraged to use acquired skills and knowledge in their daily work. We suggest that BPK make sure that employees use their acquired skills and knowledge once they have finished their training. In our view, training (internal or abroad) should be used for no other purpose (e.g. as a reward) than individual employee development as agreed upon in individual career plans.

Performance assessment and management

BPK's promotion system is based on civil service criteria, competence evaluation, education, experience and input about employee performance. We understand that BPK's existing staff classification and remuneration system is still linked to its former ranking and qualification periods system rather than to employee performance. We suggest that BPK address this when developing new HRM policies and include it in the new employment framework that we recommend BPK to develop.

Furthermore, we suggest that BPK invest in a strong performance appraisal cycle concentrating on the relation between manager and employee, with feedback in both directions being a must. Appraisal results should be discussed at a higher lever to gain a better understanding of developments in a particular unit. We also suggest that group sessions be held about the targets set in each unit's Balance Score Card in order to create more awareness of and enthusiasm for the direction the unit has to take.

Because many HRM instruments are relatively new, measures and other provisions to ensure stable and qualified personnel are not fully in place and effective yet.

In view of the important role management plays in implementing HRM policies, we suggest that BPK invest in strengthening the relationship and communication between line management and the HRM unit. This would create mutual awareness and understanding and promote the use of HRM instruments. We believe that such an

investment would increase management's responsiveness to maximising the benefits of BPK's greater operational flexibility and ability to promote and reward its talented people. Our Peer Review found that a lot of the staff potential at BPK remains unused and we consider this a terrible waste. We strongly believe that managers should guide and nourish the creativity and knowledge of their personnel. Given the number of new staff that have joined BPK, we suggest that investments be made in the coaching of new employees and a system of mentorship be introduced in which more experienced employees act as coaches for new colleagues.

Welfare and career development

BPK has taken measures to increase employee satisfaction; they include gender specific measures. As we indicated above, we suggest that BPK clarify its placement and rotation policy and communicates it to staff. We believe such clarity will enhance the welfare of BPK's personnel. Furthermore, we believe BPK's management should invest more in coaching in order to help staff work to their full potential.

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