Final Report

Prepared by
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KPMG Consulting LLC

For

Indonesian Bank Restructuring Agency

("IBRA")

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List of Abbreviations

Administrative Units	AU
Agency Planning and Secretariat	APD
Asset Disposal Division (AMC)	ADD
Asset Disposal Unit (AMI)	ADU
Asset Management Credit	AMC
Asset Management Investment	AMI
Badan Penyehatan Perbankan Nasional/ Indonesian Bank Restructuring Agency	IBRA
Bank Indonesia	BI
Bank Restructuring	BRU
Barents Group of KPMG Consulting	Barents
Finance & Accounting	F&A
Government of Indonesia	GOI
Indonesian Deposit Insurance Corporation	IDIC
Ministry of Finance	MOF
Ministry of State Owned Enterprises	BUMN
Systems and Support Division	SSD
United States Agency for International Development	USAID

I. Introduction and Project Background

In the late 1990s, several East Asian nations suffered severe economic and financial distress. The Asian Financial Crisis hit Indonesia the hardest. The nation's financial sector was on the brink of collapse and economic growth had begun to contract. In 1999, the United States Agency for International Development (USAID) offered to fund a technical assistance program to help the Government of Indonesia (GOI) resolve its distressed banks, loans, and enterprises. From May, 2000 to September, 2002, the Barents Group of KPMG Consulting (Barents) provided contracting services to the Indonesian Bank Restructuring Agency (IBRA). Barents recently completed its USAID contract and presents this Final Report as a summary of its activities, benefits obtained, and results achieved. The Final Report is separated into three main sections: Project Background; Technical Assistance Programs; and Lessons Learned.

The following Project Background section presents an overview of the following topics:

- Indonesian Financial Crisis;
- Government Response;
- USAID's Technical Assistance Program; and
- Barents' Project Team.

A. Indonesian Financial Crisis

As the "Asian Miracle" brought high levels of capital inflows to East Asia in the 1980s and 1990s, the absence of developed capital markets coupled with an inexperienced financial sector resulted in many imprudent credit decisions. Governments throughout region often directed or encouraged banks to issue loans to promote industrial growth and macroeconomic goals. Prudential lending standards and supervisory safeguards were largely absent. Businesses became highly leveraged and vulnerable to market and economic setbacks. Major companies became unable to service their foreign denominated debt when local currencies were devalued. The funding problems experienced by major companies had a chain reaction throughout the economic food chain. Increasingly smaller companies became unable to access working capital.

In Indonesia, the problems were the most severe. Indonesia's non-performing loans (NPLs) to total loans peaked at 70 percent and its NPLs to GDP peaked at over 50 percent. (For comparison, South Korea's NPLs to total loans peaked at 35 percent and the U.S.'s NPLs to total loans, during the Savings and Loan Crisis, peaked at a mere 3 percent.) The roots of the Indonesian crisis can be traced to 1988 when financial sector deregulation was combined with inadequate banking supervision and transparency. Compliance with prudential banking regulations and sound credit principles were inadequate and there were serious concerns about the accuracy of banks' financial statements. Cross-holding of equities and related-party lending served to facilitate widespread political and financial corruption. Problems were manifest as early as 1993, when NPLs were estimated to be about 14 percent of total loans. In June 1993, Bank Indonesia's Governor said that alternatives to solve bad debt were under study, including restructuring of loans, setting up an agency to buy problem loans, and writing off the loans. However, action was insufficient, resulting in the current financial crisis.

As in much of East Asia, Indonesia's impressive economic performance during the 1990's was funded through leverage. Capital markets, though growing through 1996, were relatively small. Financial leverage played the predominant role. For example, from 1990 through 1995, Indonesia's nominal GDP grew about 116 percent. During the same five-year period, domestic credit to the private sector grew almost one-and-a-half times as fast, at about 150 percent.

A large proportion of bank loans during the 1990's went to the property sector, a sector that has proven the downfall of many financial institutions throughout the world. As early as January 1995, the Association of Real Estate Indonesia warned that "the extensive property development may cause a crisis due to possible huge NPAs." However, this did not stop demand for loans in the real estate sector expanding at an unchecked pace. Year-end 1996 loans to the property sector accounted for 20 percent of all commercial bank credits. By July 1997, problem loans to real estate projects accounted for about 40 percent of total NPLs. By the first half of 1998, Indonesia's commercial banks were suffering a major deterioration in asset quality as a result of the economic slowdown and currency depreciation.

B. Government Response

In 1998, GOI took the following actions to promote economic recovery:

- Implemented a government guarantee for all depositors and creditors of locally incorporated banks;
- Recapitalized banks and transferred distressed assets into the newly created Indonesian Bank Restructuring Agency (IBRA);
- Eliminated restrictions on foreign ownership of domestic banks; and
- Suspended corporate foreign debt repayments.

GOI's financial stabilization package has placed severe strains on the resources of the Indonesian people. GOI has spent over Rp.430 trillion (USD 50.5 billion)[1] to recapitalize troubled banks and approximately Rp.220 trillion to reimburse depositors and creditors of closed banks under GOI's blanket guarantee on bank deposits. In total, GOI has spent about Rp.650 trillion (USD 76.5 billion) to pay for the liability guarantee and bank recapitalization programs. This figure equates to approximately 65 percent of Indonesia's Gross Domestic Product. Although GOI has indicated that it has completed most of the required recapitalization, additional funds may be needed given the weak state of many of the recapitalized banks.

Indonesian Bank Restructuring Agency

IBRA was established to supervise banks in need of restructuring and to manage acquired assets resulting from the bank restructuring process. IBRA has four main functions:

- Manage the commercial bank liabilities Government Guarantee Scheme;
- Close failed banks, capitalize surviving banks, and restructure, merge, or sell banks taken over;

[1] This paper uses an exchange rate of Rp 8,500 per USD 1.

- Transfer, restructure, and liquidate assets of failed banks and non-performing loans of recapitalized banks; and
- Sell corporate assets transferred to Holding Companies by former bank shareholders in repayment for former related party borrowings.

IBRA's established mandate was to maximize value over expediting asset sales. This hold strategy has been balanced with the need for immediate revenue to offset a shortfall in the GOI budget. Although IBRA has often been criticized for not selling assets quick enough, IBRA has met its annual revenue targets each of the past three years.

IBRA initially operated as an agency of the Ministry of Finance, but is now under the Ministry for State Owned Enterprises (BUMN). Under current legislation, IBRA has a finite life of five years ending in February 2004. The current Chairman, however, plans to terminate IBRA mid-2003.

To accomplish its mission, IBRA is organized into three main divisions:

- <u>Asset Management Credit (AMC</u>) - AMC is the repository of core and non-core assets of failed banks and the non-performing loans of state-owned and recapitalized banks. AMC's loan portfolio is comprised of over 173,000 debtors with an aggregate indebtedness of approximately Rp.281 trillion (USD 31.2 billion). About 75 percent of AMC's portfolio value belong to large corporate accounts while about 95 percent of AMC's portfolio accounts belong to smaller retail accounts. AMC utilizes or plans to utilize a number of resolution strategies including joint ventures, holding companies, and auctions.

- <u>Bank Restructuring Unit (BRU)</u> - BRU is responsible for the following key tasks: (a) Identifying and closing failed banks; (b) Recapitalizing surviving banks; (c) Monitoring bank performance and administration for 12 banks under IBRA control; (d) Restructuring, merging or selling banks taken over; and (e) Managing GOI's blanket Government Guarantee scheme.

- <u>Asset Management Investment (AMI)</u> - AMI is responsible for managing and disposing of non-bank shares, securities, and corporate assets pledged to IBRA as part of the bank recapitalization program. AMI's total portfolio was valued at Rp.175 trillion and has been managed in five holding companies, the biggest of which is Holdiko Perkasa.

The three main operating divisions are supported by a number of support departments including Finance and Accounting, Management Information Systems, Risk Management, Public Relations, and Agency Planning. A organization chart for IBRA can be found in Appendix 1.

C. USAID's Technical Assistance Program

USAID initially supported IBRA through a 1999 collaborative program with the U.S. Treasury. This program led to a new USAID Task Order that was designed to provide maximum flexibility in providing technical assistance to IBRA, taking into account the rapidly changing needs of the agency.

1999 Task Order

USAID designed the original 1999 Task Order to cover two years and five main areas:

- Bank Investment and Restructuring – advise on bank valuation techniques, how to maintain and increase the value of banks under IBRA's control, and on issues relating to bank merger, acquisition, and bank disposal.

- Asset Management Credit – advise on managing and maintaining the finance and accounting activities of loan administration, reviewing and revising department and internal control policies and procedures, and overseeing back-office support functions for settlement, loan administration, investments, accounting, and management reporting.

- Asset Management Investment –support the negotiation process with bank shareholders, help value assets, support efforts to assure the continuity of assets until disposal, provide advice on innovative and optimal settlement structures, and support efforts to optimize asset value.

- Finance and Accounting – help improve finance and accounting activities in order to carry out normal financial accounting operations and assist in finance and accounting activities relating to the closing and recapitalizing banks, disposing of assets, and settling frozen bank liabilities to a third party.

- Information Technology – help improve computerization and information systems activities to have available sufficient information about the assets under management to assure adequate monitoring and control.

2002 Task Order Modification

In March 2002, USAID extended the 1999 Task Order for an additional six months and focused on the following key areas:

- Bank Investment and Restructuring Unit – advise on the merger of five banks for ultimate disposal and provide a concept to IBRA, MOF, and BI for the Indonesian Deposit Insurance Corporation (IDIC) system to replace the "blanket guarantee."

- Asset Management Credit – advise on an ongoing pipeline of assets for sale/bid/auction, review and revise sale proposals of assets, and provide continuing advice in planning for and implementing sales transactions involving collateralized debt obligations, joint ventures with equity partners and holding companies until the closure of IBRA.

- Ministry of State-Owned Enterprises (BUMN) - USAID shifted assistance from Asset Management Investment to the Ministry of State-Owned Enterprises (BUMN) to coordinate national asset sales of companies. Advice includes privatization strategy, asset disposal and contractor management advice, and public relations.

D. Barents' Project Team

USAID awarded the IBRA Task Order to Barents in early 2000. Barents provided long-term resident advisors in each of three key divisions: Bank Restructuring; Asset Management Credit; and Asset Management Investment. Barents complimented this long-term assistance with short-term specialists in each division. Barents also provide short-term specialist assistance to a number of support areas including: Finance and Accounting; Information Technology; Agency Planning; and Public Relations. The key members of the Barents team are listed below.

Table 1: Barents' Team

Martin Dinning	Chief of Party and Resident Bank Restructuring Advisor
Bernard Nelson	Resident Asset Management Credit Advisor
Lee Babcock	Resident Asset Management Investment/ BUMN Advisor
James Hambric	Asset Management Credit Specialist
James Satterfield	Finance and Accounting and Bank Restructuring Specialist
Mike McNertney	Bank Restructuring Specialist
John Fenton	Information Technology Specialist
Brooks Dickerson	Information Technology Specialist
Gary Fechtmeyer	Chief Financial Officer Specialist
Stan Silverberg	Deposit Insurance Specialist
Alan Whitney	Public Relations Specialist
Bill Olcheski	Public Relations Specialist
Charles Ratliff	Bank Monitoring & Supervision Specialist
Sandra Waldrop	Deposit Insurance Specialist
Bill Dudley	Strategic Plan and Asset Management Credit Specialist
Bill Cleary	Public Relations Specialist
Richard Longstaff	Enterprise Privatization Specialist
David Cooke	Project Director (based in Washington D.C.)
Jason Foley	Project Manager (based in Washington D.C.)

II. Technical Assistance Programs

Barents provided technical assistance to the following divisions and support areas:

- Bank Restructuring Unit;
- Asset Management Credit;
- Asset Management Investment and Ministry of State-Owned Enterprises;
- Information Technology;
- Finance and Accounting;
- Agency Planning; and
- Public Relations.

A. Bank Restructuring Unit

Barents assisted IBRA's Bank Restructuring Unit (BRU) in the following five main areas:

- Bank Merger and Divestment;
- Banking Landscape;
- Bond – Asset Swap;
- Bank Performance Monitoring; and
- Deposit Insurance.

The following section will summarize Barents progress in working with BRU to achieve its objectives as well as outline several areas where future USAID-funded assistance would be beneficial.

Bank Merger and Divestment

BRU originally had 11 banks in its portfolio as described in further detail in Appendix 2. For the past 2.5 years, BRU has been focused on the merger of Bank Danamon and the divestment of Bank Central Asia (BCA). The legal merger for Bank Danamon was delayed until June 30, 2000 and the operational merger of eight small banks into Bank Danamon was completed in October 2000. The Initial Public Offering (IPO) of BCA involved 22.5 percent of the shareholding and a further 10 percent was sold via a secondary public offering. In addition to fully divesting BCA, IBRA agreed under the terms of an IMF Letter of Intent to sell GOI's interest in Bank Niaga by middle 2002. Due to a number of political reasons, including market confusion over the Chairman's stated need to achieve a premium over quoted stock market prices, the sales have been delayed. BRU plans to sell its shares in Bank Danamon, BII, and Bank Lippo in the near, although undefined, future but likely to be 1st Semester 2003. Additionally, BRU is actively engaged in the merger of five banks (Bank Bali, Bank Universal and three smaller banks). This merger is expected to create a bank that will be divested in the third quarter of 2003.

Through its Resident Bank Restructuring Advisor, Barents provided long-term policy advice to BRU on the Bank Danamon, BCA, and Bank Niaga merger and divestment process. Barents' neutrality enabled it to serve as BRU's trusted advisors in this politically charged area. Barents worked with the designated BRU bank project teams as well as the various Deputy BRU Chairmen to review the work of the various legal and investment banking consultants and to provide objective advice. This trusted relationship also enabled Barents to help coordinate the bank divestment strategies of the Ministry of State-Owned Enterprises (BUMN). Barents provided advice to BUMN relating to the review of the BTN – the state-owned mortgage bank. Barents' Resident BRU advisor also joined the GOI's Steering Committee for the forthcoming IPO for Bank Mandiri – the largest state-owned bank in Indonesia.

Five Bank Merger

As mentioned above, BRU is actively involved in merging the following five banks under its control:

- Bank Bali;
- Bank Universal;
- Bank Prima Express;
- Bank Arta Media; and
- Bank Patriot.

Within the five banks there are over 8,000 staff, 349 Branches and 485 ATM's. As part of the post-legal merger integration process it was planned that there would be some 2,350 staff who would be released and 64 branches closed. The number of staff to be released was subsequently reduced to 950 by the Chairman. BRU requested short-term Barents assistance to compliment the efforts of its Resident BRU advisor to advise IBRA on the operational issues and risks associated with merging these five banks. The four main elements to the merger process include:

- Legal aspects;
- Financial aspects including due diligence and recapitalization;
- Operational, including planning for the new bank strategy; and
- Re-branding.

Barents assisted in developing a general merger strategy and organizational chart, participated in interviewing candidates for the Project Director and Operational Advisor(s), met with the subject Bank's directors and senior management, and discussed merger requirements with the appointed Financial and Legal advisors. Barents guided the BRU staff, through formal written memorandums and daily meetings, in the aggressive pursuit of the merger process. This has been done with the ultimate goal of developing a stable and marketable bank for divestment by the third quarter of 2003.

Banking Landscape

As part of the above bank merger and divestment process, BRU asked Barents to assist IBRA in developing an overall exit strategy for the banks under its control. Given the significant role of these banks in the financial sector, IBRA's strategy needed to be part of a larger strategic view of the banking sector as a whole. Barents prepared a preliminary report that outlined the role of IBRA's banks in the banking sector and presented possible resolution alternatives. This report served as the basis for a more in-depth review of the Indonesian banks by Boston Consulting Group. Barents has worked with IBRA officials in developing their current version of the banking landscape and are to review it as part of the IDIC creation process (see below). IBRA asked Barents to focus its ongoing assistance on the necessary financial sector resolution and regulatory structures that should be put in place, including the creation of a Deposit Insurance Corporation.

Indonesian Deposit Insurance Corporation (IDIC)

The GOI acknowledges that the implicit guarantee program needs to be replaced with an explicit deposit insurance structure (IDIC). Barents has been asked to take the lead in working with IBRA to coordinate the IDIC's policy development and implementation with the Ministry of Finance (MOF) and Bank Indonesia (BI). In late 2001, Barents reviewed and commented on the proposed draft law to create an Indonesian Deposit Insurance Fund. The primary concern was the need to clarify the IDIC's operational and enforcement authority as well as independence. Barents believes that providing the IDIC with sufficient authority to pursue its mandate as free as possible from political interference is very important.

In mid-2002, Barents provided short-term technical assistance to outline and briefly address the key issues for the IDIC's transition from the blanket guarantee to a limited scheme. Barents reviewed all available IDIC project information from IBRA, MoF, and BI, reviewed the revised decree, and prepared a white paper on "Transition Issues and Recommendations for an Indonesian Deposit Insurance Corporation." Barents also prepared a high-level Action Plan for implementing the transition plan. Barents presented its key findings at a high-level seminar including officials from MOF, BI, IBRA, World Bank, and IMF.

The transition plan covered the following key areas:

- Role of Government-Owned banks;
- Scope of Coverage;
- Multiple Depositor Accounts;
- Foreign Bank Liabilities;
- Timing of Depositor Claims Settlement;
- Loan Offsets;
- Creditor Priority;
- Funding of Scheme;
- Premium Assessments and Reserve Levels;
- Investment Policies;
- Role in Failing Bank Resolution Process;
- Liquidation Responsibilities;
- Large Bank Failures;
- Collection of Failed Bank Assets;
- Relationship with Supervisory Authority;
- Membership in Deposit Insurance System;
- Organization and Staffing;
- Timing of Phase-in;
- Public Relations; and
- Governance.

Bond – Asset Swap

IBRA asked Barents to advise on considering swapping restructured loans for government bonds in the recapitalized banks. In late 2000, Barents provided short-term technical assistance to consider such issues as the need for government guarantees, the possibility of put-back options, pricing mechanisms, and legal and accounting implications. Bond/Asset Swaps are now a primary target for IBRA. The bond – asset swap program is linked to rationalization of the banking sector and the ability of AMC to create sufficient restructured assets that can be used to facilitate the process.

Bank Performance Monitoring

As part of the bond – asset swap program, with some sort of government guarantee, BRU acknowledges that a credible bank-monitoring plan must be in place. On a more general basis, BRU also understood the need for an effective bank monitoring program to ensure that the banks are fulfilling the conditions set forth as part of the recapitalization program. A local rating agency had been working with BRU to provide reports for each of the banks under IBRA's control. However, these reports did not adequately address management's monitoring needs and BRU requested Barents assistance to develop the necessary reports.

In mid-2001, Barents provided short-term assistance that encompassed three main tasks:

- Reviewed the Performance Agreements under which BRU manages its relationship with the 11 bank's under its control;
- Advised and recommended improvements in BRU monitoring and supervision of the 11 banks; and
- Recommended improvements in management reporting, organization of BRU, and training necessary to carry out the improved supervision.

Barents recommended that the changes to the Performance Agreements were too cumbersome to achieve given the need to involve the MoF, Bank Indonesia, IBRA and the banks. With respect to the second two item above, BRU efforts were found to be inadequate for proper management oversight and understanding of the current financial condition of the banks under IBRA's supervision. Barents designed new monthly and quarterly reporting formats and suggested a revised organization structure. Barents also held workshops to help the BRU staff understand the new reporting methodology.

Future Areas of BRU Assistance

BRU has asked for further USAID-funded assistance in the following main areas:

- <u>Bank Mergers and Landscape</u> - BRU has asked for Barents continued assistance in providing strategic assistance to guide IBRA in the five bank merger process as well as the bank divestments scheduled over the next year. From a broader perspective, BRU has asked Barents to advise on the necessary components for a healthy and strong financial sector, including strategy for IBRA banks, role of Financial Supervisory Agency and Bank Indonesia, role of mortgage and non-bank financial institutions, and role of capital markets.

- <u>Indonesian Deposit Insurance Company</u> – Barents has been asked to develop a comprehensive Transition and Implementation Plan that provides further detail as to the recommended strategic approach for establishing the IDIC. GOI also has asked Barents to develop an Operating Manual for the IDIC and a pro-active public relations campaign. A detailed analysis will be needed that maps the current functional capabilities of IBRA, MOF, and BI against the requirements for IDIC. GOI needs to nominate a dedicated cross-agency implementation team that will be accountable for the IDIC's establishment.

Barents anticipates the need for a comprehensive training program for the IDIC designees.

- Bank Supervision and Regulation - BRU has asked for Barents' continued assistance in the following areas: (a) develop operating policies on how to increase or enhance the value of the banks so that the divestments can bring a higher price; (b) review and refine management report to Deputy Chairman of BRU; and (c) help review Bank Danamon's loan portfolio to identify assets that should be carved-out as part of the bank's rehabilitation program.

- Financial Supervisory Agency (FSA) - BRU asked for Barents assistance in developing a comprehensive roadmap toward the development of the FSA, including the following key tasks: (a) identification, review and analysis of technical, operational and commercial prerequisites on the establishment of FSA; (b) identification, review, and analysis of rights, responsibilities and authorization of FSA; (c) identification, review and analysis of aspect to be considered for a smooth transition of supervisory and monitoring functions from BI and BAPEPAM to FSA; and (d) identification, review and analysis of necessary functions needed to be incorporated into FSA.

B. Asset Management Credit

In AMC, Barents' contributed to the intellectual development of a range of alternative management structures and disposal strategies aimed at accelerating the disposal of AMC's bulging portfolio of restructured and unrestructured loans. Barents' recommendations formed the basis for many of the disposition strategies adopted by the agency over time. As it became clear to all that asset disposal should be the main focus of USAID's assistance to the BPPN, Barents' work with the AMC Asset Disposal Division had considerable impact in assisting the Department—and by extension, BPPN—in accomplishing its objectives. Barents' participated in AMC Board of Directors' meeting advising on a wide range of issues connected with the day-to-day management of the Department.

The same level of "strategic" advice and consultation was provided to the Chairman and Vice Chairman under Pak Edwin. Once BPPN management selected among the various options presented for expediting the sale of AMC assets, the thrust of our work—and that of the entire department—shifted to implementing those strategies, rather than further efforts at "strategizing" options for management's consideration. Example of key policy decisions taken as a direct result of input from Barents' include the early termination of the outsourcing program and sale of the outsourced portfolios, and the use of joint venture asset management companies as vehicles for selling off large portfolios of non-performing loans.

Our advisors worked on the very first loan sale ever undertaken by AMC as well as assisted in the expansion of the Asset Disposal Unit into a full-fledged division. We provided advice regarding alternative management structures and disposal strategies that AMC management could deploy in accelerating the disposal of its core asset portfolio.

Focused advice was also provided in the following specific areas:

- The strategic design and implementation of a variety of loan sales initiatives, including formation of joint ventures with equity partners, wholly-owned holding companies and collateralized debt obligations;
- Various alternative management structures and disposal strategies suitable to assisting AMC in accelerating the disposal of its restructured and unrestructured loan portfolios;
- Stratification of the various groupings of assets comprising AMC's restructured and unrestructured loan portfolio;
- Operating policies and procedures for the AMC Asset Disposal Division;
- Negotiations with company management and the creditors' committee in connection with the non-performing debts of a local credit card company;
- Alternative strategies for enhancing the value of equity and quasi-equity holdings maintained by IBRA; and,
- Highlights on a range of issues associated with establishing and managing a newly-created unit within AMC charged with managing its equity and quasi-equity holdings in debtor/obligor companies, including reporting requirements and formats, terms of reference for financial advisors and others representing its interests on company Boards of Commissioners and in line positions, exit strategies and timetables for the sale of its holdings, and performance evaluations for account officers.

The following section will summarize Barents progress in working with AMC to achieve its objectives as well as outline several areas where future USAID-funded assistance would be beneficial.

1. *Developed policies and procedures for selling loans,* equity and quasi-equity holdings to banks, institutional investors, and private investors.

Barents assisted AMC Management in transforming what was then an Asset Disposal Unit into a fully functioning division (ADD). Specifically, Barents drafted policies and procedures covering the ongoing operations of ADD’s loan marketing and sales efforts, developed multiple loan disposal strategies and disposal schedules, and developed position descriptions for ADD Asset Disposal Officers. Subsequent drafts of ADD’s standard operating policies and procedures and loan disposal strategies, and timetables included BPPN’s equity and quasi-equity holdings stemming from debt restructuring agreements.

2. *Provided assistance to the Asset Disposal Team in marketing and selling restructured loans.*

Barents assisted AMC and its financial advisors in marketing and selling a pool of restructured corporate loans with a nominal value of Rp 870 billion (USD 103 million) for Rp 600 billion (USD 72 million). In connection with this sale, Barents helped prepare the due diligence methodology, marketing timetable, and solicitation letters to a select group of investors.

3. *Alternative Management Structures & Asset Disposition Strategies*

Barents was asked to analyze alternative management structures and disposal strategies that could possibly help expedite the process of disposing of AMC's unrestructured, corporate loan portfolio and, as a result, help BPPN management accelerate the process of winding down the agency's activities. The alternative management structures and disposal strategies considered included:

- Formation of joint venture asset management companies with equity partners and international asset management firms;
- Formation of wholly-owned holding companies;
- Profit participations;
- Sale of collateralized debt obligations through special purpose vehicles;
- Direct issuance of asset-backed securities by BPPN; and,
- Rapid, systematic sell-off of entire portfolio.

After consideration of the various elements, AMC management recommended, and the BPPN Executive Committee and the FSPC ultimately approved, that the agency look into setting up one or more joint venture asset management companies with equity partners and international asset management firms to purchase portfolios of AMC unrestructured, corporate loans and manage the recovery of those assets.

4. Terms of Reference for Appointments in Relation to Management of Equity and Quasi-Equity Holdings

Barents was asked to help design a new organizational structure or structures to hold the equity and quasi-equity investments held in the companies owned by the top 21 debtors/obligors. There was an urgent need to design and implement the new structure to accommodate the transfer and management of the operating companies of Texmaco and Tirtamas pledged to AMC as part of the debt restructuring agreements reached with both companies. In connection with this project, Barents provided the following assistance:

- Drafted terms of reference for a "strategic" advisor who would, among other things, assume primary responsibility for creating the entire infrastructure for a holding company, or supervisory board, that would be responsible for managing the various operating units or companies;
- Drafted selection criteria for "strategic" advisor;
- Drafted terms of reference for an executive search firm that would be responsible for recruiting a "strategic" advisor, chief executive officers, chief financial officers and chief operating officers for the holding companies or operating units;
- Advised on selection criteria for executive search firm;
- Drafted position descriptions for chief executive officers, chief financial officers and chief operating officers; and,
- Provided a broad outline of duties and responsibilities of a supervisory board to oversee the holding companies.

5. Non-Core Assets

AMC asked Barents to review its management and disposal of non-core assets and to help develop alternative management structures and disposal strategies for those assets. Non-core assets consist of real estate and other fixed assets acquired from banks and from debtors through asset settlements. At its peak, the department had over 5,500 non-core assets in its portfolio.

Barents also presented draft alternative disposal strategies for selling non-core assets, standard operating procedures for managing and selling portfolios of non-core assets through wholly-owned property holding companies, and provided input into a proposal to be submitted to the BPPN Executive Committee and the Financial Sector Policy Committee recommending formation of joint ventures or special purpose vehicles to purchase, manage and sell non-core assets.

6. Oversight Compliance Management

Barents' was instrumental in developing the operating infrastructure for a unit created to manage AMC's ever-growing portfolio of equity and quasi-equity investments stemming from AMC restructuring agreements. This unit is responsible for placing representatives on the boards of commissioners of the companies in which BPPN has taken equity stakes and convertible and exchangeable bonds. Occasionally, the unit places representatives in key management positions within those companies. The unit is well-positioned to promoting principles of good corporate governance and help engineer real corporate restructuring throughout the private sector, a crucial component of the hoped for recovery of the business sector that has heretofore received insufficient attention.

The specific components of the operating infrastructure to which Barents has contributed included:

- Operating policies and procedures;
- Job descriptions for Account Officers;
- Performance measurements for Account Officers;
- Identification of "tools" needed to ensure that the staff of the unit are able to accomplish the goals and objectives set out for the unit;
- Identification of the key reports that should be reviewed or prepared by Account Officers in the course of their work;
- Sample Property/Company Inspection Report;
- Sample Quarterly Financial and Operational Performance Report to be prepared for each debtor/obligor company;
- Proposed Terms of Reference for External Advisors engaged to represent BPPN's interests on the Boards of Commissioners of companies in which it retains an equity interest; and,
- Proposed Terms of Reference for President Directors, Financial Directors and Chief Operating Officers;

- Essential data elements to be used in mapping the equity and quasi-equity assets in AMC's portfolio;
- Alternative strategies for enhancing the value and disposing of AMC's equity and quasi-equity holdings; and,
- Outline of a report dealing with the analysis of alternative exit strategies applicable to the various components of a debt restructuring package (i. e., sustainable debt, equity and quasi-equity).

7. Internal Advisor to the Asset Disposal Division

As Internal Advisor in connection with the Department's asset disposal activities, particularly the Asset Management Division and Asset Disposal Division I (the two units with responsibility for disposing of the largest concentration of assets in the entire agency), Barents has been strategically positioned to make the greatest possible contribution to the most significant area of the Department's operations—and arguably that of the entire agency. Barents has been involved in assisting the Asset Management Division in designing and implementing the structured transactions.

Specific duties and responsibilities have included participation in meetings of the AMC Board of Directors; advise to the AMC Board of Directors; participation in meetings of the technical teams responsible for designing and implementing the structured transactions, including external parties with a stake in those transactions (e. g., governmental regulatory bodies and potential investors); and review and commentary on all relevant documents developed during the design and implementation phases of each transaction. Finally, Barents has acted as a regular sounding board to Department Management, including the Deputy Chairman, and members of the program (sales) design and implementation teams in addressing specific issues, or special projects, that arise from time-to-time.

The new AMC Deputy Chairman requested that Barents, in addition to advising, the AMC Board of Directors, assist the Division Head, Asset Management Division (one of the new divisions created under the Chairman's reorganization plan), in designing and implementing the structured components of the Department's overall disposal program. Specifically, those programs include the formation of joint venture asset management companies with equity partners, wholly-owned holding companies, clearinghouse and collateralized debt obligation (through one of the holding companies).

Selected contributions made by Barents to the Asset Disposal Division include:

- Assisted in revising Terms of Reference for the Corporate Core Asset Sales Program (CCAS);
- Assisted in revising Terms of Reference and accompanying attachments for the Corporate Unrestructured Loan Sales Program (CULS);
- Reviewed and revised Terms of Reference for the Commercial Loan Sales Program (CLPS) and attachments;
- Revised Terms of Reference for Financial and Legal Advisors for the CLPS Program;

- Served as a member of the evaluation team reviewing presentations from PriceWaterhouseCoopers and Niaga Sekuritas, and Ernst and Young regarding their proposals to serve as Financial Advisors for the Joint Venture Project;
- Reviewed and edited Terms of Reference for Financial and Legal Advisors to assist in the formation of wholly-owned non-property holding companies;
- Advised on the risks associated with the implementation of the CDO project;
- Reviewed and revised Terms of Reference for a Disposal Advisor to assist in the sale of the restructured loan, convertible bond, equity and other assets of PT Caterison Sukses;
- Drafted core features of the Terms of Reference for a Loan Service to connection with the CDO project;
- Drafted core features of the Terms of Reference for an Investment Manager in connection with the CDO project;
- Drafted core features of the Terms of Reference for a Custodian in connection with the CDO project;
- Provided written comments on Financial Advisor's memorandum outlining the key points regarding the formation of and sale of assets to multiple asset management joint venture companies;
- Reviewed and prepared written comments on the proposed timetable for implementing the Asset Management Joint Venture Project prepared by the Financial Advisor;
- Reviewed and prepared written comments on legal opinion prepared by Legal Advisor on the Joint Venture Project regarding the proposed structure of the Joint Venture Asset Management Company developed by the Financial Advisor;
- Advise on sales strategy, including packaging of assets;
- Reviewed and modified Terms of Reference and accompanying attachments for the Restructured Core Asset – Direct Sales Program;
- Reviewed and prepared written comments on a briefing memorandum developed by the Financial Advisor for the purpose of sounding investor interest in becoming a joint venture partner with BPPN in the management and disposal of selected, unrestructured assets;
- Revised Terms of Reference for appointment of Financial and Legal Advisors to assist in the creation of a property holding company;
- Reviewed and made revisions to the Terms of Reference for the sale of the commercial loan portfolio, which will include between 2,800 and 2,900 debtors with a combined face value indebtedness of approximately Rp. 25.5 trillion;
- Drafted Terms of Reference for a Disposal Organizing Servicer to manage the sale of the commercial loan portfolios;
- Drafted Terms of Reference for a Valuer to prepare internal valuations on the commercial loans packaged and offered for sale;
- Reviewed and revised attachments to the reconstituted Corporate Core Asset Program.

Future Areas of AMC Assistance

In the second phase of USAID's technical assistance to BPPN and BUMN, as far as AMC is concerned, all of it should geared toward aiding the department in accelerating the disposal of the remainder of its portfolio. From this point forward, ***all*** of AMC's efforts will be geared toward asset disposal, as the last of its restructuring initiatives comes to a halt.

The remainder of AMC's portfolio of roughly Rp 126 trillion, or USD 14 billion (at Rp 9,000 to the USD) will be disposed of through the following programs:

PROGRAM	BOOK VALUE (TRILLION RUPIAH)	BOOK VALUE (BILLION USD)
Strategic Asset Sales	53.85	5.99
Credit Asset Portfolio Sales	57.91	6.43
Non-Core Asset Sales/Holdco Property	10.25	1.14
Retail & Small & Medium Enterprise Sales	4.03	.45
Total	126.04	14.01

Although the joint venture project has been postponed indefinitely, there is a chance that it may reemerge next year. The only other structured transaction looming on the horizon is the wholly-owned holding company project. The wholly-owned holding company is envisioned to serve as a catalyst for the development of low-income housing, mortgage-backed securitization and secondary mortgage markets, as well as developer of underutilized commercial properties in AMC's portfolio. After many months of planning and preparation, however, the project has yet to be presented formally to KKSK for formal approval.

The four projects noted above represent the main thrust of AMC's disposal activities between now and the agency's closure. Each project is to be sold through public auction, a sales mechanism with which AMC has much experience in executing. Through a careful blend of long- and short-term technical assistance applied to the four projects, USAID will play a substantial role in ensuring the successful completion of each program

C. Asset Management Investment and Ministry of State-Owned Enterprises

Barents assisted IBRA's Asset Management Investment (AMI) and the Ministry of State-Owned Enterprises (BUMN) in resolving both agencies' portfolios of companies. The following section will summarize Barents progress in working with AMI and BUMN to achieve its objectives as well as outline several areas where future USAID-funded assistance would be beneficial.

Holdiko Perkasa

As part of GOI's resolution program, bank shareholder pledged assets to IBRA in return for financial assistance. IBRA's AMI was charged to manage five holding companies that received the pledged assets. These holding companies included: Holdiko Perkasa; Tunas Sepadan Investama; Kiani Wirudha; Bentala Kartika Abadi; and Cakrawala Gita Pratama.

Holdiko Perkasa (Holdiko) was established in late 1998 as part of the settlement between the Salim Group and IBRA with regard to liquidity credits provided to Bank Central Asia (BCA) and BCA loans to affiliated companies that exceeded the legal lending limit. As part of the Master Settlement Acquisition Agreement (MSAA) with IBRA, the Salim Group transferred 107 companies to Holdiko while the total number of other companies controlled by AMI is 117. Holdiko disposed of over 70 percent of its assets, providing disposal proceeds of Rp8.7 trillion and Rp.11.67 trillion for 2000 and 2001, respectively.

The remaining holding companies have not made significant progress due largely to the nature and design of the underlying legal agreements between the former shareholders and IBRA. The following table provides a profile of the previously mentioned five holding companies as well as two other, much smaller holding companies Arya and Hoswar:

	Holdiko	Bentala	Tunas	Kiani	Cakra.	Arya	Hoswar.
Cooperation	Medium	Low	None	None	None	None	Unknown
Remaining Companies	30	21	12	30	9	19	8
Disposal Activity	High	Low	None	None	Low	None	None

The Barents Resident AMI Advisor served as transaction advisor for several of Holdiko's largest companies. Specifically, Barents assisted AMI on the following key transaction management issues:

- Contractor (financial, legal, and appraisers) selection, management, and oversight;
- Implementation of established marketing procedures;
- Onsite due diligence reviews; and
- Mentoring, business coaching, and training to AMI staff in preparing for and implementing company dispositions.

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Many of Holidiko's and the other holding companies' assets had been stripped of value by the former shareholders and company management. AMI officials suggested implementing a Special Administration concept in where IBRA would appoint an official to take control of the company. AMI asked Barents to comment on the proposal. In its analysis, Barents agreed that AMI needed to take immediate actions to prevent asset stripping and get a better understanding of the true financial and operational nature of the remaining companies. However, Barents raised several issues that needed further clarification before it would recommend its implementation at IBRA. Moreover, Barents believed that current structures in place at AMI should be sufficient to prevent asset stripping without the need for a new concept.

To address ongoing management issues within AMI companies, Barents organized and implemented a Corporate Governance Workshop. The workshop outlined the Organization for

Economic Cooperation and Development Corporate Governance Principles, Indonesia's Code of Conduct, the Audit Committee roles and responsibilities, and the recently completed Indonesia Corporate Governance Questionnaire.

Future Areas of AMI Assistance:

There may be some ongoing level of assistance to help with the sale of any remaining assets and to properly structure the incentives for original asset owners and managers to maximize recovery value. Any level of assistance is anticipated to be relatively small.

D. BUMN Privatization

To better coordinate asset sales on a national level, USAID agreed to provide Barent's technical assistance to the Ministry of State-Owned Enterprises (BUMN). Barents initially provided short-term assistance to help BUMN refine its three-year Strategic Plan. Having helped Holdiko dispose of 70 percent of its assets, the Barents Resident AMI advisor began assisting BUMN in January 2002. Barents reviewed the BUMN Master Plan and worked with appropriate personnel to monitor activities for its compliance. Part of the plan called for the establishment of a standardized process of privatization. BUMN had historically focused on privatizing the high-value companies that required contracting legal and financial services. The BUMN officials, therefore, did not develop in the in-house capacity to handle privatizations.

As a working case study to provide a standard model, Barents worked with an internal team to manage and dispose of nine state-owned enterprises. These companies include engineering consulting firms, a tire manufacturer, boiler production and service firm, property management, and special purpose facility construction contractor. The nine companies are small enough as to not warrant, practically and economically, high end legal advisors or success fee based financial advisors. Barents is working to systematize the privatization process with BUMN counterparts with these nine transactions.

An integral part of the privatization process is due diligence. Barents stressed the need for onsite visits that included facility/plant tours and discussion with management. These visits solicited input from management about how best to facilitate privatization of their respective enterprises. Of the eight SOE's visited, the management and employees of six SOE's were open to further discussion and consideration of ultimately privatizing their enterprise.

Additional Barents BUMN assistance included:

- Barents developed an "Analysis of Publicly Traded State Owned Enterprises" that graphically tracks the Jakarta Stock Exchange market valuation of the state's ownership portion.

- Barents facilitated a presentation by a Forestry Expert to 14 individuals from the technical division as well as the restructuring and privatization division including two Assistant Deputy Ministers. This activity was consistent with USAID's and other donor's concerns about this sector.

- Barents facilitated a meeting between the Secretariat of Ministry of SOE's and the World Bank/MIGA Group. Discussion focused on the benefits to the Ministry of participating in MIGA's website (www.privatizationlink.com) which is a vertical portal, online content provider that can leverage the internet to facilitate the marketing of Indonesia's privatization opportunities.

Public Relations

Barents agreed to provide a short-term Public Relations specialist to help BUMN develop and project an appropriate message about the benefits of privatization. Specially, Barents performed the following key tasks:

- Reviewed existing BUMN communications plan and the ministry’s master plan;
- Interviewed over 20 BUMN staff, economists, reporters/ news media, BUMN consultants;
- Prepared a SWOT analysis indicating strengths, weaknesses, opportunities, and threats;
- Prepared questionnaire to establish national baseline for privatization awareness and attitude;
- Prepared a strategy and initial set of tasks going forward for BUMN; and

Supported PR to the Deposit Insurance initiative at IBRA with SWOT analysis and preparation of questionnaire for opinion research.

Future Areas of BUMN Assistance

Given the foregoing, in the second phase of USAID’s technical assistance to BUMN all of it should be primarily geared toward the continued development of an in-house capacity to do privatization deals. The consequent extension of such development of in-house capacity will be strategic and public relations advisory that promotes privatization.

A close examination of the majority of the Ministry's portfolio reveals the impracticality of retaining outside, commercial advisory. This is because the size and condition of the portfolio precludes such option. In keeping with the requisite need, therefore, of an in house capacity to do deals *USAID can claim sole responsibility for the current site visit/due diligence process that has been adopted by the whole of the Ministry's Privatization Department*. The Privatization Department, in the past, had relied upon their outside, commercial advisors and, as such, had not the requisite skills and experience with this most fundamental of steps necessary to successfully privatize a state owned enterprise.

In addition, *USAID can claim sole responsibility for the utilization, by the whole of the Ministry's Privatization Department, of local appraisal companies to estimate fair market values*. Historically, the Ministry's Privatization Department relied upon outside, commercial advisors for appraisals. While this was convenient it served to preclude any fundamental awareness, on the part of staff, about fair market value. As part of USAID's lobbying efforts leading representatives of the Indonesian Appraisal Association were invited to present their qualifications to Ministry personnel.

USAID achieved the above successes by serving as an example while providing close guidance to a select portfolio of actual transactions. One of the transactions will, hopefully, close this year thereby being another success story as it will be the very first in-house managed deal ever conducted by the Ministry! For the larger, politically sensitive deals this type of in-house skills development improves the Ministry's management and oversight of outside, commercial advisors which, heretofore, has been very limited. As such, Phase Two of USAID's assistance program to BUMN should remain primarily focused on the development of the Ministry's in-house capacity to do privatization deals. The consequent extension of such development of in-house capacity will be strategic and public relations advisory that promotes privatization.

E. Information Technology

Barents assisted IBRA's Information Technology (IT) unit in developing policies and procedures and reviewing their operating IT systems. The following section provides a background of the IT area and summarizes Barents progress in working with IT to achieve its objectives.

Background

Barents Although IBRA's Systems and Support Division is responsible for overseeing the agency's Information Technology (IT), each division within IBRA has its own Administrative Unit (AU) that maintains its own databases and operating systems. Systems and Support Division is to ensure that the entire organization operates from the same set of IT based policies and procedures.

The decentralized nature of IBRA's IT functions and the lack of coordination between Systems and Support Division and the other operating units of IBRA has contributed to data inconsistency and integrity problems making it very difficult for top management to have a clear picture of the activities of IBRA.

IBRA currently uses an Oracle-based accounting system to support the basic accounting operations of the agency, including the General Ledger, sub-ledgers, and preparation of agency financial reports. This system operates primarily in the Finance and Accounting Division, although there are terminals in Core Asset Administration (CAA) and Non-Core Asset Administration (NCA) that are used to impute cash transactions related to loan collections and asset sales. The system is maintained by the agency's System and Support Division (S&S). The other principal system used by IBRA is Bunisys, propriety, and loan administration system supported by the Asset Administration Division of AMC.

Policies and Procedures

Barents performed a review of the existing S&S Division policies and procedures and determined that a complete set of policies should be written and implemented. S&S

management agreed with this recommendation. Barents developed a total of ten policies covering the following areas:

- Electronic Communications;
- Data and Software;
- Security of IT Assets;
- Access to Computer Information and Hardware;
- IBRA Network;
- Data and Information Security;
- General Office Policy;
- Software Development and;
- Disaster Recovery.

Systems Review

Barents assisted S&S with a review and evaluation of the IT systems supporting the financial and accounting applications as follows:

- Reviewed the systems in place within each division of IBRA and evaluated how well these systems support the data flow within and between the agency's divisions;
- Determined where there are system weaknesses that require changes or enhancements to improve the control of financial information reported within the agency and the quality and efficiency of the data flow;
- Reviewed the financial and accounting applications that are part of the Oracle system and evaluate which applications could be installed in the user divisions of IBRA to correct weaknesses and/or improve the integration of the IBRA's accounting and reporting systems;
- Assisted the staff of the S&S Division with the preparation of a plan to implement the appropriate financial and accounting applications based on the relative weaknesses noted and priorities within the agency;
- Conducted a specific evaluation of Oracle's loan administration system and determine the feasibility and cost/benefit of converting the loan administration functions from Bunisys; and;
- Conducted a feasibility study on Bunisys System readiness and the possibility to enhance the integration between Bunisys and Oracle Finance application if necessary.

Barents recommended that retaining Bunisys and modifying it to extract data for the General Ledger was the most cost-effective as well as the quickest option for IBRA. This solution would ensure that the AMC data and timeliness would be consistent with other divisions. SSD then would extract data from the General Ledger and place the data into the Data Warehouse. The Data Warehouse then could be accessed directly by IBRA employees without affecting the official records or production systems of IBRA.

This access would be accomplished with user-friendly software such as Impromptu and Powerplay to provide custom reports and research capability. The Oracle-based General Ledger, Accounts Payable, and Accounts Receivable would continue to run unchanged except for accepting the Bunisys Extract. All other IBRA financial systems, such as General Affairs, Treasury, Asset Management Investments, Asset Management Credit, NCA System, BL System, Procurement System, and Personnel, would feed the General Ledger directly. This integrated design would insure the integrity of the accounting information and facilitate reporting accuracy and timeliness.

F. Finance and Accounting

Barents assisted IBRA's Finance and Accounting (F&A) unit in the following key areas:

- Data Mapping;
- Corrective Action Plan; and
- Appointment of a Chief Financial Officer (CFO)

The following section provides a background and summarizes Barents progress in working in the F&A area to achieve its objectives as well as outline several areas where future USAID-funded assistance would be beneficial.

Background

F&A is responsible for preparing corporate financial reports for IBRA. IBRA utilizes a fund accounting approach where each division manages separate accounting records and does not produce income or balance sheet reports. In producing corporate financial reports and consolidated financial statements, F&A faces challenges in reconciling the sub-ledgers maintained by the various divisions with the general ledger, as evidenced by discrepancies between the reported numbers. Each division collects and processes its data and issues financial reports through a separate Administrative Unit (AU). Each AU then sends updated reports to the following divisions: Risk Management; Agency Planning; F&A; and the division head of the department. Some of these reports are produced regularly, while others are produced on an ad-hoc basis.

There is minimal coordination between AUs, as each division sends their reports to F&A in different formats, containing different data fields. The Agency Planning Division (APD) is tasked with reporting the current financial status of IBRA to various government ministries and international financial institutions. APD staff indicates that they often collect their information directly from the AUs as F&A takes two months to process and check the accuracy of the financial data. The AMI AU is in the process of developing an asset database, but has expressed concerns about the location of many of their division's asset documents. This situation has been significantly evidenced in that the Independent Audit Report for the year ended December 31, 1999 was issued with a Disclaimer of Opinion. The Independent Audit Report for the year ended December 31, 2000 was also issued with a disclaimer.

Data Mapping

Initially, IBRA asked for Barents assistance in making the financial reporting process more efficient and accurate through helping F&A integrate the finance and accounting activities within each of the divisions' Administrative Units. In fulfilling this request, the Finance and Accounting Advisor worked with various organizational elements within IBRA to perform a "data mapping" analysis. The purpose of this analysis was to determine the major causes of the disparate financial and accounting processes of IBRA and provide recommendations to improve them. This effort culminated in the development of a report (please see November 2000 quarterly report) that set forth a number of "Substantive Findings, Observations and/or Opinions" that are deemed to be root causes of the data integrity concerns. A major finding is that the integrity of much of the data is so suspect that production of meaningful management reports is questionable. This report included numerous recommendations for IBRA management to consider in improving the data integrity of the financial reporting process.

Corrective Action Plan

IBRA also requested Barents to assist in the resolution of issues that gave rise to the Independent Audit Report being issued with a Disclaimer of Opinion. Towards the end of last year, Barents worked with F&A in the development and implementation of a "Corrective Action Plan" (CAP) for identifying and instituting actions to resolve the exceptions noted in the 1999 Audit Report. In conjunction with this process, the F&A advisor helped articulate the request for approval from the Ministry of Finance to change the Accounting Policy to use an International Accounting Standards "Fair Value" approach to evaluate IBRA assets for Financial Report Presentation, rather than the current "Historical Value" methodology. The "Fair Value" concept was included in the 2000 year end financial statements and agreed by the new Chairman of IBRA. This was a major accomplishment for this USAID funded project because for the first time the magnitude of the difference between the book value of the assets recorded in IBRA's books and a fair value based upon IAS was clearly stated.

Appointment of a Chief Financial Officer (CFO)

To better manage the financial information flow, Barents proposed the creation of the office of a Chief Financial Officer at IBRA and, following approval from the Chairman, worked to design and implement the new position. Barents assisted the Chairman in the following areas:

- Defining the role of a CFO;
- Detailing the functions that would form part of the CFO's functional responsibilities;
- Preparing a job description;
- Preparing a revised organizational chart; and
- Preparing a candidate evaluation form.

Barents assisted IBRA set up the function and provide continuing transitional support. As part of this process, Barents designed a Weekly Chairman's Report thus providing a condensed, consolidated summary of the asset balances at the end of the week and the financial activities during the week. The purpose is to help top management see the assets managed by IBRA and the internal operations by giving them a weekly 'snapshot' report. In addition a Weekly Report of Projected Cash Receipts from Collections and Asset Disposal was been designed. Both reports are to insure timeliness and accuracy of the consolidated reporting process in an effort to overcome the current data integrity deficiencies and need refining.

Future Areas of Assistance

This is a significant area of IBRA operations and as with Systems and support will be almost the last function to operate within the Agency. Additionally given that the GOI is to develop a deposit insurance scheme there is a fund of skills and experience that resides in this functional area that could be 'tapped' to be utilized with the 'IDIC'. At the time of drafting of this report it has not been determined how or in what manner the Director of Finance would utilize further assistance. At this juncture there are two probable scenarios. Firstly, advising on a phased close-down strategy and implementation plan bearing in mind that the Agency will be active in disposing of assets during the period up to and including September 2003. And second, working with both the finance function and the IDIC implementation team to 'carve out' those functions that could and should form the building blocks of the new organization.

G. Agency Planning

Barents assisted IBRA's Agency Planning Division (APD) unit in developing its Annual Strategic Plan. The following section provides a background and summarizes Barents progress in working with APD area to achieve its objectives.

Background

APD is responsible for monitoring the progress of each division and producing performance reports to IBRA executive management. APD summarizes the financial information collected from each division and publishes regular monthly reports. APD is charged with producing an updated Strategic Plan as well as developing Authorization Approval Guidelines (Guidelines). APD officials expressed their frustration over the lack of an efficient reporting process that allows them to respond quickly to various government officials and international financial institutions.

Strategic Plan

In mid-2000, APD identified updating the Strategic Plan as a main priorities and asked Barents to participate. After beginning the planning process, GOI decided to hire McKinsey and Company to perform the study. In January 2001, McKinsey and Company ceased to be employed by IBRA for this work and IBRA turned once again to Barents. During early 2001, Barents provided short-term assistance and completed the following tasks:

- Provided advice on the current status of the strategic planning process following the dismissal of McKinsey;

- Advised on the time-scale, next steps, and issues that need to be resolved to enable the process to be finalized;
- Reported on an efficient and effective methodology to complete a Strategic Plan for the period 2001 –2003;
- Researched and drafted the Comparative Studies section of the Strategic Plan; and
- Put together a project team, composed of IBRA officials and KPMG/Barents consultants, to complete the Strategic Plan.

Barents worked with Agency Planning functional teams to produce individual contributions to the overall plan on an iterative basis. At the end of April, a plan was produced that is a IBRA designed and written product. Barents agreed and assisted IBRA in June with a further review and assistance with the final editing prior to publication on the web-site. To date the final version of the plan has not been signed off by the new Chairman and is not therefore available for publication.

H. Public/ Investor Relations

Barents assisted IBRA's Public/ Investor Relations (IR) unit in developing a Public Relations strategy for IBRA. The following section provides a background and summarizes Barents progress in working with IR area to achieve its objectives.

Background

IBRA has established both an Investors Relations (IR) Division and a Communications Division to educate both investors and the public about the agency and its assets for sale. These two units were to be combined under the management of the Head of Investor Relations. IR currently works with IBRA's Asset Disposal team to fulfill the following tasks:

- Provide input on investor demand;
- Communicate proposed timeline to interested investors;
- Create investor interests;
- Interact with relevant investor groups;
- Target key investors;
- Provide updates on specific markets;
- Publicize transaction details; and
- Facilitate investor contract.

The Communications Division is responsible for monitoring IBRA's evolving image in the media and among key political constituents. The function is required to initiate rapid responses in the form of news releases, public statements, and spokesperson interviews and to manage the use of professional service providers such as Advertising Agents and Public Relations firms.

Public Relations Strategy

Barents provided a short-term senior advisor to the Vice Chairman, the Communications Division, and IR develop a cohesive and aggressive marketing message to investors and the public on an urgent basis. The advisor helped IBRA target the following audiences:

- Members of Parliament;
- News Media;
- Business Community;
- General Public;
- Domestic and Foreign Investors; and
- Debtors and Creditors.

Barents assisted IBRA develop the initial work for a clear message that proactively presents IBRA, its accomplishments, and its challenges. The message focused on the importance of IBRA's mandate to the economic recovery of the country. The advisor also reviewed the preparation of news releases and public statements and how spokesperson interviews could be developed. Finally, the advisor assessed the need for on-the-job training to the Communications and IR staff.

Barents continued its IR assistance with further short-term assistance to review the communications strategy in relation to the forthcoming publication of the 2000 year end financial results and the 2001 – 2004 Revised Strategic Plan and develop an overall public and investor relations program. Specific areas of assistance included:

- Introduced the concept of a press kit to improve relations with the press;
- Reviewed and suggested improvements to the management of the web-site;
- Drafted specimen press releases for both the publication of the 2000 y/e Audit Report and Strategic Plan;
- Conducted a seminar on Speech Writing;
- Edited and rewrote portions of the Chairman's introduction for the Annual Report;
- Reviewed and rewrote a form letter in respect of completed asset sales; and
- Reviewed and edited a speech to be made by the former Chairman at a conference in China together with the related slides.

The key recommendation was for the appointment of a Corporate Communications Director to vest all responsibility for media related activities in one individual. It was envisioned that a further input would take place some two/three months later but the Head of IR/AC resigned at the end of this assignment and has not been replaced.

Work with BUMN

As described above, Barents also assisted BUMN in designing a Public Relations message.

III. Conclusion

IBRA has been placed in the Indonesian political and economic scene as the lightening conductor for many of the ills of its society, by virtue of its mandate, and as a consequence, has and continues to attract the ire of politicians, economists and commentators both local and international when it suits their purposes.

There is no doubt that the USAID project at IBRA represented a unique challenge given the scale and scope of the problem with which the Agency was mandated to tackle within the allotted time-scale, namely 1998 – February 2004. In the introductory remarks the depth and breadth of the crisis that had hit Indonesia was specified as was the GOI response. The financial stabilization package circa Rp 650 Trillion has placed severe strains on the Indonesian economy and although the Agency was given unique powers under PP 17 it has chosen not to use these. Instead it has preferred to work through the court system to deal with recalcitrant debtors and major obligors. This has proven costly both in terms of reputation and recovery. In the latter case it is generally accepted that distressed assets diminish in value over time and in the IBRA case this problem has been exacerbated by the poor quality of the documentation relating to the vast array of NPL's. The legal system in Indonesia is also generally regarded as highly suspect and corrupt and it would fair to assume that the reluctance to use the more direct and possibly draconian PP17 process was 'uncomfortable' for a consensus minded nation.

As the sole Agency charged to deal with the effects of the 1997/8 financial crisis four 'management' issues must be considered in any attempt to evaluate performance and these are:

1.<u>Political interference and frequent management changes</u>.

During the lifetime of this project there have been, for example, four Chairmen of the Agency and in total, seven to date. Each of the changes could be construed as having a political undertone. The net effect has been to give the agency a more problematic performance profile while each Chairman has gone through some kind of learning curve. What has also had a detrimental effect have been the changes that have been effected as a direct result of change of Chairman – see appendix 7. This managerial change process has also been driven down the organization structure to middle management levels.

A derivative of the above process occurred following appointment of the current Chairman's predecessor because the US Embassy believed that it was inappropriate for the project to be closely aligned with him or his business methods. During the ensuing ten months the management of the project at IBRA was difficult because no short-term assistance was available to the agency and it became necessary to develop other avenues for the provision of assistance. At the same time the responsibility for IBRA was transferred to BUMN. There was therefore a 'natural bridge' for the project to work with BUMN providing advice and guidance to the Minister. This developed to the extent that the focus of the projected shifted toward BUMN by virtue of the transfer of the resident long-term advisor in AMI to BUMN on a full time basis in January 2002 to provide technical assistance. At the same time the COP and long-term advisor to BRU was also mandated to allocate time to BUMN. When the current Chairman was appointed in late April 2002, there was an immediate change of perception by the US Embassy and as a consequence focus by the USAID toward IBRA. There has been an increasing sense of urgency since the appointment given that he has clearly stated that the agency will close prior to February 2004. The current emphasis and drive achieve this by end of the third quarter 2003.

2.<u>Organizational Design</u>.

The agency was created, as shown in Section – see pages 6 and 7 – essentially to takeover, restructure and liquidate assets such banks and NPL's. In essence this was following the Securam methodology and so the whole ethos of IBRA, and indeed the expectation of the wider Indonesian public was that the agency's role was to restructure, hold and sell by 'timing the market'. The organizational design was consistent with this philosophy despite the fact that the vast array of assets under the agency's management could never be restructured managed and sold within the lifetime of the agency. Furthermore the management and staff, at all levels had neither the skills nor experience to undertake the task. In is not surprising that with rapidly changing Chairmen, regular political interference, criticism of performance that in a reasonably short period of time the organization develop a defensive stance and each functional area began to operate almost as a separate entity. For example AMC had its own legal function, accounting and planning function and produced its own data which on many occasions differed from that produced by the Agency's Finance & Accounting function. Hence the project viewed the organization as having a 'silo structure and mentality' that was operationally dysfunctional.

3.<u>Vast array of assets and investments transferred to the agency</u>.

As was noted in the point 2 above the Agency was the repository of a vast array of assets and investments ranging from banks and NPL's to industrial companies all of which demanded managing, restructuring and selling. The skill sets do not and did not at the outset exist for well known and understood historical reasons within the Indonesian Banking and Finance sector. The immediate solution was to employ consultants and Investment Bankers to provide assistance. This was to prove costly to the agency in terms of loss of reputation because of the costs involved and because these types of firms are transaction oriented and thus do not 'invest' by imparting knowledge. These 'advisors' became over time a natural and necessary adjunct to the daily performance of the work of the agency.

It is generally recognized that government institutions are not good managers of assets and that the 'market place' is better able to undertake the task. This was a key philosophical change that needed to occur if IBRA was to succeed i.e. to delineate those assets/investments that could or should be directly restructured, managed and sold by the agency with the remainder to be sold or at the very least outsourced to the private sector. It has proven difficult to move the agency's thinking in this direction.

4.<u>Skills and experience of the staff involved</u>.

As was noted above the staff at all levels had neither the skills nor experience to manage the task allotted to the agency albeit that they could and would acquire some of these over time. By the same token it has also been apparent that the fundamental idea that the staff would in time work themselves out of a job was not deeply held. The previous Chairman (Pak Putu) began the process of changing the mindset that the agency would sell assets, staff numbers would reduce and the agency would close as scheduled. The current Chairman has been even more ambitious in his approach and the staff are now clearly aware that there will be a regular release program leading to an early closure of the agency.

The staff, from a middle management upwards face the daunting task of dealing with the complexities of packaging and selling a vast array of assets while at the same needing to garner support from a xenophobic DPR, who themselves are financially undereducated. Given the size and complexity of the task it was and is necessary to employ the sale of assets using a variety of techniques most of which are new to Indonesia and for which the legal framework is ill equipped to handle e.g. Joint Ventures, CDO's. The inexperience of the staff reveals itself when faced with aggressive Investment Banking institutions that 'sell' concepts such as CDO's to the agency as a method of raising cash. Our experience has been that once sold the idea the agency personnel will want to undertake that type transaction either because it is 'sophisticated' or because they do will not push the IB's to offer an alternative and do not want to be seen to lose face. The project eventually succeeded in pushing forward the simpler option, that of merely selling NPL's on an unrestructured basis.

A. Pivotal Events

There were four events that can be construed as pivotal within the life of the project given the long-term implications that arose from these events/work and they are;

- Development of the CFO concept.

In August 2000 Barents met with the then Vice-Chairman and as a consequence of that conversation a preliminary briefing note was prepared which in effect outlined what had been discussed which were the features and benefits of having a CFO operating at Board level. Hitherto the Agency had no such person who was in control of and responsible for communicating financial performance.

Having agreed with the Barents view it took a further twelve months to work through the issues and arrive at point whereby it was agreed to recruit a CFO. At that point the then Chairman was removed. However, the significance of this development is firstly, the obvious fact that such a person, appointed at Board Level would have the power to control, have responsibility for and communicate the financial results to a variety of audiences to ensure consistency and accuracy. However, the second reason was in the organizational changes that would be needed in structure, approach and attitude. In summary it would be necessary to dismantle the 'silo approach and mentality'. The subtlety of the necessity for change was not fully appreciated at the outset. Nonetheless the project worked through the required changes, in AMC for example, to achieve the goal. Concurrently the project was also working to bring about a further change in relation to the need to sell assets either restructured or unrestructured.

- Advice on Asset Management techniques.

During the life of the project Barents has had and throughout maintained an excellent working relationships with all of the top management team and this is exemplified in particular through the relationship with Pak Ade Sumantri formerly Deputy Chairman – Systems and Support and now Vice-Chairman. In August 2000 at his request we undertook to advise him and ultimately Pak Cacuk, the then Chairman on Asset Management techniques that could be available to the Agency. A short-term expert was specifically assigned to this task which, as will be appreciated, was outside the AMC division to advise the Agency see indexed list of documents- AMC Hambric). This was a reflection of the already perceived difficulties in working in and with different divisions. When Pak Ade Sumantri was promoted to Vice-Chairman the advisory continued but now more clearly with access to then Chairman – Pak Edwin Gerungan. The culmination was a presentation to Pak Edwin and Pak Ade at the end of May 2001 at which the Chairman openly declared his support for the sale of loan portfolios and unrestructured loans. This was a policy with which the then Deputy Chairman – AMC sought not to implement. Interestingly the presentation to Pak Edwin was to form the backbone of his successor, Pak Putu.

- Work in F & A on Market Value.

The impact of the project work in the F & A area covered a number of issues but one in particular was of import given the significance in terms of improving the understanding of the diminishing value of the assets under IBRA's management. When the first asset sales were concluded the average recovery rate was marginally over 70% and this became a formal benchmark by which IBRA was to be judged. This was a grossly over optimistic view of what could and would be achieved across a whole range of assets when considering, for example that the NPL's transferred to IBRA were mostly categorized as 4 or 5. When the year-end 2000 accounts were in the course of preparation the project advised that under IAS rule the assets managed by IBRA should be more accurately described and shown in the notes to the accounts on a Market Value basis. This required IBRA to work with the MoF in addition to IBRA to persuade both the Ministry and the Agency that this was a fundamental principal that would improve the understanding of the Agency's work. This change was achieved and the accounts for the year ended 2000 revealed an asset valuation of circa 27%. The principal was subsequently repeated in the 2001 Financial Report.

The Market Value principal was explained privately to the then Chairman of Commission IX the DPR Committee that acts as the parliamentary function for the Agency. More fundamentally however, is the fact that subsequent asset sales were at reduced average prices and without adverse criticism.

- Deposit Insurance – Seminar in August 2002.

The project has always believed that the current blanket guarantee on <u>all</u> deposits was detrimental and should eventually be replaced with a formal deposit insurance system. Since the inception of the project this proposition has been nurtured within IBRA and specifically BRU, the division that managed the guarantee system. The formal responsibility for the development of a guarantee system resides with the MoF and with the BI as a further interested party. In 2001 BRU formed a working group to take the development of this idea forward and the project provided advice through out 2000 and 2001 on a mostly informal/ad hoc basis. Following the arrival of the new Chairman the development process attained a new status in as much as he decided that he Agency would use its skill base – from the blanket guarantee system – to drive the formation. The project has worked with the Agency and over the life of the project on this issue but in late 2001 developed a relationship with the MoF on this issue and then in 2002 with BI. Naturally each organization has its own but different agenda and in August 2002 the project organized a seminar. In addition to the three organizations noted earlier, the IMF, WB and ADB attended alongside academics etc. This was the fist time that all interested parties sat and openly debated the issues presented by the project experts.

This subsequently turned to a groundbreaking event because all, including the IFI's are now collaborating toward the development of the deposit insurance system.

B. Lessons Learned

1.Original Task Order was well-conceived and allowed flexibility.

2.The later extension in narrowing the areas of project work is beneficial in allowing the beneficiaries to understand the limitations of USAID assistance

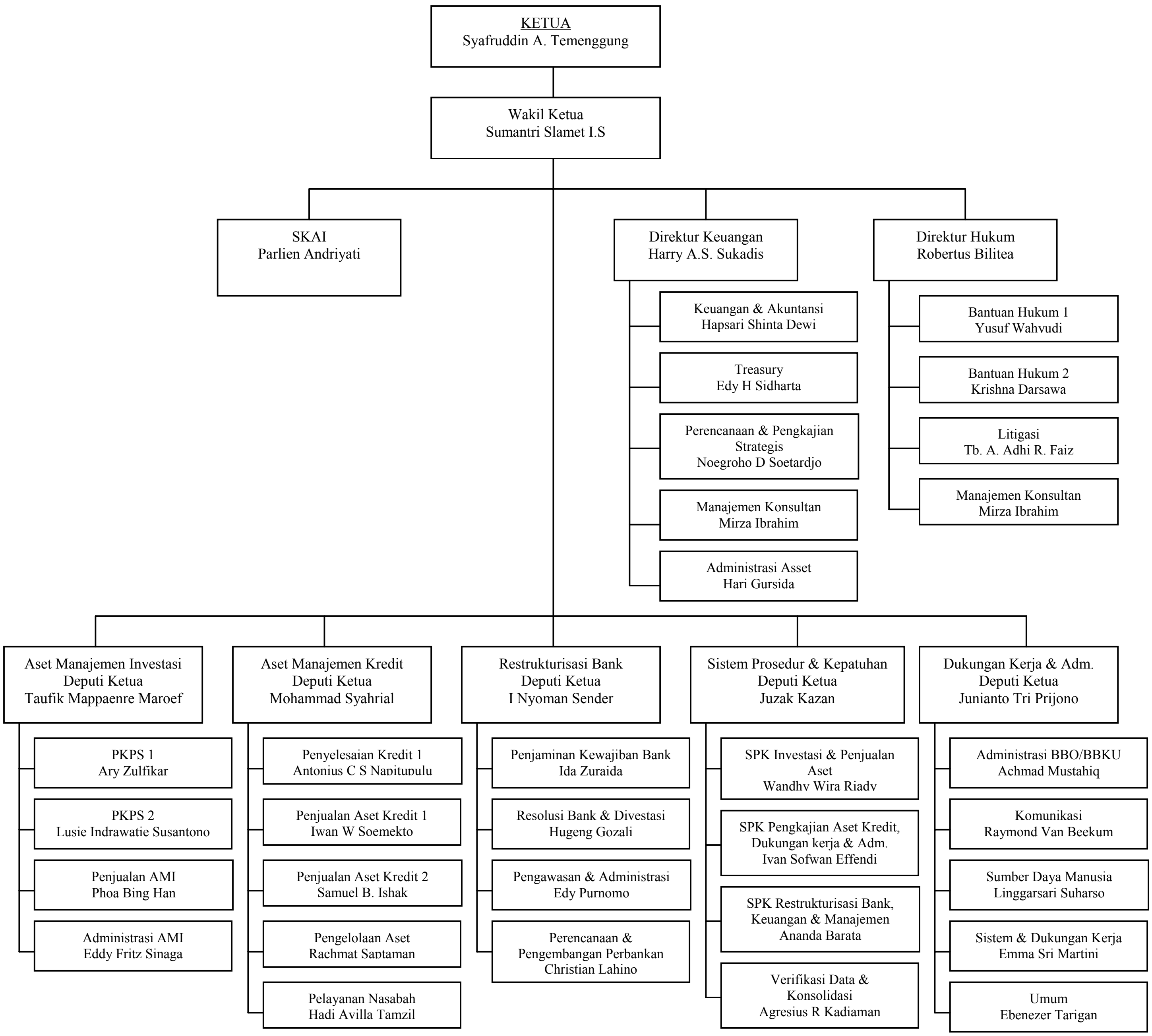
3.Organizational design crucial and seemingly not taken into account by a variety of audiences.

4.Hiatus when Pak Putu was Chairman was detrimental and despite misgivings we could have increased our work on non-controversial issues such as F & A and IDIC.

5.Long-term team should have been bigger to reflect the importance of the Agency to the economy.

Appendix A

IBRA ORGANIZATION CHART



Appendix B
IBRA Banks

BANK	Privatized	Listed in JSX	GOI/IBRA Ownership	
BCA	Yes	Yes	6.66%	
Danamon	No	Yes	99.35%	
BII	No	Yes	93.69%	
Niaga	No	Yes	97.15%	
Lippo	No	Yes	59.25%	
Universal	No	Yes	78.65%	
Bali	No	Yes	98.23%	
Bukopin	Yes	No	16.42%	owned by MOF
Media	No	No	76.91%	
Prima Express	No	No	88.64%	
Patriot	No	No	80.99%	
Mandiri	No	No	100.00%	
BNI	No	Yes	99.12%	
BRI	No	No	100.00%	
BTN	No	No	100.00%	