



Australian Government

PUBLIC FINANCIAL MANAGEMENT CHALLENGES:

Lessons Learned from the Budget
Constraint Analysis
in 15 Districts



KOMPAK

*Kolaborasi Masyarakat dan Pelayanan untuk Kesejahteraan
Kemitraan Pemerintah Australia - Indonesia*

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LIST OF TERMS

| | |
|-----------------|--|
| ADD | Village Fund Allocation |
| AIPD | Australia-Indonesia Partnership for Decentralisation |
| APBD | Local Budget |
| BCA | Budget Constraint Analysis |
| BLUD | Local Public Service Agency |
| BOS | School Operational Assistance |
| BPJS | Social Security Administrative Body |
| CaLK | Notes to the Financial Statement |
| DAK | Special Allocation Fund |
| DAU | General Allocation Fund |
| DJPK | Directorate General of Fiscal Balance |
| DPA | Budget Implementation Documents |
| EKPPD | Performance Evaluation on Local Governance |
| IDR | Indonesian Rupiah |
| JKN | Health Insurance Program |
| LAKIP | Government Institution's Performance Accountability Report |
| LKPJ | Local Government Accountability Report |
| LLPADYS | Other Legal Own-Source Revenues |
| LO | Operational Report |
| LPPD | Local Government Performance Report |
| LRA | Budget Realisation Report |
| MoF | Ministry of Finance |
| OPD/SKPD | Local Apparatus Organisation/Subnational Government Unit |
| PAD | Local Own-Source Revenues |
| PDRB | Regional Gross Domestic Product |
| PEACH | Public Expenditure Analysis and Capacity Harmonization [program] |
| PER | Public Expenditure Review |
| PERA | Public Expenditure and Revenue Analysis |
| SAKIP | Government Institution's Performance Accountability System |
| SAL | Report on Changes in Accumulated Budget Surplus |
| SEPAKAT | E-poverty Analysis and Planning Tool |
| SIKD | Local Financial Information System |
| SILPA | Budget Financing Surplus |
| TAPD | Subnational Government Budget Team |

EXECUTIVE SUMMARY

KOMPAK conducted Budget Constraint Analysis (BCA) research to identify planning and budgeting challenges at the district level. BCA explores and analyses constraints that affect the financial management of district governments, including planning, budgeting, and financial reporting. This analysis was carried out on 15 district governments from five KOMPAK partner provinces: Aceh, Central Java, East Java, West Nusa Tenggara (NTB), and South Sulawesi.

BCA methodology is an adaptation of Public Expenditure Review (PER) and lessons learned from other budget analysis programs. The World Bank conducts PER at different levels of government in Indonesia on an annual basis. BCA adapts PER to carry out specific analyses at the subnational government level, particularly at the district level. In addition, BCA also builds on lessons learned from the implementation of budget analysis programs supported by the Department of Foreign Affairs and Trade (DFAT), including PEACH (Public Expenditure Analysis and Capacity Harmonization) and PERA (Public Expenditure and Revenue Analysis). The methodology of these programs has been adapted and simplified, so that it can be carried out independently by subnational governments in the future. In general, there are three areas of scope for the analysis carried out in this study, including Budget and Financial Performance Analysis, Analysis of Sectoral Budget Performance and its Achievements (Outcomes), and Analysis of the Stakeholder's Institutional Partnerships.

This analysis used data obtained from national and subnational governments over the period of five fiscal years from 2014–2018. Data on financial planning and management, as well as other macroeconomic data, were used for the analysis. The data were obtained from the Local Financial Information System (SIKD) database from the Directorate General of Fiscal Balance of the Ministry of Finance (DJPK, MoF). The data were also compared with data obtained from the district government where the analysis was conducted.

The main challenges for this analysis were data inconsistency and limited data coverage. Researchers encountered plenty of inconsistencies and limitations in data provision, which resulted in the low data reliability generated from different sources. Hence, the analysis was adapted to take into account these limitations of data availability and inconsistent data reliability. This analysis focuses on the district budget (APBD) and its relationship with services provided by the district government, and not on services provided by central and provincial government.

This analysis was carried out in KOMPAK's partner districts, which have different budget and socio-economic characteristics. Initial analysis conducted in these districts generally identified that public service delivery is still hindered by various aspects of subnational public financial management, including the rules and regulations that require improvement from time to time and/or government staff rotation. Specifically, this analysis found several challenges and obstacles faced by subnational governments, as follows:

1. General challenges identified for local financial management showed that the quality of financial and performance reports remained varied among regions, due to the following factors:

- a. Financial reports, accounting processes, and expenditure allocation policies require significant improvement, considering the notable differences between financial statements before and after the audit; the absence of a direct linkage between capital expenditure and fixed assets; and the increasing number of short-term liabilities. These may also be related to human resources limitations in applying the accrual-based accounting system.
- b. The audit report and assessment of local government performance reports by authorised ministries were occasionally different and inconsistent. A good result from a financial report audit did not necessarily reflect a good achievement in terms of performance accountability and governance performance, and vice versa.
- c. The allocation of expenses and maintenance expenditures for fixed assets fluctuated and tended to decline, based on the calculation of the ratio of maintenance expenditures compared with the number of fixed assets in each district. On average, the ratio in each district had a sharp decline and was not proportional to the increasing number of fixed assets. Fixed asset management should be improved to maintain the optimal performance of fixed assets.

2. Revenue challenges signified that the subnational governments had difficulties optimising Local Own-Source Revenues (PAD) spending due to the following factors:

- a. High dependency on transfer funds from the central government. Between the province, districts, and cities, district government was the level with a remarkably high dependence on transfer funds and had the lowest levels of PAD.
- b. The contribution of local taxes and levies was considered low and tended to decrease against the Regional Gross Domestic Product (PDRB). The rate of PAD growth sometimes failed to move in line with Local Budget (APBD) growth and local economic growth through the value of PDRB. In other words, there was PAD potential that might not be identified properly, and which, therefore, was not reflected in the collection of local taxes or levies.
- c. Capitation Funds from the Health Insurance Program (JKN) and the Social Security Administrative Body (BPJS) were recorded under PAD, which affected the level of local financial independence. The funds were reported under the Other Legal Own-Source Revenue (LLPADYS) component. This could be misleading because those two components were not suitable to be categorised as PAD, since they came from the central government and were not closely related to the performance of subnational governments in collecting the revenues.

3. The challenges for budget spending indicated that budget absorption and the quality of spending were still not optimal. In addition to the challenge of being able to mobilise revenue from local tax sources, local levies, and dividends from government owned businesses/companies, regions also faced challenges of using existing fiscal resources. These challenges can be seen through the following findings:

- a. Subnational governments tended to have budget surplus policies that led to a Budget Financing Surplus (SILPA). Some of these were because: (i) revenue realisation exceeded the revenue target, which occasionally occurred when the revenue objective was easy to achieve; (ii) there was improved efficiency in spending; (iii) the spending was not realised due to poor implementation; and (iv) there was a plan to use SILPA for special purposes, such as to cover delayed activities, or to fund multi-year activities that caused several activities to be transferred to the next fiscal year.
- b. Subnational government spending was still focused on indirect expenditure, particularly for personnel expenditure. This resulted in limited flexibility for capital expenditure and for creating new and innovative program/activity expenditure.

- c. Mandatory spending added complexity to the spending composition. Not all subnational governments were competent to fulfil mandatory spending, due to varied comprehension by these subnational governments. For some subnational governments, mandatory spending resulted in limited budget flexibility.

4. The challenges in the sectoral area indicated that sectoral expenditure faced various obstacles, both in terms of quantity and quality of budgets, as well as their relation to the sector performance.

The following findings confirm these challenges:

- a. Although its sectoral budget increased in amount, the spending on education declined in ratio. On average, fiscal resources increased in all subnational governments of KOMPAK partners. However, in ratio, the spending on the education function decreased in almost all districts, even though they met the mandatory spending regulations. This was different from the ratio of the health function budget, which tended to increase.
- b. An increase in the budget had not yet been accompanied by an increase in sectoral performance. On average, the spending on the nine-year compulsory education program had increased significantly in the last five years. However, the increase in the spending on the nine-year compulsory education program was not followed by a performance improvement at the middle school level. In fact, some of the performance results had decreased in quality.
- c. Variations in the level of program spending complicated the monitoring and evaluation processes. In some Local Apparatus Organisations (OPDs), such as the Population and Civil Registration Office (*Dinas Dukcapil*), program continuity from year to year tended to be low. These factors made it difficult for the monitoring and evaluation process to assess the extent to which programs and activities were performing well.

5. Institutional challenges were particularly evident in the findings in which non-financial and non-technical factors were shown to influence the performance of subnational governments.

The dynamics of institutional relationships (e.g. differences in political interests) between the executive and legislative parts of government, and the community in general, affected the quality of coordination between institutions in subnational governments, and the improvement of local financial management in terms of planning, implementation, and accountability.

6. Challenges that have been identified by the District BCA are partly beyond KOMPAK's mandate.

These challenges have been identified by the analysis and discussion with the local government counterparts, and have proven to be problematic. However, due to the scope limitation, further research is required to identify the source of these problems and how to overcome them.

This analysis provides several recommendations for the relevant national and subnational governments.

The improvements recommended for subnational governments include the need to:

1. Improve financial management and financial databases.
2. Prepare methods or assistance to produce output indicators that are more specific, measurable, attainable, reliable, and time (and cost) bound, and continuously improved (SMART-C).
3. Adjust reporting forms prepared by subnational governments on the realisation of budget execution by OPDs, by linking budget with performance so that the effectiveness and efficiency can be monitored and appropriately evaluated.

There are also improvements that could be enacted by the national government, including:

- Synergising various financial reporting systems and local performance to avoid data inconsistencies.
- Encouraging Local fiscal independence through a more consistent fiscal decentralisation policy.

The following Table 1 summarises challenges identified from the research.

TABLE 1. BCA EVALUATION

| CHALLENGES | DETAILS |
|--|---|
| General Local Financial Management Challenges. | <ol style="list-style-type: none"> 1. Financial statements, accounting processes, and expenditure allocation policies require improvement. 2. The audit report and assessment of a local government's performance report by authorised ministries were occasionally different and might not be consistent. 3. The allocation of expenses and maintenance expenditures for fixed assets tends to decline. |
| Revenue Challenges: The subnational governments have not yet optimised their revenue streams. | <ol style="list-style-type: none"> 4. There is high dependence on transfer funds from the central government. 5. The contribution of local taxes and levies is still relatively low and tends to decrease in terms of Regional Gross Domestic Product (PDRB). 6. Capitation Funds of JKN and BPJS are recorded under PAD, so they affect the level of local financial independence. |
| Expenditure Challenges: Budget absorption and quality of expenditure are still not optimal. | <ol style="list-style-type: none"> 7. Subnational governments tend to have budget surplus policies that lead to SILPA. 8. Subnational government expenditure is still focused on indirect spending, particularly for personnel expenditure. 9. Mandatory spending adds complexity to the spending composition. |
| Sectoral Challenges: Sectoral expenditure faces a variety of challenges. | <ol style="list-style-type: none"> 10. Although the sectoral budgets have increased, education spending has declined in ratio. 11. Budget increases for strategic functions have not been accompanied by performance improvements. 12. Variations in the level of program spending complicate the monitoring and evaluation processes. |
| Institutional Challenges: Subnational government performance is influenced by non-financial and non-technical factors. | <ol style="list-style-type: none"> 13. The dynamics of institutional relationships between the executive and legislative parts of government, and the general community, affect the quality of coordination between institutions in subnational governments, and the improvement of local financial management in terms of planning, implementation, and accountability. |

INTRODUCTION

1.1 BACKGROUND

The era of decentralisation places district/municipal governments at the forefront of providing basic services such as population administration and civil registration, as well as access to the education and health services. Law No. 23 of 2014 on Local Government distributes mandatory requirements to central, provincial, and district authorities. The planning and management of Local Budgets (APBDs) reflect the fulfilment of basic services in accordance with these authorities. The analysis of APBD by KOMPAK and the Directorate General of Fiscal Balance, Ministry of Finance (DJPK, MoF) revealed varying capacities on APBD management by different governments, making it difficult to demonstrate the quality of basic service fulfilment by district/municipal governments.

Several policy changes have occurred since Local autonomy was implemented in 1999, including some that are significant to subnational public financial management (PFM). These policy changes include changes in the functional divisions between government levels, the budgeting structure (i.e. revenue, expenditure, and financing), program and activity arrangements, regulations of revenue types that can be collected by regions (PAD), regulations of Minimum Service Standards (SPM), performance measurement and reporting, accounting and reporting, as well as policies on transfer funds formula and management from the central government. These changes collectively provide a major impact on the measurement and sustainability of subnational government performance between fiscal years.

The financial and performance reports of subnational governments at the end of each fiscal year present their accountability and performance in using public funds. These reports describe the accountability of subnational governments in carrying out the mandate of the higher government level and the community for the development, implementation, and use of budgets in their regions.

Subnational financial statements are regulated in Government Regulation No. 71 of 2010 on Government Accounting Standards, followed by enactment of the Minister of Home Affairs Regulation No. 64 of 2013. Subnational governments prepare financial statements, consisting of a: Balance Sheet; Budget Realisation Report (LRA); Operational Report (LO); Cash Flow Statement (LAK); Report on Changes in Accumulated Budget Surplus (SAL); Report on Changes in Equity; and Note to the Financial Statements (CaLK). The LRA is required to fulfil the government's obligation to be accountable for budget execution, as mandated in the laws and regulations. The applicable accounting basis for the LRA refers to that used in budget preparation and execution, which generally uses a cash accounting basis, while the Balance Sheet and Operational Report have applied an accrual accounting basis since the 2015 financial reports.

In addition to mandatory submission of annual financial statements, local governments are also required to submit annual performance reports on governance implementation (LAKIP and LPPD). The Government Institution Performance Accountability Report (LAKIP) is the final report of the Government Institution Performance Accountability System (SAKIP), which describes the performance achievement of a government institution in implementing programs and activities funded by the APBN/APBD in a fiscal year. For LAKIP preparation, a government institution will need to determine performance measures quantitatively, in units or percentages. LAKIPs can then be used as material for evaluating the relevant government institution for the particular fiscal year. Meanwhile, the Local Government Performance Report (LPPD) contains information on the implementation performance of local government programs/activities in all Local Apparatus Organisations (OPDs). The head of a district/city provides LPPDs to the central government, no later than three months after the end of the fiscal year. Based on LPPD information submitted by local governments, the Ministry of Home Affairs prepares the evaluation of LPPD, which is the Performance Evaluation on Local Governance (EKPPD). This refers to Government Regulation No. 6 of 2008 on Guidelines for the Evaluation of Local Governance. The regulation has been revised through Government Regulation No. 13 of 2019, but has not yet been implemented in the period on which this research focuses.

Subnational government planning and budgeting has not yet been prepared based on local needs and evaluation of previous fiscal year spending. Analysis of the data contained in various reports is not used as a reference for improving the preparation of planning and budgeting documents. This appears to be caused by a limited ability to analyse and link the analysis results with the actions that need to be taken by subnational governments. In addition, the limited budget flexibility for innovation in planning is constrained by the rigidity of the central government regulations.

KOMPAK focuses on improving basic service governance through four approaches – policies, systems and procedures, public financial management, and social accountability. KOMPAK focuses its support on integrating basic services, especially in the sectors of education, health, mandatory affairs in population administration and civil registration (for legal identity), as well as local economic development, in government programs to be accommodated in the government planning and budgeting process. The analysis of subnational financial management can indicate the capability of subnational governments to finance their services in a sustainable manner. These capabilities include: (1) maintaining existing service levels; (2) overcoming disruption to local economies; and (3) fulfilling the demands of natural growth, decline, and change occurring in the regions.

Obstacles remain that hinder the process of improving basic service governance. Particularly for the financial management approach, various constraints can affect basic service governance in subnational governments, including: (1) inconsistent and different references and directives from the central government or ministries, which confuse subnational governments; and (2) constraints on the capacity of subnational governments in implementing basic service governance, creating inconsistencies in the determination and measurement of input, output, and outcome indicators. The unavailability of segregated data for sex and disability status also leads to a less inclusive budgeting process. This affects the ability of local governments to provide responsive basic services for all, including women, people with disabilities, and other marginalised groups.

Comprehensive analysis of various constraints is crucial. Thus, KOMPAK conducted Budget Constraint Analysis (BCA) to analyse the obstacles that affect the public financial management in KOMPAK's partner districts. BCA is the term used for the public expenditure review in 15 districts in 2019. This study aimed to review and identify challenges in public financial management of subnational governments. This analysis also assessed the readiness of subnational governments in general, particularly their financial condition

and capacity, as well as the performance of government services in the sectors of education, health, and mandatory affairs in population administration and civil registration (for legal identity). KOMPAK and the Directorate of Evaluation and Information Systems (of DJPK, MoF) analysed public financial management, especially in terms of planning, implementation, and reporting, as well as financial achievements in the performance of programs and activities, to analyse the conditions and challenges faced in providing public services, both generally at a district level and at the subnational government unit/local apparatus organisation (SKPD/OPD) level.

The BCA results in the 15 districts were further analysed to obtain an overview of the subnational government challenges in the planning and budgeting processes. This evaluation analysis is part of the BCA review results for the 15 districts to be used for policy dialogue with subnational governments on the challenges and improvements in public financial management. The challenges can be classified into five major types, namely: (a) general challenges in public financial management; (b) revenue challenges; (c) expenditure challenges; (d) sectoral challenges; and (e) institutional challenges.

1.2 OBJECTIVES

In general, the overarching objective of the Budget Constraint Analysis was to encourage evidence and analysis-based planning and budgeting in a simple manner for subnational government, by focusing on the challenges it faces. Each BCA was a collaborative activity with the subnational government counterpart to assist with the overall subnational PFM. It was designed to identify challenges and inform the subnational and central government counterparts of these challenges. To facilitate this process, the KOMPAK team prepared data templates and tutorials to create graphs and charts that could be aligned to the needs of subnational governments in conducting BCA.

In particular, the objectives of the BCA were as follows:

- **To provide simple and quick analysis to identify challenges that a specific subnational government faced in the PFM process, as well as in service delivery.** In conducting BCA, the team worked with the subnational government to analyse overall PFM and identify challenges in the PFM.
- **To provide assistance to subnational government in the PFM process.** BCA has proven to be useful in providing findings and recommendations to subnational governments for various activities; i.e. providing a summary of findings to heads of regions; providing technical inputs for the RPJMD process and documents; and providing inputs during the revision of APBD 2020.
- **To provide assistance and inputs to central government in terms of challenges faced by subnational governments in complying with the fiscal decentralisation rules and regulations.** These inputs would inform central government regarding common challenges across the regions, as well as specific challenges found in particular districts. For example, BCA provided input to DJPK to improve the regulation and implementation of mandatory spending in the regions.
- **To put emphasis on the importance of evidence and analysis-based planning and budgeting, by sharing knowledge on quick and simple analysis that can be done by BCA.** The team and the subnational government collaborated in the data collection process, and analysing and brainstorming on the findings and recommendations. BCA provides guidance on the data needed, the methodology, and the analysis, by providing hands-on training to the subnational counterparts with ready-to-use modules and spreadsheets. In the future, BCA could be adapted by subnational governments and conducted independently and regularly.

Hence, the purpose of this report is to compile and summarise the challenges in subnational PFM in the 15 KOMPAK counterpart districts. It will also compile and summarise the findings across the 15 districts, and consider findings that occur for specific districts. While the report may not be adequate to summarise the challenges for the whole fiscal decentralisation framework, it will provide inputs to specific subnational governments, as well as the fiscal balance office at the Ministry of Finance.

1.3 METHODOLOGY

The analysis covered 15 KOMPAK partner districts as following:

1. Aceh Province: Bener Meriah and Bireun.
2. Central Java Province: Brebes, Pemasang, and Pekalongan.
3. East Java Province: Pacitan, Trenggalek, Lumajang, and Bondowoso.
4. West Nusa Tenggara Province: Lombok Utara, Lombok Timur, Bima, and Sumbawa.
5. South Sulawesi Province: Pangkajene dan Kepulauan (Pangkep), and Bantaeng.

The BCA methodology was prepared based on evaluations of several programs that were previously supported by DFAT, such as the Public Expenditure Analysis and Capacity Harmonization (PEACH)¹, and Public Expenditure and Revenue Analysis (PERA) programs.² PEACH and PERA evaluations considered: (a) the use of information generated from Public Expenditure Review (PER) in planning and budgeting; and (b) the capacity increase of subnational government officials in implementing PER independently. Based on these evaluations, a simpler PER approach was required to make it more understandable and to assist in planning and budgeting in a sustainable manner. Therefore, BCA did not strictly follow the PER approach, but was based on parts of PER that subnational governments considered important in improving the quality of public financial management and the welfare of its citizens.

FIGURE 1. ASPECTS ANALYSED IN BCA PROCESS



¹ Public Expenditure Analysis and Capacity Harmonization (PEACH) has been conducted by the World Bank with support from the Government of Canada and the Australian Government.

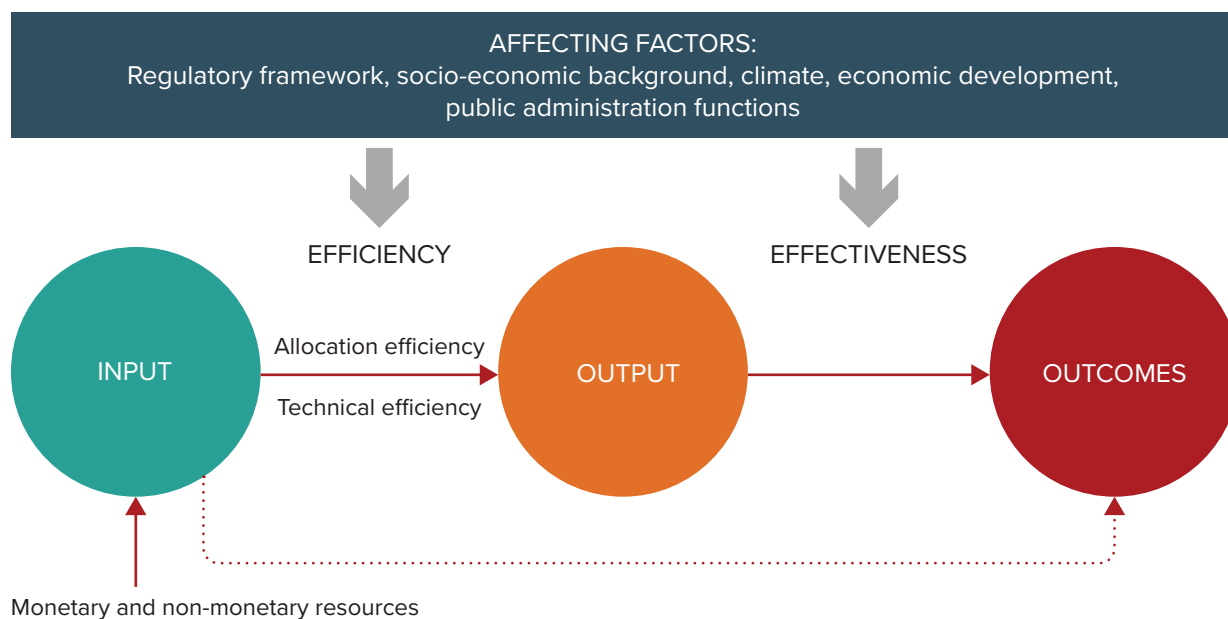
² PERA is implemented by the Australian Government through the Australia-Indonesia Partnership for Decentralisation (AIPD) program, which aims to provide technical assistance and capacity building support to subnational governments and civil society for better management of allocation and financial resources.

This BCA considered three main aspects that affect public financial management, including: (a) budget and financial analysis; (b) sectoral expenditure; and (c) institutional relationships (see Figure 1). Public financial analysis, with reference to the process used for the PEACH and PERA programs, tracked the financial performance of both financial and non-financial indicators, such as the targets and achievements of the Local Mid-Term Development Plan (RPJMD). Sectoral analysis observed the correlation of sectoral expenditure to the related sectoral indicators, by referring to sectoral performance data from either OPDs, the Indonesian Statistics Agency (BPS-Statistics Indonesia), or the E-poverty Analysis and Planning Tool (SEPAKAT).³ The first two analyses were carried out mostly quantitatively, while the institutional analysis was carried out qualitatively as a complement to the other two analyses.⁴ The institutional analysis explored how institutional relationships and interactions influenced the dynamics of local government implementation, in the context of institutional relationships between the main stakeholders in the government.

The team adopted a conceptual framework developed by the European Commission (Mandl et al., 2008), particularly related to sectoral analysis, by linking the correlation between inputs and outputs, as well as between outputs and outcomes, with the following explanation (see Figure 2):

- Inputs include monetary and non-monetary resources, which are usually recorded only in the form of money used to carry out an activity.
- Outputs are a direct result of an activity process, commonly measured based on the number of products generated from an activity. However, some activities still found it difficult to measure these output indicators, due to lack of data and measurement weaknesses.
- Outcomes are a measurement of the output quality from the impacts of a program on society.

FIGURE 2. BCA SECTORAL ANALYSIS



Source: Mandl, U., Dierx, A., dan Ilzkovitz, F. (2008). *The Effectiveness and Efficiency of Public Spending*. Retrieved from <https://ec.europa.eu/economy_finance/publications/pages/publication11902_en.pdf>.

³ SEPAKAT is a poverty analysis tool at the provincial/district/municipal level to generate empirical evidence so that the planning and budgeting for poverty alleviation policy programs is more targeted and efficient. SEPAKAT was developed by the National Development and Planning Agency (Bappenas) with support from the Australian Government through KOMPAK and the World Bank. Details about SEPAKAT can be accessed at <<https://sepakat.bappenas.go.id>>.

⁴ For information, the resources allocation for institutional analysis was not as large as those allocated for financial and sectoral analysis, which definitely affected the depth of the analysis. The institutional analysis was added to complement the context in which fiscal and sectoral policies occur.

1.4 DATA AND DATA SOURCES

The following documents served as the data source for the BCA for a five-year period from 2014–2018:

1. Local government financial data from DJPK, MoF.
2. Planning documents for each district, including Local Mid-Term Development Planning (RPJMD), Local Work Plan (RKPD), and Work Plan – Local Work Unit (Renja SKPD).
3. Documents for APBD/P-APBD and Budget Implementation Documents-Local Work Unit (DPA-SKPD).
4. Program and Activity Reports.
5. Budget Realisation Reports (Laporan Realisasi Anggaran) and attachments.
6. Auditing Result Reports (LHP) of the State Audit Board (BPK).
7. Documents for Government Institution Performance Accountability Reports (LAKIP) and Local Government Performance Reports (LPPD).

1.5 LIMITATIONS OF ANALYSIS

Budget Constraint Analysis in 15 districts was carried out with several limitations, which later affected this evaluation document, including:

- 1. The analysis only captures district government expenditure** obtained from relevant officials at the district level or through the Ministry of Finance Local Financial Information System (SIKD) at the central level. This data certainly does not represent the total resources managed by the district, because several services are provided directly by central and provincial government.
- 2. The data availability and variations in data coverage across service providers affect data reliability.** Therefore, the BCA focuses on the district budget and basic services provided directly by the district government. For specific districts, the data used were APBD and district performance data from the districts' Statistics Agency and other related agencies. It is noteworthy that the availability and detail of the data from each district also vary, so that the analysis could not be carried out for all 15 districts. For example, financial analysis was only available in seven districts in Central and East Java based on availability of Audited District Financial Statements. Meanwhile, the macro-analysis comparing between districts was based on data from SIKD and Statistics Indonesia.
- 3. The unavailability of budget documents with segregated data by sex and disability status.** Inclusive development requires more inclusive supporting data, although this is not yet common practice in Indonesia. The Presidential Instruction No. 9 of 2000 on Gender Mainstreaming in National Development, and Ministry of Home Affairs Regulation (*Permendagri*) No. 67 of 2011 on General Guideline on Implementation of Gender Mainstreaming in Subnational Development, have become the basis for more gender inclusive development processes in Indonesia. These regulations give a mandate to local governments to conduct gender analysis and develop gender budget statements in the planning and budgeting processes. Mainstreaming disability issues into local planning and budgeting processes began in 2015 when Bappenas developed a guideline that district governments must include these issues in submitting their Work and Budget Plan (RKA). Recently, disability mainstreaming has been strengthened through the enactment of Government Regulation No. 70 of 2019 on Planning, Implementation and Evaluation in Acknowledgment, Protection and Fulfillment of the Rights of Persons with Disabilities. However, the planning and budget documents, implementation status, and outcomes are not yet included in the realisation reports, and are not

available in the Local Financial Systems. Hence, this analysis is unable to cover gender and social inclusion aspects in district development planning and budgeting.

- 4. The low validity and reliability of subnational governments in defining and determining the inputs, outputs, and outcomes.** These results cause the inaccurate measurement of indicators, so that the most frequent data found can only link budget data (inputs) with macro-indicators reported as indicators of Local performance (outcomes).
- 5. Resource and time limitations affect the detail and depth of analysis.** The BCA was initially designed to cover four districts; i.e. Bener Meriah, Pematang, Pacitan, and Pangkep Districts. The data obtained from these four districts are more complete due to better resource allocation (human resources and time). As the research progressed, KOMPAK and the research team expanded the analysis further to 15 districts and added qualitative institutional analysis, all to be completed in a limited time. As a result, the data obtained for the other 11 districts are more limited, and the ability to track the complete data directly with related parties in the district was restrained, especially after the COVID-19 pandemic occurred. Eventually, the institutional analysis was only carried out in four districts, which was considered insufficient as an indicative sample.
- 6. The scope of the analysis is limited to areas within KOMPAK's mandate.** The report will identify challenges that are beyond KOMPAK's mandate. These findings would require further analysis to explain the cause and effect of the challenges, and how to overcome them. These findings will be described within boxes in this report.

Chapter 2.

REGIONAL OVERVIEW

An increase in fiscal resources not only opens up opportunities, but also presents challenges. Since the start of decentralisation at the end of the 1990s, subnational governments have received additional financial resources that continue to increase. The use of these resources to provide higher quality public services is both a responsibility and a challenge, especially if it is not supported by the strengthening of subnational government human resources. After 20 years, some effective practices have been identified, although efforts for further improvement are still required.

In general, the 15 districts have different characteristics from one to another, so the challenges faced in terms of subnational public financial management are also different (see Table 2). In 2018, district budgets (APBD) ranged from IDR 906 billion (Lombok Utara) to IDR 2.8 trillion (Brebes). The poverty rate in Bantaeng District is lower than the national poverty rate at 9.23%. In comparison, the poverty rate in Lombok Utara is 28.83%. The variation in economic dimensions is also quite considerable, and some districts only have PDRB of IDR 3 trillion (Bener Meriah, Lombok Utara). However, the PDRB of Brebes District is 10 times greater at IDR 31 trillion.

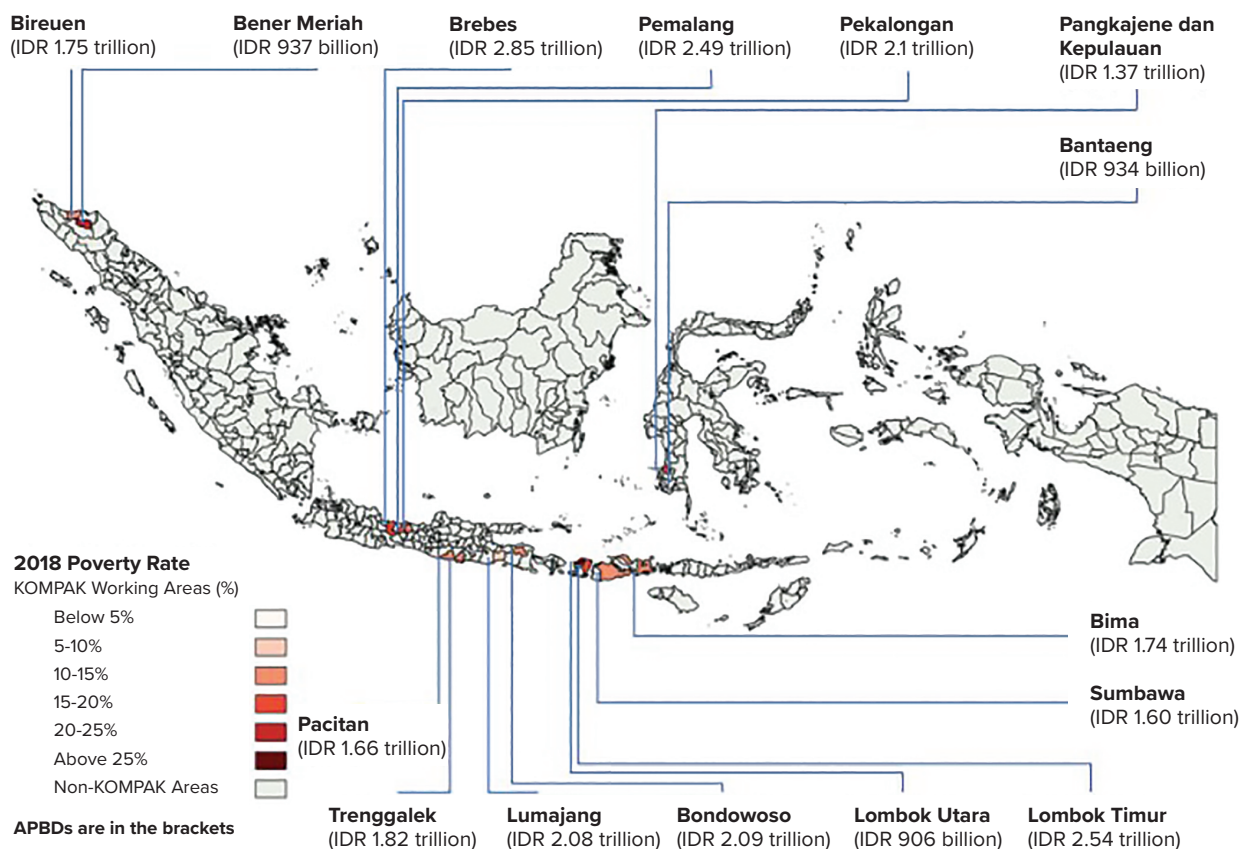
TABLE 2. 2018 LOCAL MACRO-INDICATORS

| DISTRICT | APBD (IN IDR TRILLIONS) | PDRB (IDR TRILLIONS) | POPULATION | POVERTY (%) | PDRB PER CAPITA (IN IDR MILLIONS) |
|--------------|-------------------------|----------------------|-------------|-------------|-----------------------------------|
| National | 1,894.7 | 14,837.4 | 263 million | 9.82 | 56.0 |
| Bener Meriah | 0.938 | 3.5 | 152,267 | 20.13 | 23.1 |
| Bireuen | 1.754 | 9.5 | 453,061 | 14.31 | 20.9 |
| Brebes | 2.854 | 31.0 | 1,850,077 | 17.17 | 16.8 |
| Pemalang | 2.496 | 17.2 | 1,336,333 | 16.04 | 12.9 |
| Pekalongan | 2.101 | 15.4 | 899,463 | 10.06 | 17.1 |
| Pacitan | 1.656 | 10.5 | 559,302 | 14.19 | 18.8 |
| Trenggalek | 1.824 | 12.2 | 702,479 | 12.02 | 17.4 |
| Lumajang | 2.077 | 21.6 | 1,048,328 | 9.98 | 20.6 |
| Bondowoso | 2.095 | 13.0 | 776,557 | 14.39 | 16.7 |
| Lombok Utara | 0.906 | 3.4 | 196,521 | 28.83 | 17.3 |
| Lombok Timur | 2.541 | 13.9 | 1,222,559 | 16.55 | 11.4 |

| DISTRICT | APBD (IN IDR TRILLIONS) | PDRB (IDR TRILLIONS) | POPULATION | POVERTY (%) | PDRB PER CAPITA (IN IDR MILLIONS) |
|--------------------------------|-------------------------|----------------------|------------|-------------|-----------------------------------|
| Bima | 1.743 | 7.9 | 472,751 | 14.84 | 16.7 |
| Sumbawa | 1.605 | 10.1 | 455,156 | 14.08 | 22.2 |
| Pangkajene Kepulauan (Pangkep) | 1.370 | 17.2 | 335,313 | 15.1 | 51.4 |
| Bantaeng | 0.934 | 5.1 | 192,734 | 9.23 | 26.4 |

Source: Statistics Indonesia processed by E-poverty Analysis and Planning Tool (SEPAKAT), and District Budget Realisation Report.

FIGURE 3. DISTRICT CHARACTERISTICS ANALYSIS



Chapter 3.

CHALLENGES FOR PUBLIC FINANCIAL MANAGEMENT

Government Regulation No. 12 of 2019 on Local Government Financial Management states that ‘local government financial management is required to be carried out in an orderly, efficient, economical, effective, transparent and responsible manner’. The analysis conducted through the BCA identifies the obstacles to local government financial management in managing revenue and expenditure, as well as general challenges.

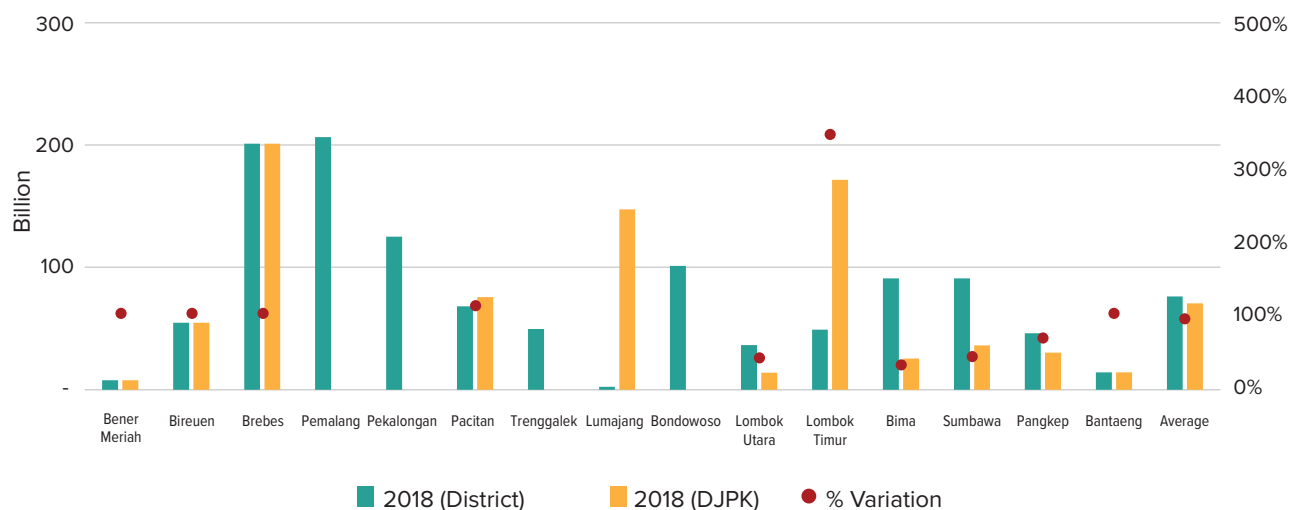
3.1 GENERAL PFM CHALLENGES

This analysis identifies three significant challenges in subnational public financial management, including:

1. Inadequate financial statements, accounting processes, and expenditure allocation policies.
2. Unreliable assessment of performance and financial reports.
3. The non-strategic priority of allocating expenses and expenditures, including the limited allocation for asset maintenance.

3.1.1 QUALITY OF FINANCIAL REPORTS

The reliability of subnational government financial data is still limited, especially for data with more details. This data inconsistency is found between the database in SIKD at the Ministry of Finance, and the data reported at the district level. As an illustration, Graph 1 illustrates the data variation percentages between the two sources. These variations can be due to several reasons, including differences in recording periods and input errors. However, this analysis was not designed to explore these differences more deeply.

GRAPH 1. VARIATION IN EXPENDITURE DATA FOR THE NINE-YEAR COMPULSORY EDUCATION PROGRAM IN 15 DISTRICTS

Note: Bima District – The 12-year compulsory education program.
 Source: Districts' APBD and DJPK of Ministry of Finance (2018).

The application of the accrual-based accounting system is not optimal due to limited human resources.

Government Regulation No. 71 of 2010 on Government Accounting Standards (SAP), updated through the Minister of Home Affairs Regulation No. 64 of 2013, became the initial milestone in implementing accrual-based SAP. However, there is a dispensation to implement SAP towards accrual for subnational governments that are incapable of meeting the four-year deadline. The standards will assist the management of public finances in a more accountable manner, because they enable accounting for the results (outputs) and not just inputs, comparing costs with benefits obtained. Nevertheless, to date, there are still difficulties in applying the accrual-based SAP. This situation indicates the limited capacity of human resources, both regarding knowledge and skills, as well as political commitment.

Differences in the recording of financial statements between pre-audits and post-audits can still be identified, indicating that the recording process of the reports is inaccurate. The team's data analysis reveals that there are many differences in the number of accounts in the financial data from the Local Government Accountability Report (LKPJ) attachments of the Bupati to the Local Representative Council, and those accessed from the post-audit financial statements by the State Audit Board. Although the documentation is not designed to be able to explore the causes of these differences in a more detailed way, it indicates the need for strengthening human resources, especially in understanding budget codes under regulations. This would ensure they are created more in line with national accounting standards, and the reports' reliability could be maintained.

BOX 1. THE RELIABILITY OF PERFORMANCE ASSESSMENT AND FINANCIAL STATEMENTS

The audit report and assessment of local government performance reports by authorised ministries were occasionally different and might not be consistent. The State Audit Board carries out its mandate to oversee the management and utilisation of state assets (Law No. 17 of 2003 on State Finance), which is expected to encourage better governance of government resources. However, the results of the Audit Results Report on positive Subnational Government Financial Statements do not necessarily position a district to have good results in the assessment of the Government Institution Performance Accountability System (SAKIP) and Local Government Performance Report (LPPD), and vice versa for negative reports (see Table 3).

TABLE 3. ASSESSMENT OF THE PERFORMANCE AND FINANCIAL STATEMENTS PREPARED BY THE SUBNATIONAL GOVERNMENT IN 2018

| DISTRICT | ASSESSMENT RESULT | | |
|--------------|-----------------------------------|---------------------|--------------------|
| | AUDIT RESULTS REPORT ⁵ | SAKIP ^{b6} | LPPD ^{c7} |
| Bener Meriah | UO | CC | 1.75 |
| Bireuen | UO | CC | 2.73 |
| Brebes | QO | B | 2.92 |
| Pemalang | UO | B | 2.91 |
| Pekalongan | UO | B | 3.13 |
| Pacitan | UO | B | 3.18 |
| Trenggalek | UO | BB | 3.10 |
| Lombok Utara | UO | B | 2.89 |
| Lombok Timur | UO | CC | 3.05 |
| Bima | UO | B | 2.87 |
| Sumbawa | UO | B | 3.19 |
| Pangkep | UO | CC | 3.02 |
| Bantaeng | UO | B | 3.03 |

Source: The reports of the Ministry of Administrative and Bureaucratic Reform, the Summary of the State Audit Board, and Ministry of Home Affairs audit results.

⁵ Assessment Reference: UO = Unqualified Opinion; QO = Qualified Opinion.

⁶ Assessment Reference: BB: 70–80; B: 60–70; CC: 50–60.

⁷ The Local Government Performance Report (LPPD) contains the information on the implementation of local governance by all OPDs, no later than three months after the end of the fiscal year, as the main material for the EKPPD in accordance with Government Regulation No. 6 of 2008 on Guideline for the Evaluation of Local Governance. Assessment Reference: The higher, the better.

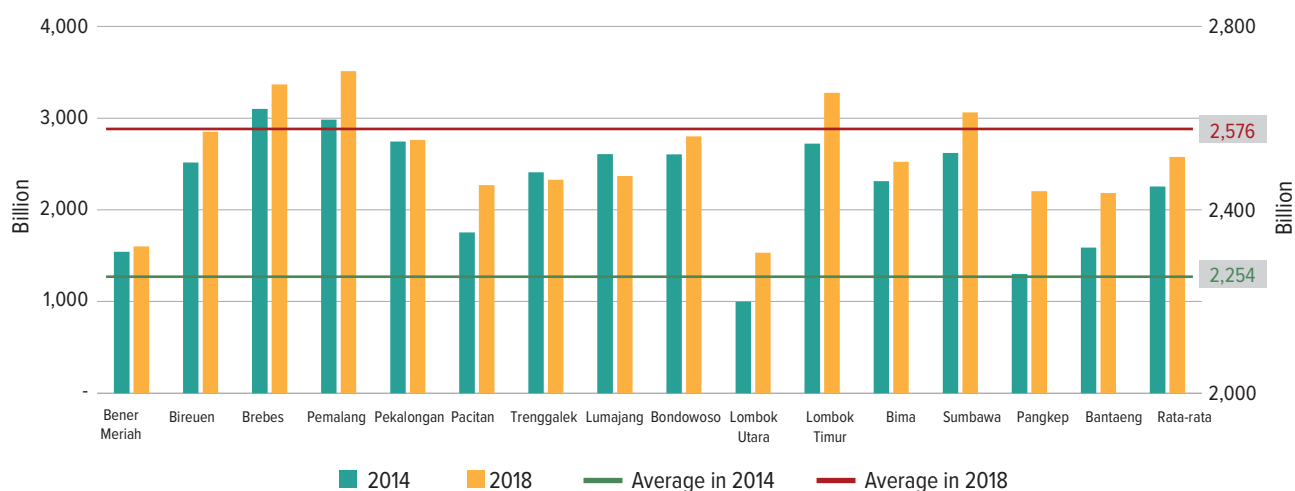
3.1.2 ASSETS AND LIABILITY COMPONENT

Asset growth over five years is evident, but it keeps fluctuating. The growth in the value of wealth (assets) is one indicator of the health of public finance. For the 2014–2018 period, nearly all districts in this analysis obtained an increase in asset value, except for Lumajang and Trenggalek Districts. The range of asset value growth in Graph 2 is varied, from the highest growth of 69.5% in Pangkep District to the negative growth of minus 9.2% in Lumajang District (see Graph 2). In other example, fixed assets in Bener Meriah and Pangkep Districts increased over five years, while two districts declined in the last two years (see Graph 3). This situation requires improvement, because it will have an impact on fixed assets, and smaller district equity can result in financial underperformance.

Out of the four districts for which we obtained detailed data for their asset composition, the following issues as findings were identified:

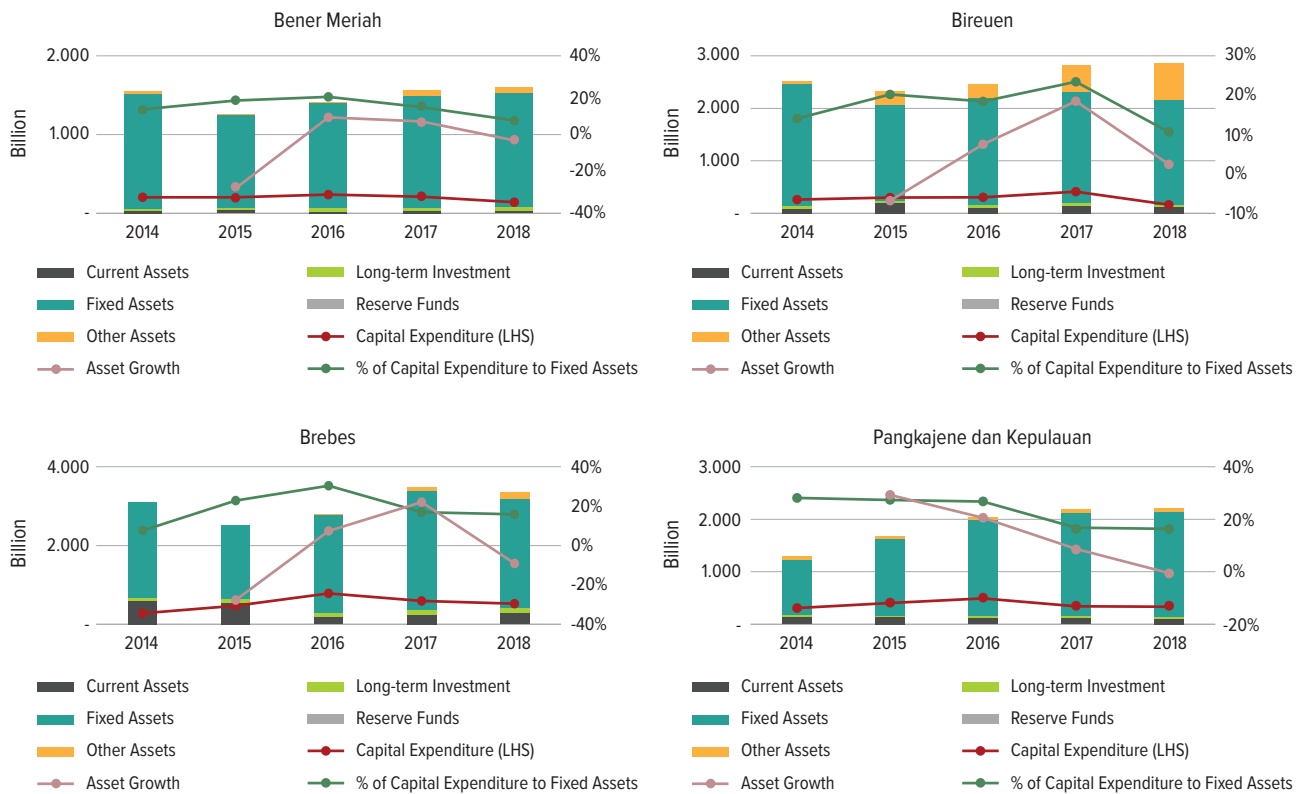
1. Fixed assets dominate the asset structure in the four districts, with varied growth from year to year. Fixed assets include land, buildings, and equipment. Assets such as roads, bridges, and irrigation resulting from physical development (capital expenditures) are also included in this category.
2. Current assets and long-term investment are relatively minimal in the asset structure of the four district governments.
3. Other assets include reserve funds, which tend to be very minimal in asset structures, except in Bireuen District.

GRAPH 2. ASSET VALUE, 15 DISTRICTS, 2014–2018



Source: DJPK, Ministry of Finance.

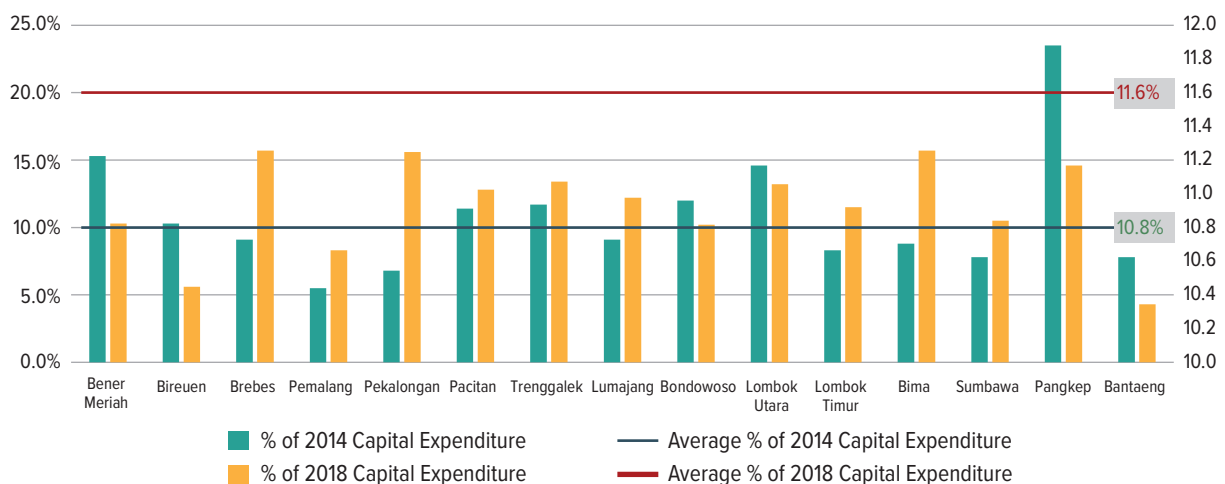
GRAPH 3. ASSET GROWTH, FOUR DISTRICTS, 2014–2018



Note: The data were collected based on financial statements per district. Source: District Financial Reports, 2014–2018.

An increase in assets is not frequently attributed to an increase in the capital expenditure percentage relative to the total asset value. However, the percentage of capital expenditure to assets does not indicate a specific pattern (see Graph 4). Nine districts had the ratio increase, while the ratio in six districts had decreased. On average, it increased from 10.8% to 11.6% in five years.

GRAPH 4. CAPITAL EXPENDITURE RELATIVE TO ASSETS, 15 DISTRICTS, 2014–2018

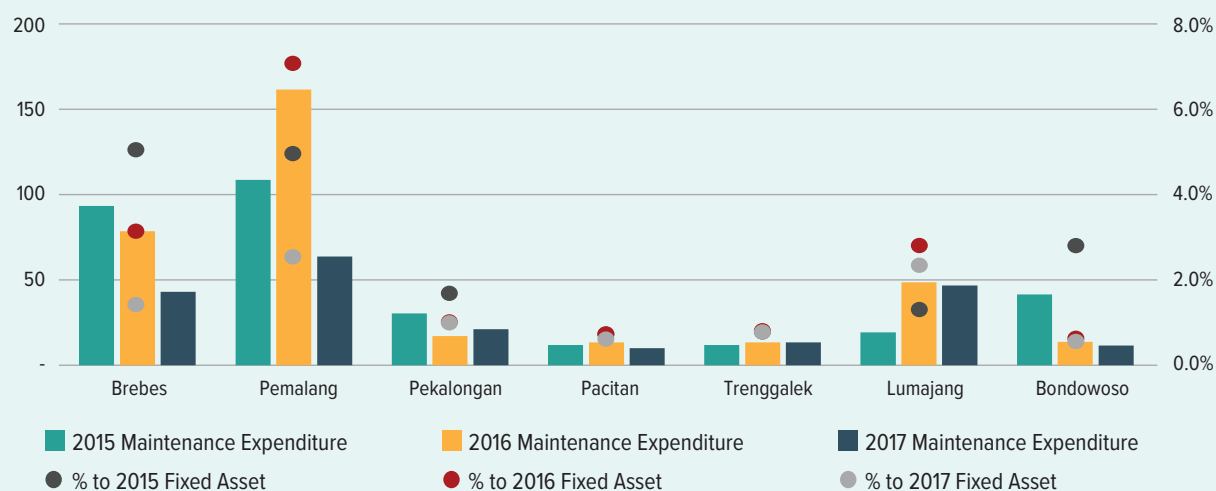


Source: DJPK, Ministry of Finance.

BOX 2. THE ALLOCATION OF EXPENDITURE AND EXPENSES FOR MAINTAINING FIXED ASSETS FLUCTUATED AND TENDED TO DECLINE DURING 2015–2017

Based on detailed data on the allocation of maintenance expenditure from seven districts, the increase in allocation of maintenance expenditure occurred in Trenggalek District, decreased in Brebes and Bondowoso, and fluctuated in the other four districts (see Graph 5). The allocation of maintenance expenditure in Pemalang, Pacitan, and Lumajang Districts had increased in 2016 but decreased in 2017; on contrary, in Pekalongan District, the allocation decreased in 2016 but raised in 2017. Furthermore, the ratio of maintenance expenditure allocation to fixed assets were fluctuated and tended to decline. For example, the 2015 ratio in Brebes District was 5% and fell to 1.4% in 2017, however, the ratio in Pemalang District in 2015 was only 4.9%, then increased by 7.1% in 2016, and decreased to 2.5% in 2017. In other districts, the average ratio of maintenance expenditure to fixed assets was only around 1–3%, which is quite far from the average maintenance requirement for fixed assets. The interview results with subnational governments indicate that this pattern occurred because the allocation of asset maintenance expenditures is not based on fixed asset value or capital expenditure allocations in the previous year. There is also no standardised amount that must be allocated by the subnational governments. Asset management still requires improvement to maintain the optimal performance of fixed assets. Eventually, this situation can lead to the negligence of maintaining some fixed assets, and their utilisation becomes less optimal.

GRAPH 5. ASSET MAINTENANCE EXPENDITURE, SEVEN DISTRICTS, 2015–2017



Source: Audited District Financial Statements, 2014–2018.

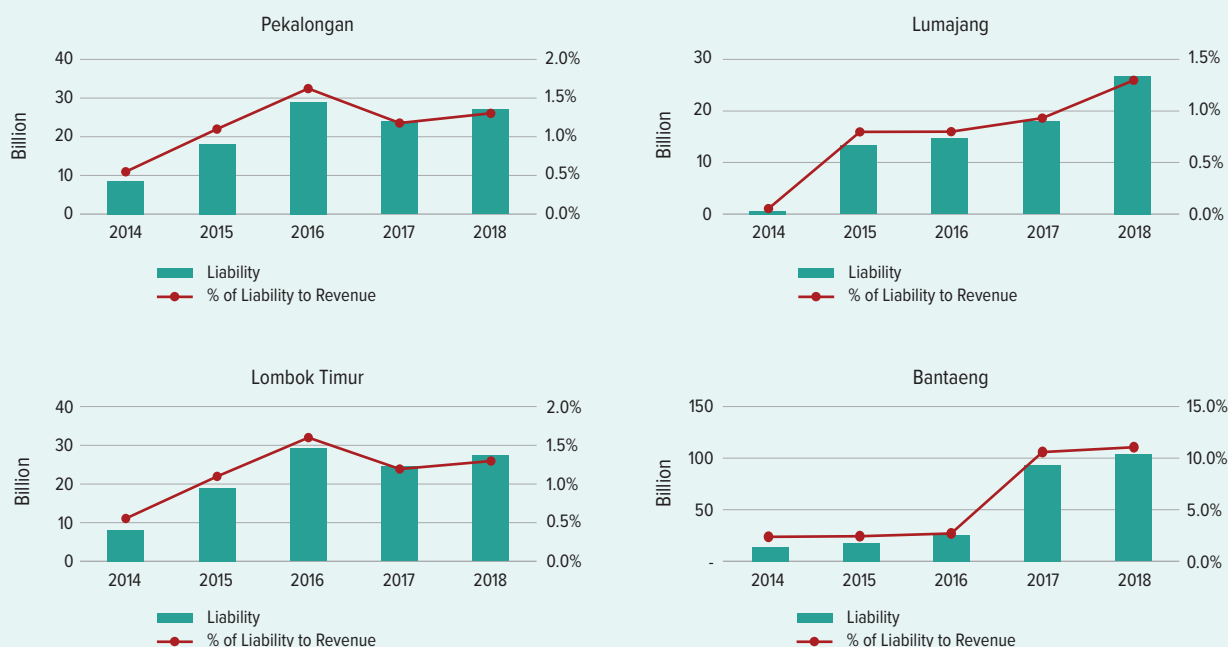
BOX 3. SHORT-TERM LIABILITIES (DEBT) LIABILITIES CHALLENGES

The average value of liabilities is derived from short-term liabilities (debt) and has an increasing trend in recent years. This analysis found an increase in short-term liabilities (debt), which mostly came from government debt to third parties, especially for the procurement of goods and services and tax liabilities, as occurred in four districts (see Graph 6). This situation has emerged because the activities management and the disbursement process of the budget for payment of third-party invoices are still not on schedule and may even pass the fiscal year.

Short-term debt is generally caused by a discrepancy between the need for fund disbursement and the availability of cash flows. This situation typically occurs in the processing of invoice payments to third parties. To avoid interest charges, subnational governments generally prefer to defer payments until cash is available, rather than taking loans from financing institutions to cover debts to third parties. In general, this practice is not a problem as long as there is no conflict of interest. However, it indicates the following challenges:

1. Cash flow in Budget Implementation Documents (DPA) from the Local Work Unit and the Cash Budget from the Finance Department have not been well structured by estimating the conditions of cash inflows and disbursements accurately.
2. The improvements in revenues from either the transfer component or Local Own-Source Revenues (PAD) and how to ensure both sources can be manifested in the form of cash following the revenue plan.
3. The schedule for the procurement of goods and services should be adjusted to the needs and availability of cash at the maturity date.

GRAPH 6. EXAMPLES OF DEBT LIABILITY PROBLEMS, FOUR DISTRICTS, 2014–2018



Note: The data were collected based on financial reports per district.
Source: District Financial Reports, 2014–2018.

3.2 CHALLENGES FOR SUBNATIONAL GOVERNMENT REVENUE MANAGEMENT

PAD reflects the economic conditions in a region, which are not always capable of keeping up with the growth of the APBD and the local economy through the value of Regional Gross Domestic Product (PDRB). A more developed region tends to have more PAD, since the local potential is more identified and utilised. Ideally, the PAD generated is the result of the contribution of local taxes and levies. However, this is not always the case. PAD growth that does not keep pace with APBD growth increases the dependence on other sources, especially transfers from the central government, as well as emphasises the limited utility of existing resources. This situation was found in several locations, where the subnational government had not yet optimised the utilisation of its revenue potential. There are three significant challenges in local revenue management as a result of the analysis, including:

1. High dependence on transfer funds from the central government.
2. The contribution of local taxes and levies is low and tends to be smaller in terms of PDRB.
3. The effect on local fiscal independence of the Capitation Funds of the Health Insurance Program (JKN), and Social Security Administrative Body for Health (BPJS Kesehatan).

3.2.1 DEPENDENCE ON TRANSFER FUNDS FROM THE CENTRAL GOVERNMENT

The district government⁸ still depends on central government transfer funds, which can be seen from the ratio of local financial independence⁹ and the Degree of Fiscal Decentralisation (DDF)¹⁰. The DDF indicator signifies that the PAD proportion from the total of APBD in the 15 KOMPAK partner districts remains below 20%, meaning that more than 80% of budget allocations in all of these districts still depend on the transfer funds from the central government or others (see Graph 7). Meanwhile, based on the indicator of local financial independence, which compares the PAD value with other components of the local revenue, it remains below 25% (see Graph 8).

⁸ A separate calculation of the DJPK budget data illustrates that, on average, district governments could only contribute 11% of the total APBD in 2014 and this increased slightly to 12% in 2018. For the municipal governments, the PAD contribution increased from 23% in 2014 to 28% in 2018. For the provincial governments, almost half of its revenues came from PAD, although it decreased from 52% in 2014 to 47% in 2018 (DJPK data, created from source data).

⁹ The Local Financial Independence Ratio shows the level of ability of a region in financing its government activities, development, and services to the public who have paid taxes and levies as a source of revenue required by the region. The independence ratio is illustrated by the amount of local own-source revenues compared to local revenue from other sources (external parties), including: Tax Revenue Sharing, Non-Tax Revenue Sharing of Natural Resources, Central Government DAU and DAK (general and special allocation funds), Central Government Emergency Fund and Loan Fund.

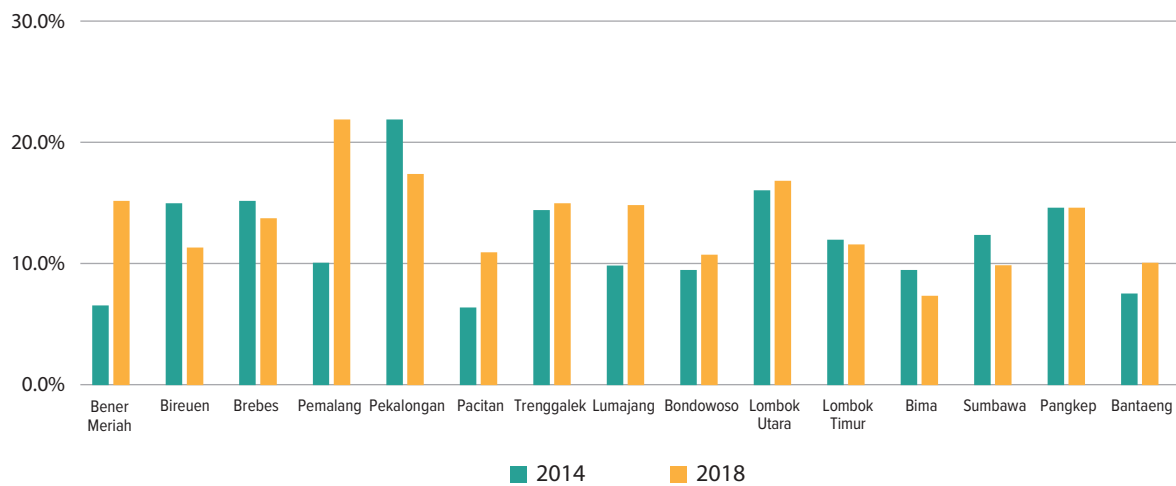
¹⁰ The Degree of Fiscal Decentralisation is the subnational government's ability in generating the Local Own-Source Revenue to finance local development. The Degree of Fiscal Decentralisation formulation is PAD component relative to Total of Local Revenue.

GRAPH 7. DEGREE OF FISCAL DECENTRALISATION, 15 DISTRICTS, 2014 AND 2018



Source: DJPK, Ministry of Finance.

GRAPH 8. LOCAL FINANCIAL INDEPENDENCE RATIO, 15 DISTRICTS, 2014 AND 2018

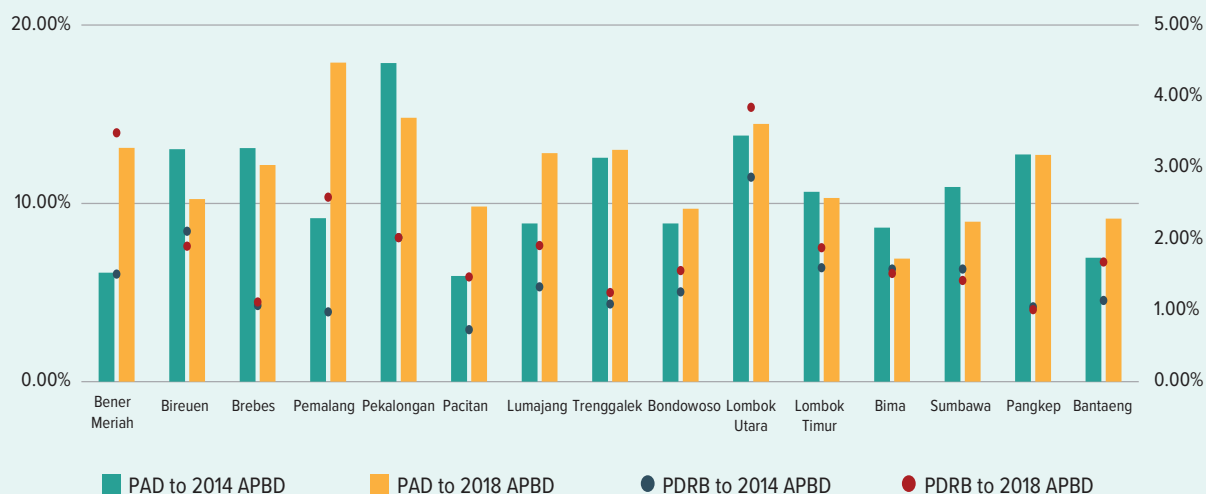


Source: DJPK, Ministry of Finance.

BOX 4. THE LOW PROPORTION OF LOCAL TAXES AND LEVIES AGAINST PDRB

The analysis results indicated a low contribution of PAD to the APBD and PDRB in the 15 KOMPAK partner districts, with high variations. In 2018, the PAD proportion against APBD in the analysis locations ranged from 18% in Pemalang District down to 9% in Bima District. The proportion of PAD against PDRB also indicated a similar situation: the highest PAD ratio against PDRB was found in Lombok Utara at 3.85%, while the lowest was 1.01% in Pangkep District.

GRAPH 9. PAD CONTRIBUTION AT THE DISTRICT LEVEL, 15 DISTRICTS, 2014 AND 2018



Source: DJPK, Ministry of Finance.

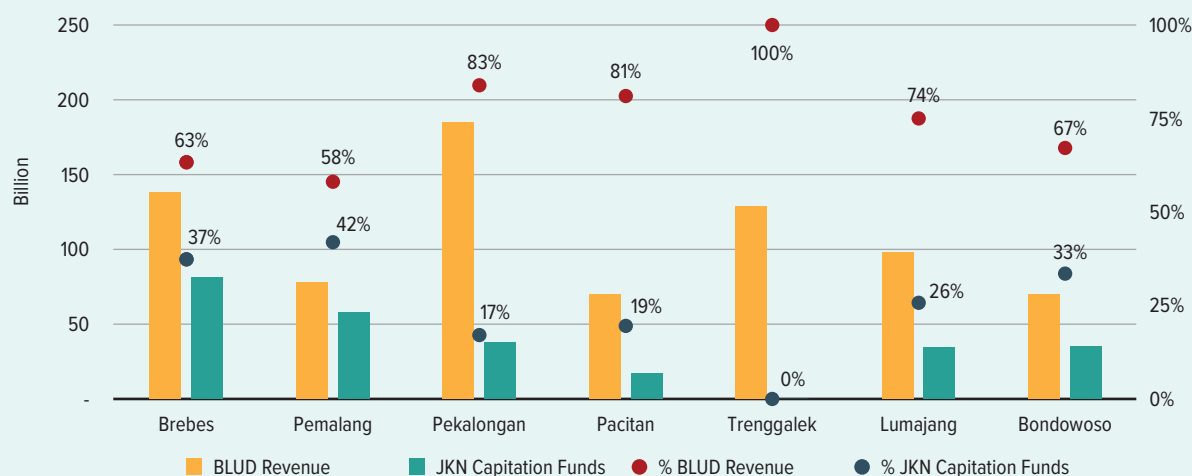
The low contribution of PAD is due to the low contribution of taxes and levies. Subnational governments are still not optimal in collecting local revenues through the existing potential channels. Local taxes and levies should be at the forefront of the local revenue sources, but they are still far from optimal. The subnational governments still have difficulties in realising the potential of their regions. They have limited access to information and networks or databases that can be potential sources of local revenues.

BOX 5. THE EFFECT OF JKN AND BPJS FUNDS ON LOCAL FISCAL INDEPENDENCE

The Other Legal Own-Source Revenues or *Lain-lain Pendapatan Asli Daerah yang Sah (LLPADYS)* contribution increases and is influenced by the allocation for health and education services; i.e. **JKN and BPJS**. LLPADYS consists of a component of the JKN Capitation Funds and the Local Public Service Agency (BLUD) as revenues received by local government for services provided by health service centres. JKN Capitation Funds are funds from the BPJS for health service centres, particularly community health centres that have not been categorised as a BLUD. BLUD revenue is a reimbursement fund from BPJS for Health, and also income from non-participating patients who are treated at BLUD health service centres (community health centres and hospitals). This situation occurred in seven KOMPAK partner districts in Central Java and East Java Provinces (see Graph 10).

An assessment of local fiscal independence can be erroneous if it is based on LLPADYS records. As previously stated, the transfer funds allocation from the central government for JKN, and BPJS for Health – components of LLPADYS – continues to increase every year. This is based on Presidential Regulation No. 32 of 2014 on the Management and Utilisation of the Health Insurance Program Capitation Funds in First-Level Health Facilities which belong to the Local Government, as well as the Minister of Home Affairs Regulation on the annual guidelines of the APBD preparation. Therefore, the analysis of local fiscal independence needs to be explored further, as these three components cannot be categorised as PAD, because they are from the central government – and not from the subnational governments' performance in increasing local revenues.

GRAPH 10. OTHER LEGAL OWN-SOURCE REVENUES COMPOSITION AT THE DISTRICT LEVEL (2018)



Source: Audited District financial statements (2018)

3.3 CHALLENGES FOR SUBNATIONAL EXPENDITURE MANAGEMENT

Promoting growth of fiscal resources requires skills in management and utilisation of these resources.

Currently, the transfer funds from the central government remain the largest fiscal resource for subnational governments – and this value continues to increase both in nominal terms and various allocations. At the beginning of decentralisation, the availability of the fiscal resources was insufficient to finance the provision of public services. Over time, the current subnational government should obtain fiscal resources to meet the requirement of quality public services quantitatively. There are three significant challenges in local expenditure management identified as a result of the analysis, including:

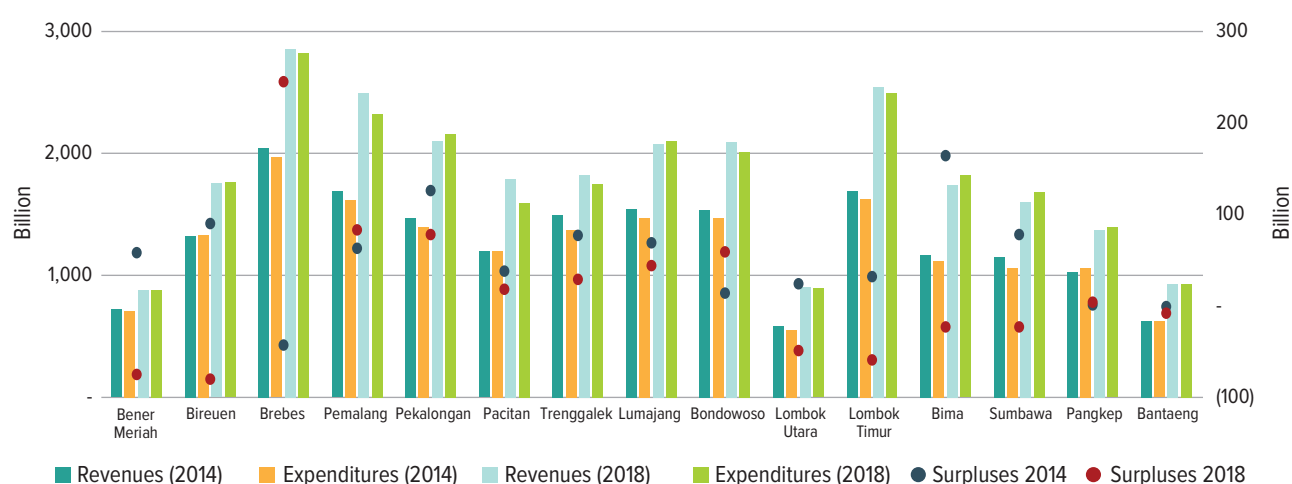
1. Budget allocations that tend to be surplus, resulting in the SILPA for the current fiscal year.
2. Subnational government expenditures that remain focused on indirect expenditure, particularly personnel expenditure.
3. Mandatory spending that limits the subnational governments' flexibility to manage budgets.

In addition, this report will briefly discuss the allocation of subdistrict expenditures, which are also the responsibility of the district government.

3.3.1 SUBNATIONAL GOVERNMENTS TEND TO HAVE BUDGET SURPLUS POLICIES, RESULTING IN THE SILPA

A budget surplus was found in six districts using the deficit approach, and this occurred in 2014 and 2018. In 2014, Pematang District was the only KOMPAK partner district that experienced a budget deficit amounting to IDR 43 billion, while in 2018, it experienced a surplus of IDR 244 billion.

GRAPH 11. BUDGET SURPLUS AT THE DISTRICT LEVEL, 15 DISTRICTS, 2014 AND 2018



Source: DJPK, Ministry of Finance.

In summary, the budget surpluses occurred due to underestimated planning on the revenue side and overestimated planning on the expenditure side. Inadequate or conservative estimation on the revenue side causes the subnational governments to exceed their revenue targets. In contrast, overestimation on the expenditure side can make it difficult for subnational governments to realise their planned activities. The existence of a budget surplus can be an achievement, if it is due to the success of using the budget efficiently. However, it is necessary to investigate further the capacity of subnational governments in the planning and implementation process.

For example, some of the causes for a surplus can include:

1. The achievement of revenue realisation exceeds the target, which occurs because the target numbers are set too low and thus are relatively easy to achieve.
2. The efficiency of expenditure is due to price adjustments of cost standards with market prices.
3. The allocated expenditure is not realised, so the implementation is not optimal.
4. There is an arrangement from the initial planning to increase the SILPA for the fiscal year for specific purposes, such as to support activities designated in the following year.

Meanwhile, the causes of a budget deficit, based on six KOMPAK partner districts, include:

1. The achievement of revenue realisation is less than the target, due to the low realisation of PAD or when the revenue component (especially the balanced fund from central government) is lower than expected.
2. The initial budget determination included SILPA from the previous year, so the expenditure for that year will be greater than the income.

Generally, subnational governments always have a budget surplus/SILPA. SILPA is the Funding Budget Surplus, which is recorded at the end of the year and calculated by observing the budget surplus-value plus the net financing. Subnational governments always report SILPA in their Budget Realisation Reports. There is even a tendency to always exceed revenue targets and not realise all planned spending, so that the budget surplus occurs frequently. The average SILPA in all 15 KOMPAK districts was IDR 131.8 billion for the 2018 fiscal year. Pematang District had the largest amount, reaching IDR 312 billion surplus, while Bantaeng and Bener Meriah Districts had the smallest at IDR 2.7 billion and 1.6 billion in the same fiscal year.

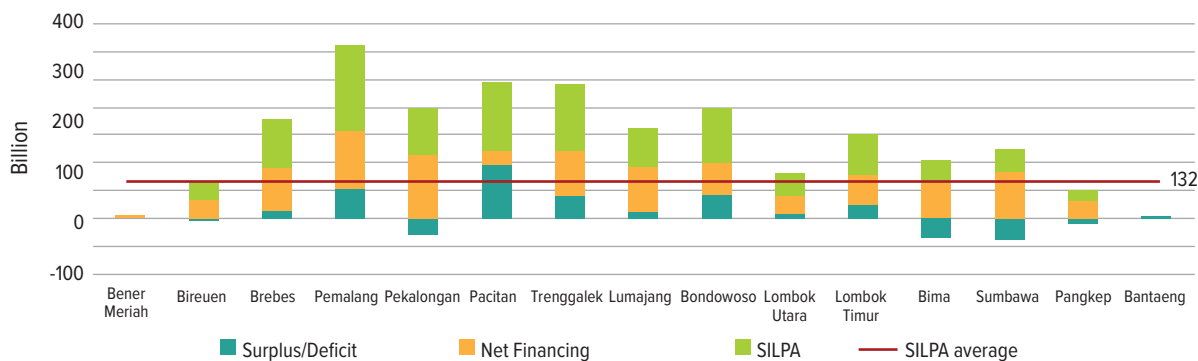
BOX 6. CAUSES OF SILPA IN PACITAN DISTRICT

As an example of local practice, analysis in Pacitan District found several factors that triggered SILPA, including:

1. Overestimated local expenditure.
2. Delay in implementation due to technical instructions delay from the central government.
3. There are strategic programs that receive a budget but cannot be implemented.
4. The expenditure efficiency or savings from a project auction.
5. The implementation is delayed due to rotation or change of echelon II and echelon III officials.
6. The existence of provincial government policies related to financial assistance for districts/cities to increase the availability of fiscal resources.
7. There are multi-year activities that cause several activities to be transferred to the next fiscal year.

Meanwhile, six of the 15 KOMPAK districts used the deficit approach (see Graph 12). This approach is used to allocate financing receipts that come from SILPA in the previous year, so that the SILPA in the ongoing year does not go higher. Districts with a large SILPA in the current year will employ a deficit approach in the following year to allocate the SILPA. The six districts that had budget deficits in 2018 were Bener Meriah, Bireuen, Pekalongan, Lumajang, Pangkep, Sumbawa, and Bima.

GRAPH 12. BUDGET SURPLUS AND DEFICIT AT THE DISTRICT LEVEL, 15 DISTRICTS, 2018

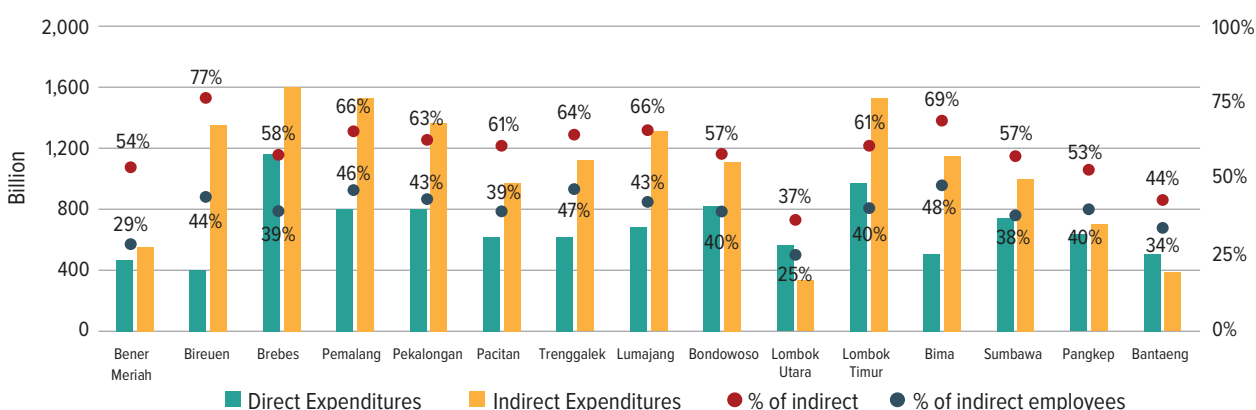


Note: The data are the realisation figures for 2018.
Source: DJPK, Ministry of Finance.

3.3.2 SUBNATIONAL GOVERNMENT EXPENDITURES REMAIN FOCUSED ON INDIRECT EXPENDITURE – PARTICULARLY PERSONNEL EXPENDITURE

Most KOMPAK districts use the APBD for indirect expenditure. Indirect expenditure is any expenditure that aims to finance operations and is not directly related to the programs and activities.¹¹ Graph 13 below illustrates how subnational governments in almost all KOMPAK districts spend a large proportion of their expenditure on indirect expenditure (subnational government operational costs). Bireuen District has the largest indirect expenditure at over 70%, meaning that less than a quarter of its budget is used for program or activity expenditures.

GRAPH 13. DISTRICT LEVEL EXPENDITURES, 15 DISTRICTS, 2018



Source: DJPK, Ministry of Finance.

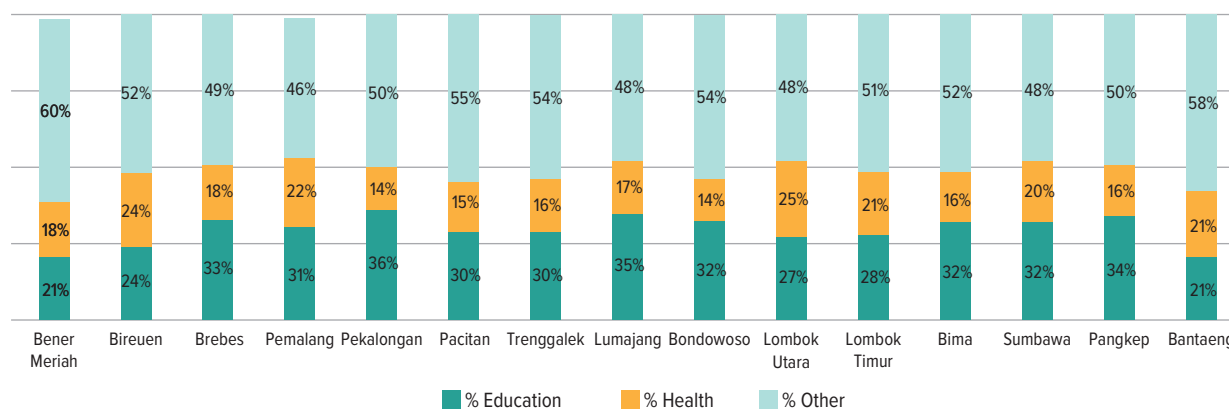
¹¹ According to the Minister of Home Affairs Regulation No. 13 of 2006 on Local Financial Management Guidelines, indirect spending includes personnel expenditures, interest payments, subsidies/grants/social assistance, financial assistance/transfers for provinces/districts/cities/villages, and unexpected expenditures. Meanwhile, direct expenditure is expenditure that can be directly linked to the implementation of programs and activities. Direct expenditure consists of personnel spending (allowance/incentives), expenditures for goods and services, and capital expenditures.

The largest component of APBD indirect expenditure is for personnel expenditure. Since the enactment of Law No. 6 of 2014 on Villages, spending on Village Funds (DD) and Village Fund Allocation (ADD) has been channelled through indirect expenditure, so that the proportion continues to increase every year. However, the number of funds channelled to the village was still smaller than the expenditure for subnational government employees. Trenggalek District for example, has the highest share of personnel expenditure at 47% of total expenditure. With 64% of its total expenditure categorised as indirect expenditure, only 17% of the indirect expenditure is used for other components, including the village budget.

3.3.3 MANDATORY SPENDING LIMITS SUBNATIONAL GOVERNMENTS' FLEXIBILITY IN MANAGING BUDGETS

Although nationally there remain several regions that have not fulfilled mandatory spending, as of 2019¹², all KOMPAK partner districts had completed these requirements. In 2015, several KOMPAK partner regions had not fulfilled mandatory spending on both education and health. However, all KOMPAK partner districts met these requirements in 2018 (see Graph 14). The challenge for education and health spending is thus no longer related to compliance with mandatory spending, but rather on optimising these financial resources to increase the number and quality of services. Even though they have complied with the mandatory spending, the proportion of education and health expenditure between districts has a reasonably wide range. Pemalang District, for example, allocates 53% of its budget for education and health, while Bener Meriah District allocates 39%.¹³

GRAPH 14. MANDATORY SPENDING IN DISTRICT, 15 DISTRICTS, 2018



Source: DJPK of Ministry of Finance.

However, mandatory spending needs to be explored further, not just in relation to fulfilling the proportion allocation. The understanding of mandatory spending still varies among subnational governments. This is indicated from the analysis results, where the variations in expenditure on education and health are found with a range typically around 12% between the highest and the lowest. The current allocation policy for mandatory spending is regulated by using a limit on the proportion of minimum expenditure and does not regulate the maximum expenditure. In the end, this causes the budget flexibility¹⁴ of subnational governments to become more limited. The existence of flexibility for subnational governments to use fiscal

¹² In 2019, only 128 districts/cities have not fulfilled mandatory spending on education, and 46 districts/cities have not fulfilled mandatory spending on health (DJPK Kemenkeu, 2019).

¹³ Further analysis related to the budget allocation for education and health sectors will be discussed in Chapter 4.

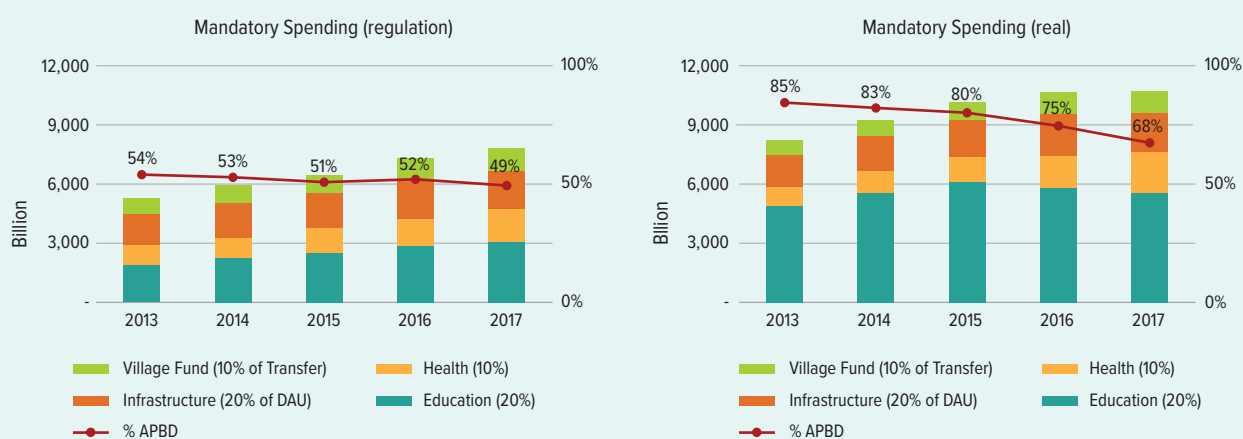
¹⁴ Budget flexibility refers to the portion of budget that is not predetermined by rules or regulation, such as the mandatory spending regulation.

resources for requirements that are more in line with other potential and existing needs is also important to determine the direction of development according to local characteristics – after the allocation for mandatory spending has been complied with at the predetermined minimum limit.

BOX 7. MANDATORY SPENDING IN PACITAN DISTRICT

Realisation data shows that the budget flexibility for Pacitan District was only 15% in 2013, due to the amount of allocation used for education, health, infrastructure, and Village Fund Allocation (ADD). Pacitan's budget flexibility increased by up to 32% in 2017. If the implementation of mandatory spending is adjusted to the minimum limit of government regulations, Pacitan District Government could add 20% to its budget flexibility.

GRAPH 15. PROPORTION OF PACITAN MANDATORY SPENDING, 2013–2017



Source: DJPK of Ministry of Finance.

3.3.4 DISTRICT GOVERNMENT RESPONSIBILITIES FOR SUBDISTRICT EXPENDITURE

This section is not part of the challenges of district governments in local expenditure mentioned above. However, it is important to include it because it is one of KOMPAK's priorities.

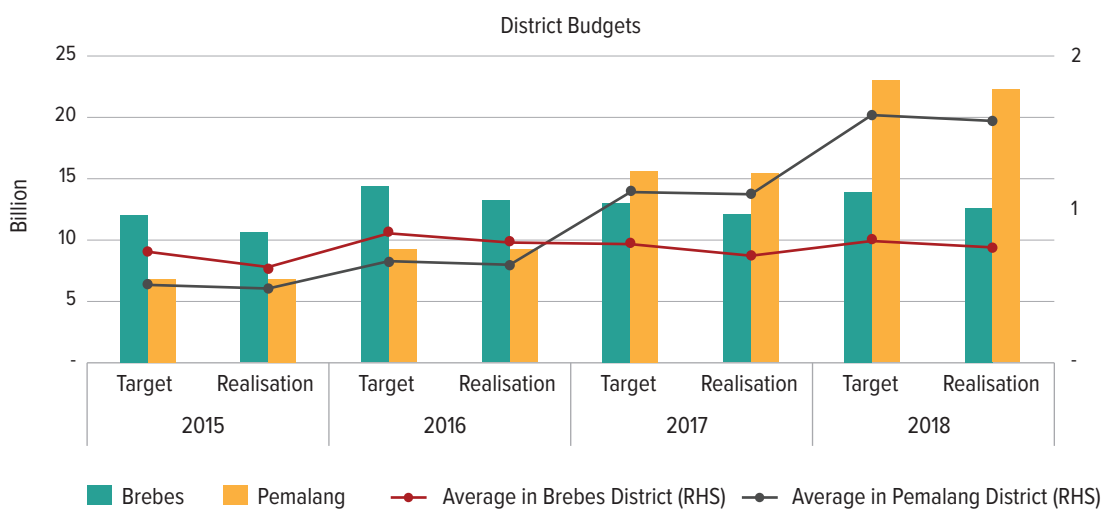
The district government is also responsible for subdistrict expenditure, although, until 2018, there was no legal basis for the amount of budget allocation at the subdistrict level. The subdistrict regulation, which is based on Law No. 23 of 2014 on Local Government, was only issued in 2018 through the Government Regulation No. 17 of 2018 on Sub Districts. This delay had the potential to affect subdistricts' mandate to carry out village assistance and supervision.

The budget allocation for the subdistricts varies between KOMPAK districts; for example, the subdistrict budget data in the two adjacent districts of Pemalang and Brebes in Central Java. The regulation in the subdistrict before the enactment of Government Regulation No. 17 of 2018 shows a changing pattern between the two districts. In 2015–2016, the subdistrict budget both in total and on average per subdistrict in Brebes District was higher than in Pemalang District. However, in the following two years, the budget for subdistricts in Pemalang District was higher (see Graph 16). Specifically, for Pemalang District, the budget for these subdistricts focuses on the implementation of office administration service programs,

and development coordination at the subdistrict level to community services such as District Integrated Administration Services (PATEN) and other administrative services. This indicates a greater commitment by Pemalang District to efforts to increase the role of the subdistricts as the forefront of basic services provision.

In terms of proportion, the realisation of subdistrict expenditure is higher in Pemalang District than in Brebes District. Based on the same data (Graph 16), Pemalang District has consistently shown better achievement realisation rates for subdistrict expenditure by an average of more than 96%; compared with Brebes District in the range of 88–93%. This analysis also shows that expenditure on subdistrict allocations has not been standardised, especially before Government Regulation No. 17 of 2018 came into effect.

GRAPH 16. COMPARISON OF THE BUDGETS FOR THE SUBDISTRICTS IN BREBES AND PEMALANG DISTRICTS (CENTRAL JAVA), 2015–2018



Note: Based on the collection of additional data in the two districts where the analysis was located in Central Java.
 Source: Local Government Accountability Report (LKPJ).

Chapter 4.

PERFORMANCE CHALLENGES OF SECTORAL BUDGET

The next set of challenges relate to the spending mix of the basic service sectors, including education, health, and population administration and civil registration. The following challenges are identified from this analysis:

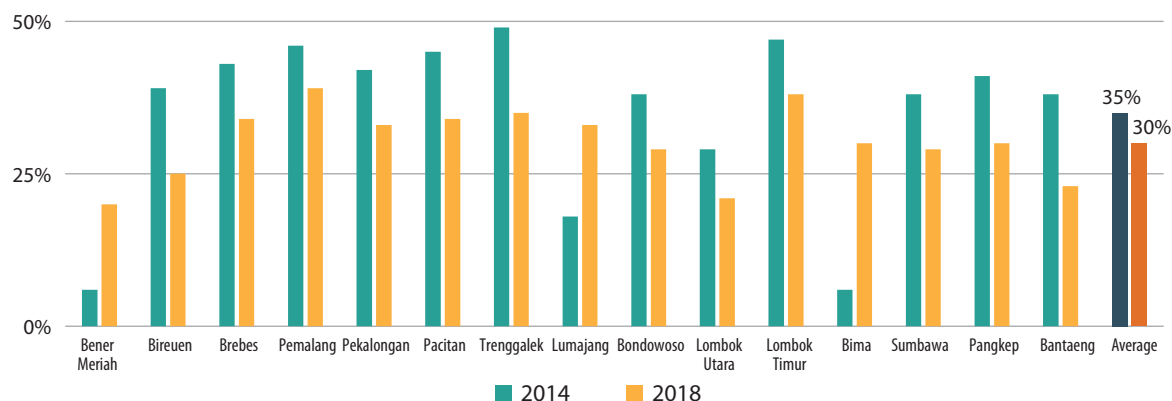
1. An increase in the sectoral budget was found, but as a ratio there was a decrease in education expenditure.
2. The increase in the budget appears to have not been optimally utilised, because a performance improvement has not been seen.
3. Monitoring and evaluation processes are hampered due to variations in the level of program expenditure.

4.1 SECTORAL BUDGET INCREASES, EDUCATION EXPENDITURE RATIO DECREASES

Annual fiscal resources in the 15 districts increased in the period 2014–2018, but the ratio for education expenditure has decreased in almost all KOMPAK districts. The increase in fiscal resources occurred nationally, and for the 15 KOMPAK partner districts the increase in APBD reached 17.8% annually during that time.

In the period 2014–2018, the size of education spending in the 15 districts has increased in absolute terms but decreased as a ratio. The growth in the amount of education expenditure always increases annually, due to the obligation to spend at least 20% of the budget on education (see Graph 17). In 2014, three of the 15 KOMPAK partner districts had not fulfilled the mandatory spending on education (Bener Meriah, Lumajang, and Bima Districts). However, as of 2018 all districts have fulfilled this prerequisite. Unfortunately, this growth is lower than the growth in total expenditure, which led the ratio analysis of education expenditure to total expenditure to show a decline. On average, the ratio of education expenditure decreased from 35% in 2014 to 30% annually in 2018.

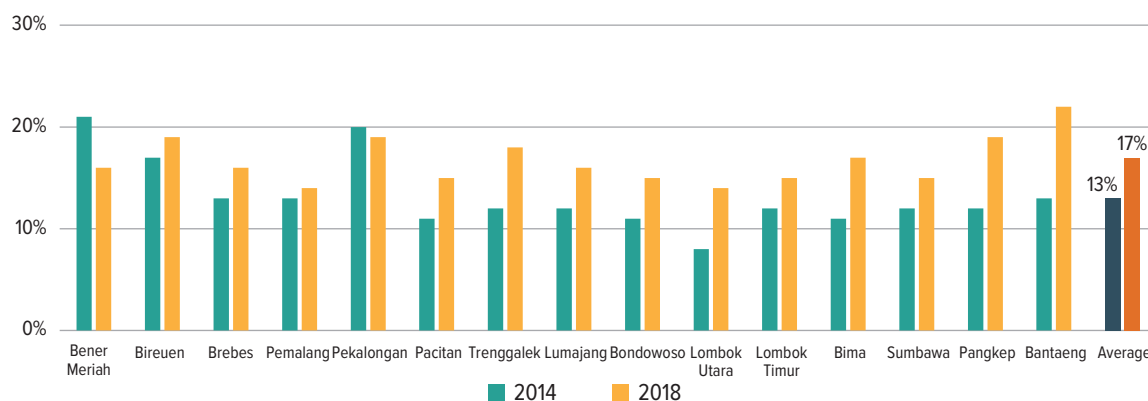
GRAPH 17. PROPORTION OF EDUCATION EXPENDITURE IN 15 DISTRICTS, 2014–2018



Source: DJPK, Ministry of Finance.

Expenditure on health functions also mostly increased from 2014 to 2018, both in total amount and by ratios. The allocation of health expenditure in each district is different and fluctuates from year to year. At the national level, the increase in health expenditure is driven by an increase in health expenditure at the district level, which includes an allocation for the Social Security Administrative Body (BPJS). On average, health expenditure in the 15 districts increased from 13% in 2014 to 17% in 2018. When viewed by district, the largest increase occurred in Bima District, where health expenditure has increased by nine times over the period, while the lowest was in Bener Meriah District, which experienced a decrease of 9% (see Graph 18).

GRAPH 18. PROPORTION OF HEALTH EXPENDITURE, 15 DISTRICTS, 2014–2018



Source: Ministry of Finance.

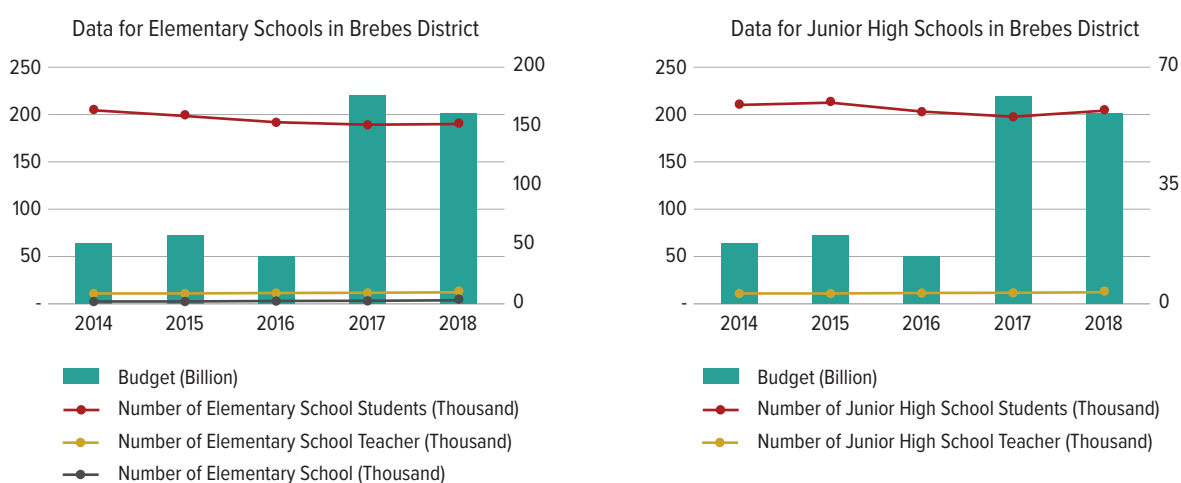
4.2 MONITORING AND EVALUATION OF PERFORMANCE IMPROVEMENT

The allocation for strategic programs continues to increase. The strategic programs referred to include the main programs for the provision of public services, education, health, and population administration and civil registration, as well as the program with the largest allocation in each function.

Performance in the education sector tends to be stagnant or even declining, indicating that education expenditure allocations have not been optimally used. For example, in Brebes District the trend of budget realisation for the basic education program has tended to increase up to five times, despite fluctuations. The number of teachers and students at elementary and junior high school level has tended to decrease, with high dropout rates. This is despite the number of elementary and junior high schools being increased – which results in schools having a smaller number of students, and which should improve the quality of teaching and learning. However, school operations are also affected, due to the small amount of School Operational Assistance (BOS) received, and this has resulted in the schools not being optimal in providing facilities and infrastructure to serve students (see Graph 19).

This situation emphasises the importance of resource optimisation policies for educational services. Policies to improve the efficient use of fiscal resources are needed, such as combining or merging schools with small numbers of students and teachers to optimise operational costs. This policy could also be used to overcome the uneven distribution of teachers in Indonesia.

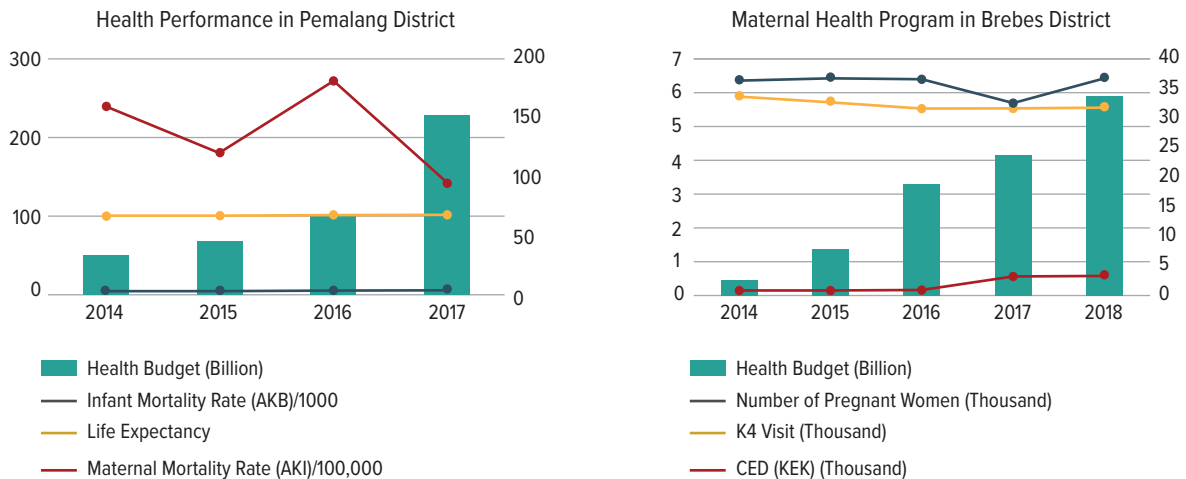
GRAPH 19. PROPORTION OF EDUCATION EXPENDITURE, BREBES DISTRICT, 2014–2018



Source: Local Government Accountability Report (LKPD) of Brebes District.

Health expenditure has increased, but several outcomes related to health service delivery have decreased. As an illustration, health expenditure in Pemalang District has quadrupled in the 2014–2017 period. Some indicators of health outcomes in Pemalang District have improved. Life expectancy has increased slightly from 72.61 to 72.98, and the infant mortality rate also decreased from 8.55 to 5.77 per 1,000 live births. However, the maternal mortality rate fluctuated with a declining trend. A similar situation for the health budget was also found in Brebes District, whereby expenditure increased by 12 times in the same period. However, the number of pregnant women who met the prerequisites for examination performance up to K-4 (minimum 4 regular antenatal care visits during pregnancy) actually decreased, and the number of women with Chronic Energy Deficiency (KEK) increased.

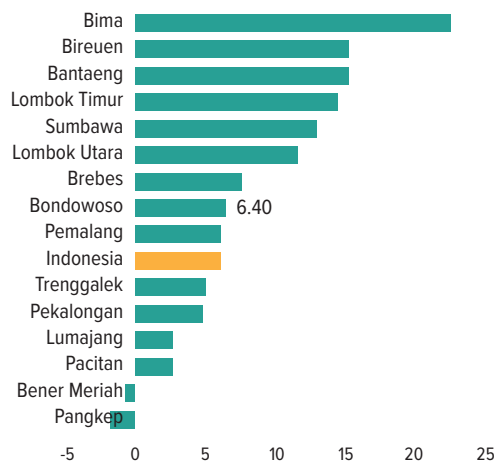
GRAPH 20. PROPORTION OF HEALTH EXPENDITURE, PEMALANG AND BREBES DISTRICTS, 2014–2018



Source: Indonesian Central Bureau of Statistics and Local Government Accountability Report in Pemalang District and Brebes District.

The provision of population administration and civil registration services has increased in unit cost, along with the improvement in performance outcomes. The activities include providing services for issuing family cards (KK) and birth certificates. In the period 2015–2018 and among the 15 districts, the percentage point of change in Under-18 birth certificate ownership decreased in Pangkep, while ownership of National Identity Number (NIK) coverage declined in five districts (see Graph 21 and Graph 22). These services became the responsibility of district government as stated in Law No. 23 of 2014 on Local Government. It explains why the program on population administration to issue these documents has existed since 2015. In four years, the program spending increased by 40%. The increase in spending has also been accompanied by improved service delivery performance, although with a lower rate of increase (thereby indicating) that the cost of providing these services has increased. The unit cost for providing the cards and certificates has increased from IDR 41,104 in 2015 to IDR 55,413 in 2018 (see Graph 23). This indicates that not only has the cost of providing the services become more expensive, but there may be risks of inefficiency in providing them. The exception is in 2016 when service delivery dropped, which made the unit cost double during the local election (*Pilkada*) period.

GRAPH 21. POINT OF CHANGE IN THE BIRTH CERTIFICATE OWNERSHIP OF UNDER-18-YEARS-OLD CITIZENS, 15 DISTRICTS, 2015–2018

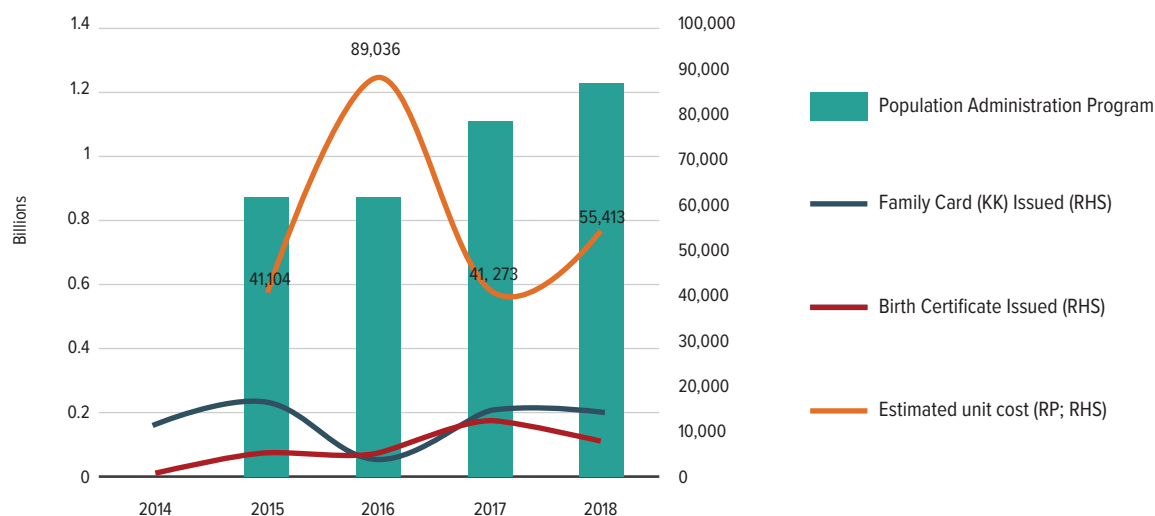


GRAPH 22. PERCENTAGE OF CHANGE IN NIK OWNERSHIP, 15 DISTRICTS, 2015–2018



Source: The National Socioeconomic Survey (SUSENAS) 2015-2018.

GRAPH 23. EXAMPLE OF THE PERFORMANCE OF THE POPULATION ADMINISTRATION PROGRAM AT POPULATION AND CIVIL REGISTRATION OFFICE, BENER MERIAH DISTRICT, 2014–2018



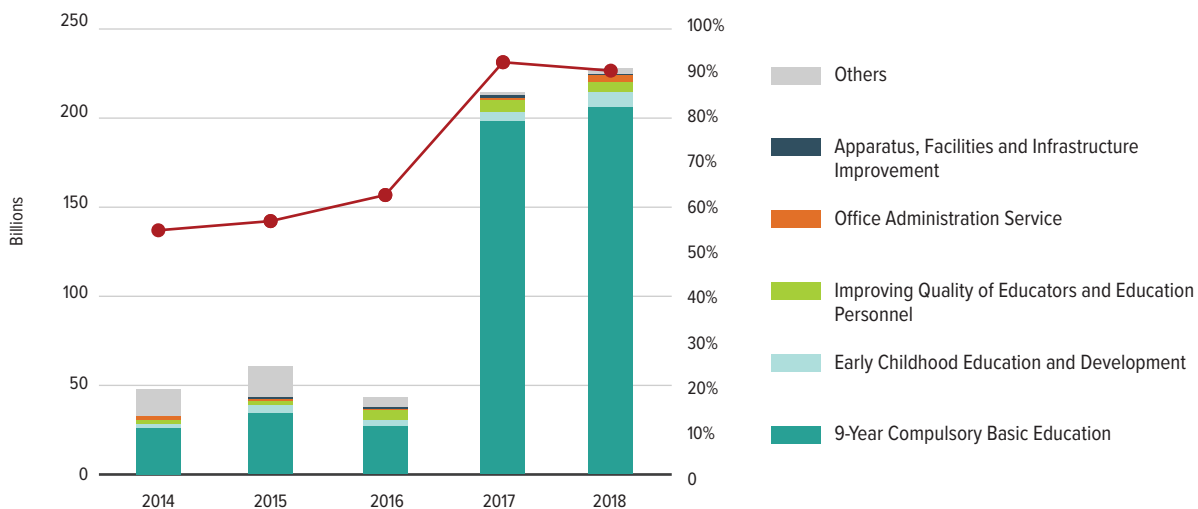
Source: Local Government Accountability Report (LKPJ) of Bener Meriah District.

4.3 VARIATIONS IN EXPENDITURE LEVELS COMPLICATE MONITORING AND EVALUATION PROCESSES

Strategic programs certainly need to be sustainable between fiscal years, and the consistency of budget allocations and realisation becomes crucial. The matching of expenditure allocations and strategic programs with the targeted outcomes could be monitored systematically if there was a sustainable basic framework. Target outcomes are often achieved only after several years, which means across multiple fiscal years – while programming policies often change, either in terms of coverage, subjects, or budget codes.

Variations in education program spending indicate district government priorities for education. An analysis of the expenditure on education functions in Pemalang District from 2014–2018 illustrates this point. During this period, the allocation and realisation of education program expenditure increased drastically, followed by program realisation (see Graph 24). In terms of coverage, there are five major programs, including: (a) the Nine-Year Compulsory Basic Education Program; (b) Early Childhood Education and Development (ECED); (c) Improving the Quality of Education and Education Personnel; (d) Office Administration Services; and (e) Apparatus Facilities and Infrastructure Improvement. The highest fluctuation occurred in the Nine-Year Compulsory Basic Education Program, which has an annual average of 71.6% of total expenditure on education. The significant jump in expenditure allocations, especially in the basic education program in 2016–2017, was caused by changes to School Operational Assistance (BOS) listings that were previously recorded by the province, but were changed to be registered by districts. Hence, this analysis also indicates the inconsistency of Pemalang District in the fulfilment of nine years of basic education program spending.

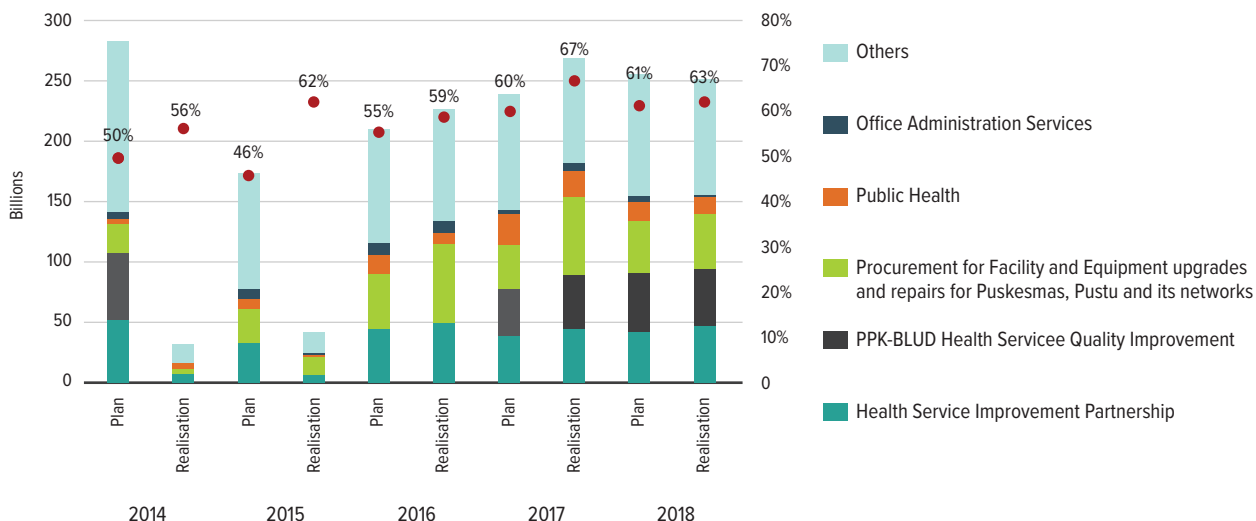
GRAPH 24. EXAMPLE OF EDUCATIONAL PROGRAM SPENDING, PEMALANG DISTRICT, 2014–2018



Source: Local Government Accountability Report of Pemalang District.

Fluctuations and inconsistencies are found in the spending allocations for health, even for programs that were once the top priority until they were not budgeted. This situation is best represented by data from Pangkep District, where budget allocations and their realisation have fluctuated (see Graph 25). In 2014–2015, the overall realisation of health program expenditure was much lower than the ceiling at the beginning of the year. A closer look at the program levels shows that the allocation for programs related to public health through Community Health Centres (*puskesmas*), which always have the highest budget compared with other health programs, actually fluctuated the most between 2014–2018. A health care quality improvement program for the Financial Management of Public Service Agency (PPK-BLUD) had the second highest budget, but was not allocated budget in 2015 and 2016.

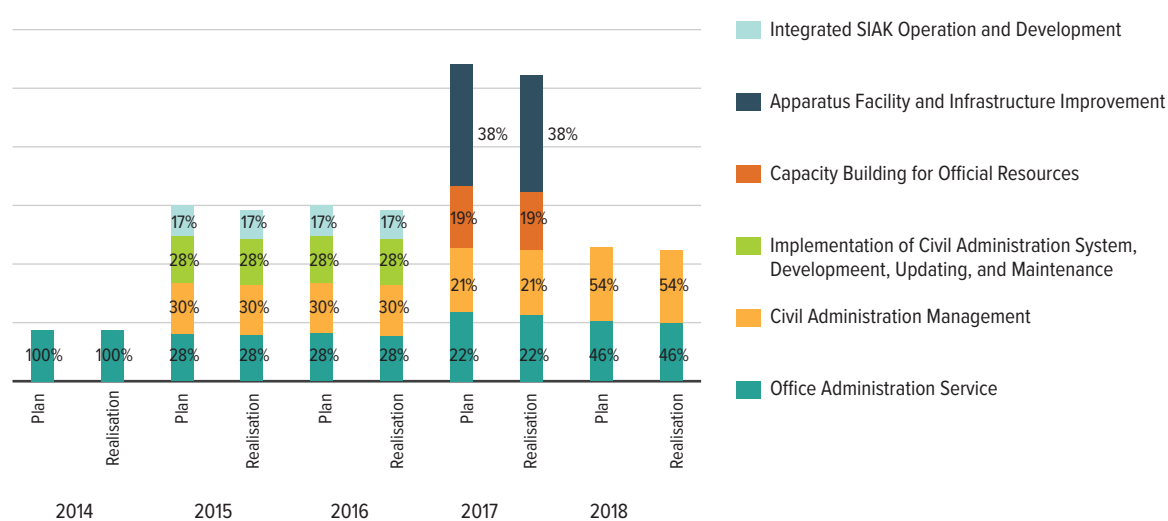
GRAPH 25. EXAMPLE OF HEALTH PROGRAM EXPENDITURE, PANGKEP DISTRICT, 2014–2018



Source: Local Government Accountability Report (LKPJ) of Pangkep District.

Programs in population administration and civil registration (*Admindukcapil*) are not sustainable, to a greater extent when compared with other functions. However, this may be caused by central government not transferring the responsibility to subnational government. As shown by Graph 24, the variety of program expenditure for Civil Registration (*Dukcapil*) programs in the Dukcapil Office only started in 2015, or up to 2017 in some locations. For example, in Bener Meriah District, the Dukcapil Office of Bener Meriah District received the delegation of authority in 2015 to directly manage public service-related programs, including civil registration. Three new programs were allocated budget in 2015 and 2016, two of which were not allocated budget in 2017, but there were two additional programs (see Graph 26). The Population Administration Program only emerged in 2015 due to the policy on ID card printing, which became a district government authority.

GRAPH 26. EXAMPLE OF EXPENDITURE FOR POPULATION AND CIVIL REGISTRATION (ADMINDUKCAPIL), BENER MERIAH DISTRICT, 2014–2018



Source: Local Government Accountability Report (LKPJ) of Bener Meriah District.

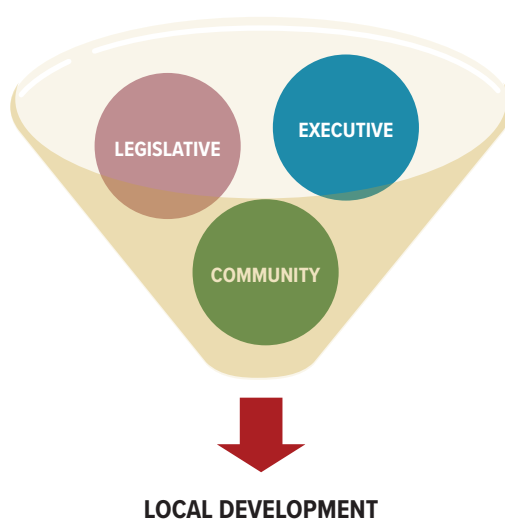
Of course, these findings cannot be separated from the context of the development of government policies at both the central and local levels. However, it is important that the processes and outcomes of subnational governments' priority programs can be monitored. Governments are accustomed to monitoring implemented programs, at least in terms of budget allocation and expenditure realisation. Analysis of sectoral achievements has also been carried out by governments, including by Statistics Indonesia. Therefore, it is not difficult to analyse the sustainability between the fiscal years and the programs as an intervention with outputs and outcomes. However, given that there is room for policy changes, which are usually intended to optimise target achievement, it is also necessary to ensure a continuous monitoring and evaluation mechanism, where program linkages and continuity can be easily coded and identified.

Chapter 5.

INSTITUTIONAL CHALLENGES AMONG STAKEHOLDERS

As a complement to the fiscal challenges that have been previously presented, this analysis also attempted to assess the institutional context in the regions that affect the planning, budgeting, and implementation of fiscal policy. As mentioned earlier, this institutional analysis explores how institutional relationships and interactions influence the dynamics of subnational government implementation, in the context of institutional relationships among the main stakeholders in government.

FIGURE 4. INSTITUTIONAL ANALYSIS



The institutional analysis was carried out in four KOMPAK partner districts; i.e. Bener Meriah, Pematang, Pacitan, and Pangkep Districts. The two focuses of this institutional analysis were:

1. Relationships between key stakeholders at the district government level, including the legislative and executive boards.
2. The dynamics of community participation in planning, budgeting, and monitoring and evaluation of program processes and outcomes.

5.1 RELATIONSHIP BETWEEN STAKEHOLDERS AT GOVERNMENT INSTITUTIONS

Strengthening the role of subnational governments, especially districts, began in the decentralisation era through Law No. 22 of 1999 on Local Autonomy, updated through Law No. 32 of 2004, and then strengthened by the Law No. 6 of 2014 on Villages. The delegation of authority to subnational governments has continued since then, as a means of flexibility for subnational governments to develop their regions according to their potential and context. The district government is now responsible for various public services for at least 20 governmental functions, including education, public health, and economic development.¹⁵ The importance of the district's role has been documented in various studies, including the World Bank report on *Indonesian Public Expenditure Review 2020*.¹⁶

The performance of government depends on the main actors, especially the synergy between the legislative and executive boards. The Local head, as the executive board at the Local level, has the authority and plays a dominant role in overseeing the planning and budgeting process. However, the district legislative boards (The District Representative Council) play a role in ensuring the sustainability of local governance to run according to the laws and regulations, in terms of legislation, budget, or supervision. In Pematang District, for example, the synergy between local and executive leaders has been challenging and is affecting the policymaking process. The difficulty of this process resulted in delays in the execution process at the subnational government unit/Local apparatus level.

The dynamics of relationships between the district executive and legislative boards are highly dependent on internal and external factors. The key actors in each KOMPAK district vary, but in general the resulting pattern of the dynamic in relationship is similar. Differences in political interests, both within the Local executive board, or between the executive board and Local legislative board, usually have a negative effect on the amount of expenditure allocations, including the allocation for public services. In Pematang District, the relationship is very dependent on personal relationships. Meanwhile, in Pacitan District, this dynamic is influenced by the winning political party in the Local Head Election. In Bener Meriah District, the key factor is conflicts that hindered the determination of the APBD and required mediation from the Aceh Provincial Government.

Comprehensive rules and capacities in the preparation of Local planning and budgeting are essential in ensuring the quality of the implementation of the program and financial reporting. The quality of program implementation and financial reporting is determined by the capacity of public financial governance institutionally and individually. In Pacitan District, the Financial Statements have constantly received an Unqualified Opinion for the past five years. However, these results do not fully reflect the capacity of subnational governments, since the budget preparation process still depends only on two agencies, namely the Local Development Planning Agency (Bappeda) and the Subnational Public Financial Management Agency (BPKD).

¹⁵ Wetterberg, A., Jellema, JR., & Dharmawan, L. (2013). The local level institutions study three: Overview (Bahasa Indonesia). Washington, D.C.: World Bank Group. Retrieved from <<http://documents.worldbank.org/curated/en/484751468041074368/The-local-level-institutions-study-three-overview>>.

¹⁶ World Bank. (2020). Indonesia Public Expenditure Review 2020: Spending for better results. Washington, DC: World Bank. Retrieved from <<https://openknowledge.worldbank.org/handle/10986/33954>>.

5.2 RELATIONSHIP BETWEEN STAKEHOLDERS AT THE GOVERNMENT LEVEL

The process of local governance is no longer the exclusive right of government officials, but also involves the community and other parties, such as non-governmental organisations (NGOs), academics, and the private sector (Law No. 33 of 2004 on Fiscal Balance Between the Central Government and Local Governments). This important role starts from the planning stage, where there must be a process of identifying problems, all the way to the reporting stage, where the community has the right to hold accountable management of existing resources. Subnational governments can involve NGOs, academics, and the private sector in ensuring the fulfilment of community needs.

Community involvement in promoting transparency and accountability governance is evident. Upward accountability has generally been implemented because some systems and procedures have been determined by regulations. Meanwhile, if a downward accountability process is carried out, it tends to be normative. However, several good practices have been found in the districts where this analysis is located. In Pacitan District, the subnational government has implemented the LAPOR application (People's Aspirations and Complaints Online Service), which allows the public to participate, including to oversee the development and quality of public service delivery. In addition, the Posko Aspirasi and Sekar Desa, which were facilitated through cooperation between KOMPAK and SEKNAS FITRA, have also encouraged improvements in the quality of basic services, especially in Trenggalek and Bima Districts. KLIK PEKKA is also implemented in KOMPAK partner location villages. It is a community-based complaint service aimed at helping the process of accelerating basic services in civil registration administration, education, and health sectors for the community. This whole social accountability approach is a good starting point in minimising the exclusivity of the Local development planning process.

Chapter 6.

CONCLUSIONS AND RECOMMENDATIONS

6.1 CONCLUSIONS

The results of this analysis indicate that subnational governments still depend on fiscal balance funds and other revenues for development funding (shown in the current Local Financial Independence values between 16–22%). Although there is an increasing pattern, the realisation of Local Own-Source Revenue (PAD) needs to be increased with good analysis of the real potential of each type of PAD, so that it can be seen to what extent this potential can be achieved. Currently, the Financing Receipt element also still has a small role as additional support for funding.

Budget planning needs to be optimised, and an in-depth analysis of the real need for each expenditure is also required. Some regions tend not to be optimal in planning their expenditure side, so that expenditure realisation tends to widen. Good planning and budget execution in accordance with planning and efficiency will provide opportunities for more flexibility for subnational governments to handle other priorities that require more budget.

Fixed assets have decreased since the implementation of Law No. 23 of 2014 on Local Government and the initial implementation of Government Regulation No. 71 of 2010 on Government Accounting Standards (SAP). Nearly all districts experienced a process of decreasing fixed assets in 2015, especially since the implementation of Law No. 23 of 2014, as well as Government Regulation No. 71 of 2010, in relation to using full accrual accounting starting from the fiscal year 2015. This is due to the overturning of some authority and function from the district level to the central and provincial levels, which had an impact on the asset values written off from the district government records. In addition, the implementation of the new SAP provides a more detailed asset recording arrangement, where some fixed assets that are still in the process of being recorded are problematic due to land ownership (for example, buildings on village land), and must be removed from the asset list, resulting in a decrease in the number of fixed assets that belong to the district government. Furthermore, the new SAP arrangement gives subnational governments the obligation to record depreciation (decrease in asset value), so that the value of fixed assets has significantly declined due to their recording adjustments.

In four of the study districts, the percentage of subnational government liabilities has increased overall, especially short-term liabilities originating from third party debts. This indicates that the implementation of activities in the government tends to be late, resulting in late disbursement of budgets for third party payments. The implementation of activities can be carried out on time, but the disbursement of payments is hampered due to cash flow, where the expected funds are not disbursed on time, as in cases of procurement with Special Allocation Funds (DAK) as the funding source.

Regarding sectoral performance, the analysis indicates the challenge in relating the amount of money managed by the technical offices and the performance of each sector properly. In general, each district has fulfilled mandatory spending on education and health. However, a large number of performance indicators, especially activity outputs that cannot be measured and reported properly, make the efficiency analysis run improperly, and it requires assumptions to analyse inputs to outcomes. Districts still need tools or assistance to make output indicators more SMART-C (specific, measurable, attainable, reliable, time (and cost) bound, and continuously improved) in the future. In addition, it is necessary to formulate a special form for subnational governments to support detailed activity reporting (as a realisation of Budget Implementation Document-Local Work Unit or DPA-SKPD), so that subnational governments can measure and assess properly how the performance of activities carried out is based on the Budget Implementation Document-Local Work Unit (DPA-SKPD), both from a performance and financial perspective. This would also enable the performance report to be consistently comparable with the financial statements.

The analysis results of institutional relationships in the four districts reveal that many factors influence the quality of institutional relationships expected to have an impact on the quality of subnational public financial management. These factors include the leadership role of Local heads and key stakeholders; complete rules and consistency of existing regulations to be implemented in the regions; role clarity of each stakeholder in planning and budgeting; political dynamics of each region; and the quality of public participation in the planning and budgeting process.

6.2 RECOMMENDATIONS

Based on the analysis and findings presented above, the table below summarises recommendations based on the five groups of challenges, and the suggested responsible levels of government.

| NO | FINDING | RECOMMENDATION | EXECUTOR |
|--|---|--|--------------------|
| General Challenges of Subnational Public Financial Management | | | |
| 1 | Financial statements, accounting processes, and expenditure allocation policies require improvement. | <ul style="list-style-type: none"> It is necessary to consolidate the Local finances to make the Local financial data used by the central government, local government, and stakeholders consistent. Limiting changes in the format and system of Local financial reporting; changes must be implemented through a one-door policy. | Local government |
| 2 | The reliability of the assessment of the performance and financial statements prepared by subnational governments needs to be improved to provide results that can describe the real situation of the region. | <ul style="list-style-type: none"> Simplification and consolidation of Local financial reporting systems is required to avoid inconsistencies in the data used in each report. | Central government |
| 3 | The allocation of expenses and maintenance expenditures for fixed assets tends to decline. | <ul style="list-style-type: none"> To facilitate similar analysis, access to consolidated and complete APBD data should be provided to the public. This would put public pressure on the relevant government to investigate further. | Local government |

| NO | FINDING | RECOMMENDATION | EXECUTOR |
|---|--|--|--------------------|
| Revenue Challenges: The subnational governments have not yet optimised their revenue streams | | | |
| 4 | High dependence on transfer funds from the central government. | <ul style="list-style-type: none"> Local financial independence needs to be improved by increasing PAD through tax and redistribution of revenues. This increase must go through an expansion of the tax base that can benefit from a consistent database on Local economic potential. | Central government |
| 5 | The contribution of local taxes and levies is still relatively low and tends to decrease in terms of Regional Gross Domestic Product (PDRB). | <ul style="list-style-type: none"> It is necessary to regroup the categories for BPJS Capitation Funds. Currently, this component is included within Other Legal PAD (LLPADYS) category, but it can create confusion in measuring the level of independence and the degree of fiscal decentralisation. | Local government |
| 6 | Capitation Funds of JKN and BPJS are reported under PAD, so that they affect the level of local financial independence. | <ul style="list-style-type: none"> It is necessary to regroup the categories for BPJS Capitation Funds. Currently, this component is included within Other Legal PAD (LLPADYS) category, but it can create confusion in measuring the level of independence and the degree of fiscal decentralisation. | Local government |
| Expenditure Challenges: Budget absorption and quality of spending are still not optimal | | | |
| 7 | Subnational governments tend to have budget surplus policies that lead to SILPA. | <ul style="list-style-type: none"> In terms of performance, SILPA is considered as negative because it implies that subnational government has weak planning and implementation capacity. With evidence-based planning (using consistent data and analysis), subnational government would be able to lower their SILPA. | Local government |
| 8 | Subnational government spending is still focused on indirect expenditure, particularly for personnel expenditure. | <ul style="list-style-type: none"> In general, indirect expenditure is quite high. This is because the salary expenditure for the education board includes salaries for civil servants and teachers. A special category should be made to measure how much expenditure is actually for the internal and operational expenses of the local government, and how much is actually for public services. | Local government |
| 9 | The fulfilment of mandatory spending on education and health should be studied further to increase fiscal flexibility. | <ul style="list-style-type: none"> In general, indirect expenditure is quite high. This is because the salary expenditure for the education board includes salaries for civil servants and teachers. A special category should be made to measure how much expenditure is actually for the internal and operational expenses of the local government, and how much is actually for public services. | Local government |
| Sectoral Challenges: Sectoral spending faces a variety of challenges | | | |
| 10 | Although the sectoral budget has increased, education spending has declined as a ratio. | <ul style="list-style-type: none"> To assess efficiency and effectiveness, it must be possible to identify what are the inputs, outputs, and final and intermediate achievements. In the Local Mid-Term Development Planning document, an attempt has been made to explain the four components, but their relevance can still be improved. There is a need for better alignment of planning documents. There should be a method or mechanism to produce output indicators that are more specific, measurable, attainable, reliable, and time (and cost) bound, and continuously improved (SMART-C). | Local government |
| 11 | Budget increases for strategic programs have not been accompanied by performance improvement. | <ul style="list-style-type: none"> To assess efficiency and effectiveness, it must be possible to identify what are the inputs, outputs, and final and intermediate achievements. In the Local Mid-Term Development Planning document, an attempt has been made to explain the four components, but their relevance can still be improved. There is a need for better alignment of planning documents. There should be a method or mechanism to produce output indicators that are more specific, measurable, attainable, reliable, and time (and cost) bound, and continuously improved (SMART-C). | Local government |
| 12 | Variations in the level of program spending complicate the monitoring and evaluation processes. | <ul style="list-style-type: none"> To assess efficiency and effectiveness, it must be possible to identify what are the inputs, outputs, and final and intermediate achievements. In the Local Mid-Term Development Planning document, an attempt has been made to explain the four components, but their relevance can still be improved. There is a need for better alignment of planning documents. There should be a method or mechanism to produce output indicators that are more specific, measurable, attainable, reliable, and time (and cost) bound, and continuously improved (SMART-C). | Local government |

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