

RESEARCH REPORT

**Changes in the LGU Structure
for the Budgeting Process**

November 2003

Prepared for

U.S. Agency for International Development

By

INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION
Building Institutions for Good Governance (BIGG)
USAID Contract No. OUT-LAG-I-808-99-00008-00
Task Order No. 808 (ICMA 4312)

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ABSTRACT

This report focuses on the budget preparation and decision-making process in local governments in Indonesia. The issues that affect the budget decision-making process in Indonesia are the same fundamental issues found in most developing countries. While the central government is decentralizing power, local governments are simultaneously implementing the beginning stages of democracy and striving to develop strong, effective local government units (LGUs) that are responsive to the local citizens.

The purpose of this report is to provide recommendations for changing the structure of local governments in departments and agencies that have responsibility for the budgeting process. Specifically, we evaluated three local governments' budget preparation processes for the purposes of recommending alternative organizational structures and processes for budget preparation. The report includes recommendations for improvements to existing departments or agencies as well as changes in organizational structure, descriptions of functions related to the structural changes, and estimates of the level and quality of human resources needed.

The initial Task 4.0 of the Task Order required that BIGG/ICMA provide assistance to selected local governments to evaluate their organizational structure, staffing needs, and performance expectations, and to initiate improvements that result in improved management and service delivery. This task was modified to focus more intensively on three of the BIGG/ICMA partner districts rather than a less intensive look at all nine Year 1 local government partners. This report is submitted to meet the requirements of Task 4.0.

RESEARCH REPORT

CHANGES IN THE LGU STRUCTURE FOR THE BUDGETING PROCESS

1 INTRODUCTION

BIGG is being implemented by the International City/County Management Association (ICMA) in partnership with the Indonesian Ministry of Finance and the Ministry of Home Affairs and Regional Autonomy with funding support from USAID. In furthering its objectives, BIGG has been concentrating on helping participating local governments understand and implement new laws and regulations, such as moving from incremental budgeting toward performance budgeting.

This report focuses on the budget preparation and decision-making process in local governments in Indonesia. The issues that affect the budget decision-making process in Indonesia are the same fundamental issues found in most developing countries. While the central government is decentralizing power, local governments are simultaneously implementing the beginning stages of democracy and striving to develop strong, effective local government units (LGUs) that are responsive to the local citizens. Power in this sense is the power of the purse—who decides how and when scarce resources are used. Shifting power from the central to the local government is a long, arduous process, and budget decision making and allocation is at the heart of this process.

2 PURPOSE

The purpose of this report is to provide recommendations for changing the structure of local governments in departments and agencies that have responsibility for the budgeting process. Specifically, we evaluated three local governments' budget preparation processes for the purposes of recommending alternative organizational structures and processes for budget preparation. The report includes recommendations for improvements to existing departments or agencies as well as changes in organizational structure, descriptions of functions related to the structural changes, and estimates of the level and quality of human resources needed.

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3 METHODOLOGY AND FRAMEWORK

Two U.S. consultants, Jack Coughlin and John Taylor, participated in the interviews and data collection for this report over the six-month period from July to December 2003. John Taylor prepared the preliminary draft of this report including the findings and initial recommendations. Kay Spearman finalized the report by refining the recommendations and documenting actual organizational changes in the decision-making process that have occurred in the sample local

governments since last year's initial interviews. This report could not have been as comprehensive without each person's unique perspective and input.

In evaluating the current organizational structures for budget decision making, we used the following principles of effective local governments as the basic starting point or framework for analysis:

- **Strong municipal leadership and management:** Prior to the decentralization legislation in Indonesia, strong municipal leadership was exercised by the Mayor and Bupati, who reported to the central government. Neither the legislative body nor citizens had much, if any, power in terms of influencing decision making at the local government level. By stressing strong municipal leadership as a principle of effective local government, we do not mean a continuation of the past practice of Mayors/Bupatis having their own fiefdom, with no checks and balances. Instead, we are advocating a strong system of checks and balances within the executive and legislative branches of the local government, and that decision making be transferred from the traditional seat of power of the Mayor/Bupati to the legislative body who should be, in turn, responsible to the citizens.
- **Transparent financial management and budgeting systems:** This principle will probably be the most difficult to implement in Indonesian local governments due to the past history of collusion, corruption, and nepotism. The budget preparation and decision-making process must be transparent to the executive and legislative branches as well as the local citizens. Indonesian local governments are still struggling with implementing transparency. Along with this concept is the additional concept of accountability. It is essential that the budget preparation and decision-making process be structured so that the legislative body and in turn the citizens who elected the legislature can hold department heads and other decision makers from the executive branch accountable for the use of scarce resources.
- **Efficient municipal and environmental service delivery:** A primary benefit of a transparent, accountable, strong budget preparation and decision-making process can be the ability to determine community priorities for service delivery and to provide mechanisms for ensuring that the prioritized services are delivered efficiently. This premise is the cornerstone of the BIGG/ICMA project, which is tasked with implementing performance-based budgeting in selected local governments. However, with the political party system that is currently in place, the party or coalition of parties usually determines the priorities for local government services rather than the elected legislators looking to the citizens to prioritize services.
- **Long-range capital planning and investment:** A strong budget preparation and decision-making process must have a workable method for ensuring that capital planning and investment are an integral part of the budgeting process. Currently, long-range capital planning and investment is handled in the operating budget, which is based on a single fiscal year. Over the next few years, the Ministry of Home Affairs plans to introduce the concept of multi-year budgets for capital planning and investment.
- **Democratic citizen participation in the LGU:** Strong citizen participation is essential to sustaining a democracy. Local governments in Indonesia are making steps in this direction, but currently most citizen participation efforts consist of informing the citizens, not soliciting their input into the decision-making process.

- **Sustainable community and economic development:** If a local government can demonstrate that it has a transparent, accountable, strong budget preparation and decision-making process, both foreign and national investors will likely be much more willing to invest in the local government’s community. Officials from local governments have demonstrated an understanding of the link between sustainable communities and local development. Also, with most of the local governments’ revenues (on average, 85-90%) coming from the national government, local governments have a strong interest in encouraging economic development so that they can increase own-source revenues as a percentage of the total revenues coming to the local government.

4 ANALYSIS OF THE THREE SELECTED LOCAL GOVERNMENT ORGANIZATIONAL STRUCTURES

Starting with the principles identified above as the framework, we evaluated three local governments to determine their current budget decision-making process, including roles and functions of the various agencies within the local government.

4.1 Agencies or Entities and Their Roles/Functions

In most LGUs, the following agencies are involved in the annual budget decision-making process: local planning body (BAPPEDA), Finance Division, Revenue Agency, ad hoc Budget Committee normally established by a decree issued from the Mayor/Bupati, oversight body, and the local legislative body (DPRD). The basic roles/functions of these agencies are as follows:

Agency	Primary Role/Function	Comments
Local planning body (BAPPEDA)	<ul style="list-style-type: none"> • Develop five-year and one-year project plans • Head usually a member of ad hoc Budget Committee 	As the overall development planning agency for the LGU, the planning body’s work in the annual budgeting process begins by formulating the five-year plan. Based on the five-year plan, as well as priorities from the Mayor/Bupati and inputs from all agencies, the planning body formulates a one-year development plan. Next, the planning body oversees the “bottom-up planning” process, in which requests from the village and subdistrict levels are filtered up to the district level. This enables the planning body to refine the one-year plan and formulate a prioritized list of projects as an input to the draft budget.
Finance Division of Secretariat	<ul style="list-style-type: none"> • Project revenues and expenditures for LGU • Determine budget allocations for departments and agencies • Head usually member of ad hoc Budget Committee 	The Finance Division of the Secretariat is often a major player in the annual budgeting process. Its most important individual function in the process is to prepare a draft budget allocation on the basis of an analysis and projection of the LGU’s income and expenditures. This indicates the total amount of expenditures and total funds likely to be available from all sources for the coming fiscal year.

Agency	Primary Role/Function	Comments
Local Revenue Agency ¹	<ul style="list-style-type: none"> • Project LGU own-source (taxes and fees) revenues • Head usually member of ad hoc Budget Committee 	With regard to the annual budgeting process, the Revenue Agency generally supports the Finance Division in carrying out an analysis and projection of LGU own-source revenues.
Ad hoc Budget Committee	<ul style="list-style-type: none"> • Prepare the Mayor/Bupati's draft budget • Function as the secretariat for preparing the draft budget, based on a review of available resources, of the one-year plan, and of budget proposals submitted by all LGU agencies • Play an important role in preparing the final draft budget, as representatives of the executive branch, after the legislative body has reviewed the draft budget • Assist in preparing the annual budget message for the Mayor/Bupati • Assist in preparing the Mayor/Bupati's accountability report to the DPRD after budget implementation 	Although not a structural or permanent agency, the ad hoc Budget Committee is usually formally established through a decree from the Mayor/Bupati. It is made up of the Secretary of the kota or kabupaten (who is usually the chair of the Budget Committee) and assistants, the Finance and Development Divisions and some other Secretariat officials, and the planning body.
Oversight body	<ul style="list-style-type: none"> • Responsible for monitoring and supervising implementation progress and assessing the degree to which implementation is conducted in accordance with the budget plan 	The results of the oversight body's investigations are reported to both the executive and legislative branches of the LGU.
Local legislative body (DPRD) ²	<ul style="list-style-type: none"> • Reviews the draft budget as representatives of the community and has responsibility for adopting the final budget. The budget is usually adopted by a subcommittee of the full DPRD. 	In contrast to the "new order" days, the DPRD now plays a key role in the LGU's annual budgeting process. Under the new decentralization regulations the DPRD now has the authority to hire and fire the Mayor/Bupati based upon his/her performance as demonstrated by the accountability report. This is a significant change in the balance of power between the executive and legislative branches of the LGU.

¹ In Kabupaten Sleman, and several other local governments throughout Indonesia, the Finance Division and the Revenue Agency have been combined to form an integrated financial management agency called the Finance and Asset Management body. In Sleman's case, asset management has also been amalgamated into this new body. Based on site visit interviews, it was learned that similar amalgamations have taken place in Kabupatens Solok and Pariaman (West Sumatra) and Kabupaten Bogor (West Java). Undoubtedly, this has occurred in other LGUs as well.

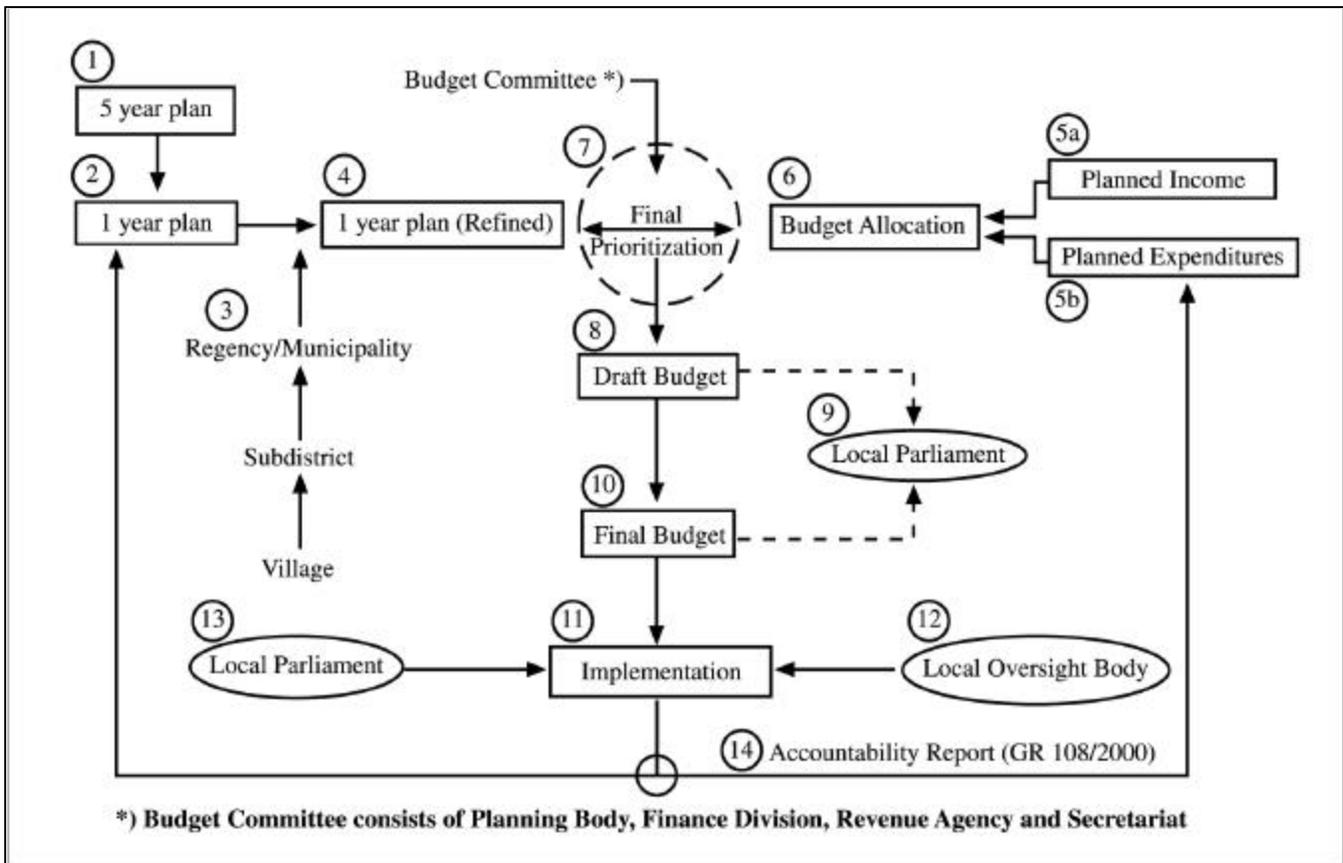
² In Bukittinggi, the DPRD plays a more proactive role in the process. In parallel with the bottom-up planning process of the LGU, the DPRD also goes into the field to discuss project priorities in every community. It then formulates a parallel list of prioritized projects and participates actively in preparing the draft budget through a consensus process involving both the executive and legislative branches. However, the intensive participation of the DPRD in Bukittinggi appears to be unusual if not unique.

4.2 Description of Current Budgeting Process

As shown in Figure 1, the annual budget cycle begins with planning.

1 & 2: The planning body prepares an annual development plan, based on a one-year portion of the five-year plan (see steps 1 & 2 in Figure 1). This annual plan includes annual proposals received from all local agencies of the LGU.

Figure 1. Current Budgeting Process



3 & 4: This tentative plan is then refined by filtering requests from the village and subdistrict level through the “bottom-up planning process,” leading to an “Annual Plan Plus” or prioritized list of projects.

5 & 6: Meanwhile, the other key player in budgeting, the Finance Division, prepares a draft budget allocation based on its analysis/projection of the LGU’s income and expenditures. Regarding the income side, they are supported by the Revenue Agency.³

7: At this point in the process, the ad hoc Budget Committee becomes the dominant player. The functions of the Budget Committee are generally outlined in the decision letter, but it is the

³ In the case of Kabupaten Sleman, the financial planning and management functions have already been consolidated into a Financial and Asset Management Body, but this is exceptional.

opinion of most officials we interviewed who are involved in the process that these functions need to be spelled out in greater detail.

- 8:** Essentially, the Budget Committee's main role is to prepare the draft budget, based on a review of budget proposals submitted by all LGU agencies.⁴
- 9:** The draft budget is then forwarded to the Mayor/Bupati, who reviews it and presents it formally to the DPRD with his budget message.
- 10:** Within the DPRD, a budget committee has particular responsibility for the budgeting process. In the course of reviewing the budget, the DPRD may hold hearings with specific agencies. The DPRD then modifies and approves the budget as final.

Figure 1 also shows that the annual budget cycle does not end with final adoption of the budget.

- 11–13:** As the budget is implemented, the DPRD and another government unit, the local oversight body, track the implementation process and attempt to assess the degree to which implementation is conducted in accordance with (or contrary to) the budget plan.
- 14:** As a final step in the budget cycle, the Mayor/Bupati is required to give an accountability report on implementation progress at the end of the fiscal year.

5 FINDINGS

In reviewing and analyzing the existing budgeting process and related organizational structure, we noted two significant findings.

5.1 Finding 1: There is a lack of transparency and accountability in the overall budgeting process.

Sub-finding 1a: There is a lack of interactive public hearings.

Interactive public hearings with citizens are not yet an integral part of the annual budgeting process.

Sub-finding 1b: There is a lack of legislative (DPRD) involvement in the budgeting process.

Despite the requirement in government regulations that the legislature become more involved in the budgeting process, the legislature's participation in most local governments is relatively limited, and should be strengthened. Government Regulations No. 105/2000 and No. 108/2000

⁴ It is particularly significant that recent legislation, including GR 105 and 108/2000 and Presidential Instruction 7/2000, stipulates that performance budgeting techniques should be used (indicators of inputs, outputs, outcomes, benefits, and impacts), that all agencies should participate, and that the DPRD should be involved in the process. However, actually applying such techniques is complex, and much training is needed to fully implement them. Presumably, MOHA Decree 29/2002 and subsequent training material developed by BIGG can provide more explicit guidelines.

In the case of Bukittinggi, the budgeting process is somewhat different because the DPRD is involved proactively and earlier than in most other LGUs. The DPRD also goes to every village and formulates its parallel prioritized project list. The draft budget then emerges from a consensus process with participation from both the executive and legislative branches. The Budget Committee functions as the secretariat for this process.

stipulate that the DPRD must become involved in the annual budgeting process: in the budget's preparation, in its final approval, and in the evaluation of budget performance. However, the site visits revealed that there is a wide variation in the extent of involvement or participation of the DPRD in this process.

In Kabupaten Sleman, although the DPRD must give final approval of the budget, its participation earlier in the process appeared to be relatively limited. It was scarcely mentioned in interviews. In Bukittinggi, on the other hand, the DPRD played a crucial role in the entire budgeting process, beginning with holding its own bottom-up planning meetings and finishing by giving final approval of the budget. The Bukittinggi model of a proactive DPRD clearly favors good governance principles. Without the DPRD being involved at each step in soliciting and considering community input, the budgetary decision-making process is much too limited and will not reflect community priorities for spending.

Sub-finding 1c: There are a number of entities involved in the process.

Multiple entities are involved in the budget decision-making process. This usually means that the annual budget preparation process is not as well coordinated, efficient, or transparent as it could be.

The revenue projection and collection, financial budget allocation, and overall planning functions are presently located in separate agencies. The permanent agencies normally include the Revenue Agency, the Finance and Development Division within the Secretariat, and the planning body, along with an ad hoc (non-permanent) Budget Committee. In addition, the oversight body plays a role in overseeing implementation, and the DPRD is involved as representatives of the citizens—both in determining the budget and in evaluating implementation progress.

Sub-finding 1d: There is a lack of accountability of the legislature (DPRD) to citizens.

The current local government election laws do not call for the direct election of a specific person to the DPRD. Instead, votes are cast for political parties, and then political parties appoint the persons who will serve in the DPRD. The effect of this system is that the elected representatives do not owe their position to the citizens but to the political parties, and that is where their loyalties lie and for whom their votes are cast. Because of this system, the issue of transparency becomes even more important to the citizens.

Sub-finding 1e: There are weaknesses with the appointed Budget Committee.

In virtually all LGUs, an ad hoc Budget Committee has been established by a decree of the Mayor/Bupati. We have identified three primary weaknesses with the current system. First, the Budget Committee's composition tends to be overly political rather than professional. For example, the Finance Division, planning body, or a consolidated "finance agency" should be represented by persons who are professionally trained in financial management. Second, the Budget Committee tends to be too heavily weighted with Secretariat administrative types rather than financial professionals. Third, the committee's roles and functions are not always well defined, and its decision-making process lacks the transparency and accountability that a permanent agency has.

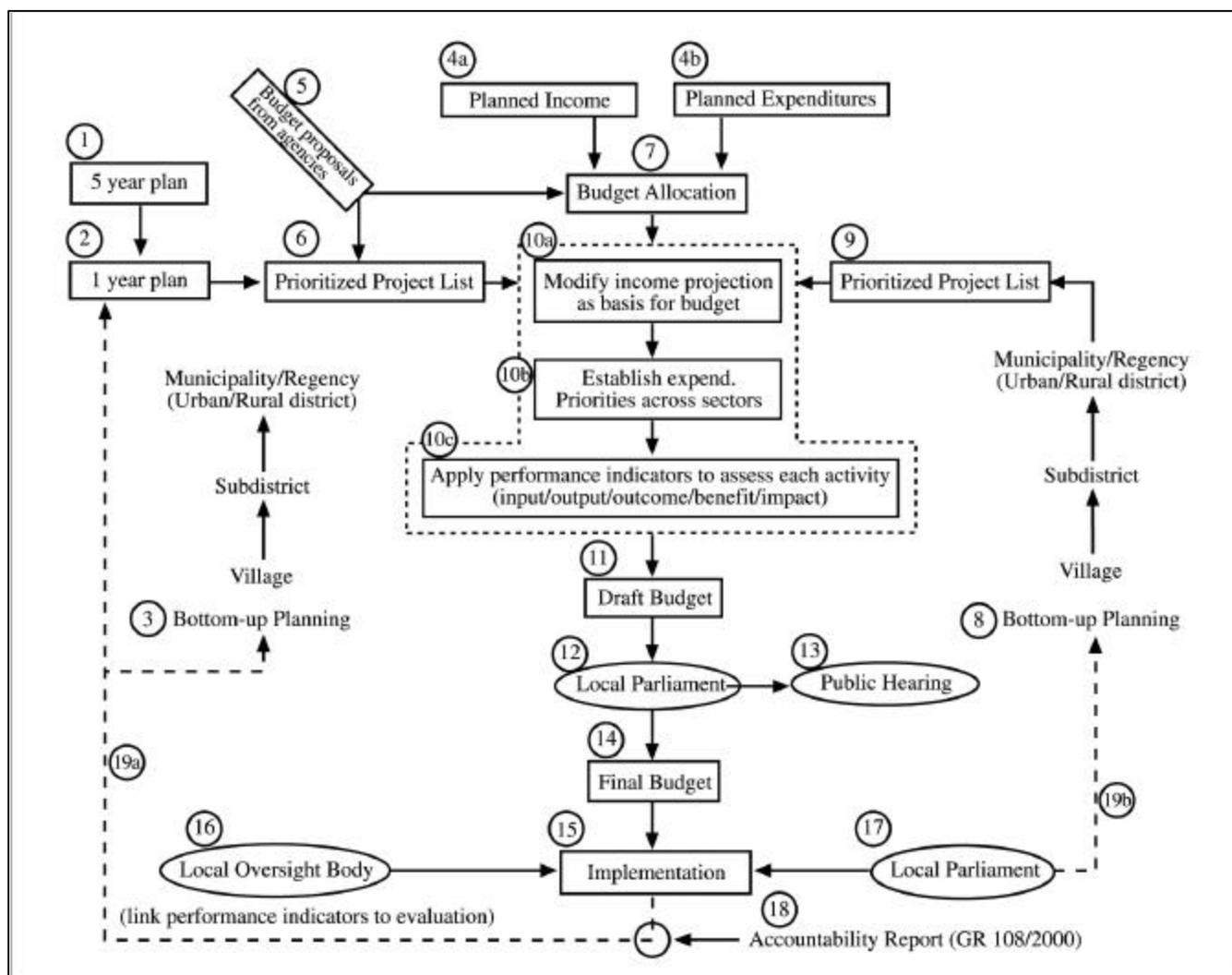
5.2 Recommendations for Finding 1

Our recommendations for addressing Finding 1 are twofold: the first is a proposed revised budget process, and the second involves three options, ranging from minimal changes to fairly drastic changes, for the proposed organizational structure of the entities or agencies that participate in the budget preparation and decision-making process.

Proposed Revised Budget Process

The proposed overall annual budget preparation process is shown in Figure 2. Although the precise agency or entity of the executive branch with specific responsibility for each technical step of the process will vary according to the three proposed organizational structures, the overall budget preparation process is roughly the same for each structure.

Figure 2. Proposed Revised Budget Process



On the face of it, the proposed budget preparation process does not appear to be very different from the existing process shown in Figure 1. However, the DPRD's "bottom-up

planning” exercise has been added (as per Bukittinggi) and the steps involving performance budgeting have been shown more explicitly (steps 5, 6, 7, and especially 10).

In terms of overall responsibility for the process, the executive branch, under the leadership of the Mayor/Bupati, is responsible for the technical aspects of preparing and recommending a performance budget consistent with the vision, mission, and strategic plan of the urban or rural district.

The legislative branch (DPRD) is responsible for adopting the budget. The capital investment and operating portions of the budget will be integrated into one document.

Proposed Organizational Changes

We are proposing three options for changes to the organizational structure. These are presented in an order ranging from least impact on the organization to the most sophisticated change in the organizational structure. The first is called the “Minimum Changes.” It reflects the minimum changes that we believe all local governments should make regarding the budget preparation and decision-making process. Primarily, it calls for the full identification of the tasks, roles and responsibilities, and functions of the ad hoc Budget Committee.

The second is called the “Alternate” structure. It includes the minimum changes and recommends the formation of a new department. The department combines the Finance Division and Revenue Agency into a newly created department named the Financial Planning and Management Agency.

The third is called the “Recommended” structure. This is the organizational structure that we believe best suits the budget preparation and decision-making process in Indonesian local governments and requires the most organizational change. It combines the planning functions by moving the budget preparation function of Finance and Revenue to the planning body where it would be integrated with the macro and longer-term planning process. Other financial functions related basically to management would remain with the Finance Division and Revenue Agency, which can either be combined or remain separate.

Each of these proposed changes to the organizational structure is further explained below.

Minimum Changes Recommended

This recommendation focuses on the need to identify the tasks, roles and responsibilities, and functions of the ad hoc Budget Committee. The Mayor/Bupati will have the responsibility for clarifying these through the annual decree establishing the ad hoc Budget Committee.

In addition, we recommend the following to improve the Budget Committee once roles, responsibilities, tasks, and functions have been clearly delineated:

- Key groups involved in the annual budgeting process, including members of the Budget Committee, need training in performance budgeting, including use of performance indicators (inputs, outputs, outcomes, benefits, and impacts), so that they all have a common reference framework.

- Composition of the committee should become more professional so that allocations are more objective and less political. For example, the Finance Division, Revenue Agency, and planning body should be better represented—and the Secretariat less so.
- Specific subdivisions of both the planning body and Finance Division should have responsibility for the annual budgeting process, thus providing permanent “structural” support to the Budget Committee. We recommend assigning this responsibility to the Budget Subdivision within the Finance Division and to the Performance Evaluation Subdivision within the Research and Evaluation Division of the planning body.
- The Budget Committee needs to ensure that the annual budgeting process includes interactive public hearings—interactive meaning that local government officials give the public opportunities to speak and to have input into the decision making rather than just disseminating information to the public without asking for input.

Understanding the Impact of the Minimum Changes Recommendation Using Figure 2. To understand the impact of implementing these changes, please refer to Figure 2 for the following: starting with Step 5, preliminary budget proposals are prepared and submitted by all implementing agencies. In reviewing budget proposals from the agencies and integrating these with the one-year plan and bottom-up planning process, the planning body then concentrates on formulating a preliminary capital investment budget (Step 6). The Finance Division, on the other hand, would focus on the preliminary budget allocation in the operating budget (Step 7).

At this point, the Budget Committee—as a joint task force involving members from Planning, Finance, Revenue, and Secretariat—would begin its main technical function in the performance budgeting process, as follows:

- The Budget Committee reviews/modifies the LGU’s income projection from Finance/Revenue as a basis for the budget (Step 10a).
- The Budget Committee establishes expenditure priorities across sectors for both the operational and capital investment budgets, based on overall goals and policies from the Mayor/Bupati and/or as imbedded in the one-year plan (Step 10b). The Budget Committee applies performance indicators to assess each “activity” or “proposal” by each implementing agency or other LGU agency. In this effort, the Budget Committee must work iteratively with the various implementing agencies to establish consistent performance indicators (Step 10c). The Budget Committee then draws up the draft budget, which includes: projected income from various sources, projected expenditures, budget by sector/agency, operating and capital investment budget (Step 11). Next, the Budget Committee assists the Mayor/Bupati in packaging the draft budget together with a message for presentation to the DPRD (Step 12a). Although basic responsibility for finalizing the budget rests with the DPRD, the Budget Committee may be called upon to help prepare the final budget (Step 14). Finally, the Budget Committee may also prepare performance evaluation data that the Mayor/Bupati can use in formulating the accountability report at the end of the fiscal year (Step 18).

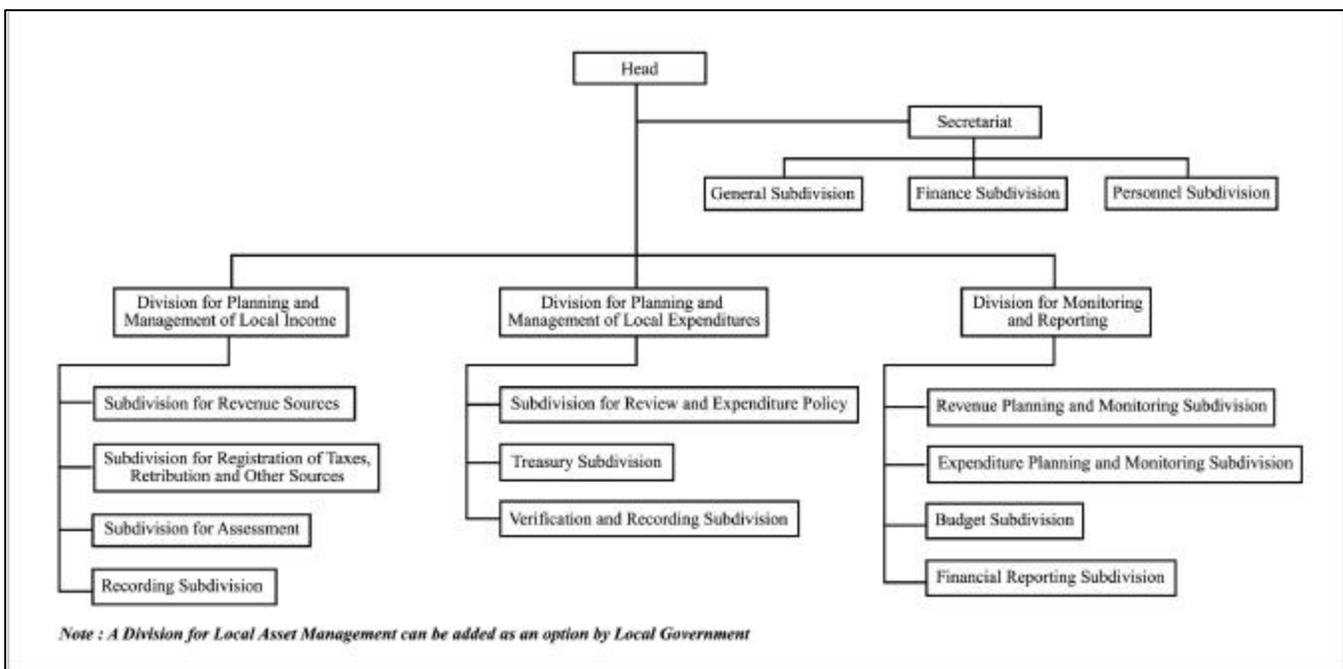
The functions described above can be formalized in a decree from the Mayor/Bupati, which together with the other recommendations can substantially improve the performance of the Budget Committee—and therefore the annual budgeting process of the local government.

“Alternate” Structure

The focus of this recommendation is on creating a new local financial planning and management body and further identifying those parts of the planning body proposed to deal specifically with the performance budgeting process. The Budget Committee would also remain present in the “Alternate” structure, and therefore the tasks and functions of this committee should also be clarified and amplified in the alternate structure.

Financial Planning and Management Agency. We recommend that certain portions of the Finance Division be transferred to a new department. Following are the tasks and functions for each division and subdivision of that new department (Figure 3).

Figure 3. New Finance Agency



Division for Planning and Management of Local Income. This division has basic responsibility for estimating, collecting, and recording local revenues. Four subdivisions have the following functions:

- **Subdivision for Revenue Sources.** Explore and/or intensify possible revenue sources.
- **Subdivision for Registration of Taxes, Retribution, and Other Sources.** Register and list objects and subjects for taxes, retribution (fees), and other revenue sources, and conduct field inspections of objects and subjects.
- **Subdivision for Assessment.** Calculate/determine tax and retribution amounts and issue official letters.
- **Recording Subdivision.** Record income received from various tax and retribution sources.

Division for Planning and Management of Local Expenditures. This division has basic responsibility for estimating expenditures, authorizing payments, and verifying and recording

authorized expenditures of the local government. Three subdivisions have the following functions:

- **Subdivision for Review and Expenditure Policy.** Review feasible expenditures in accordance with budget policy.
- **Treasury Subdivision.** Authorize the treasurer to make expenditures.
- **Verification and Recording Subdivision.** Verify and record authorized expenditures.

Division for Monitoring and Reporting. This division has basic responsibility for monitoring revenues and expenditures, estimating the local budget allocation, and reporting finances. Each of four subdivisions has the following functions:

- **Revenue Planning and Monitoring Subdivision.** Conduct bookkeeping and calculation of local revenues, together with analysis of local revenue performance.
- **Expenditure Planning and Monitoring Subdivision.** Conduct bookkeeping and calculation of local expenditures, together with analysis of local expenditures.
- **Budget Subdivision.** Estimate the budget allocation for the coming fiscal year.
- **Financial Reporting Subdivision.** Carry out reporting of local finances.

Planning Body. Under the “Alternate” structure, the planning body will continue to exist as a separate body (Figure 4). We propose that the subdivisions of the planning body dealing specifically with the performance budgeting process be concentrated within one division. This might be named the Research, Development Research, or Development and Evaluation division whose main responsibility is analyzing overall development and potential development, collecting and analyzing data, and evaluating development performance. Four subdivisions have the following functions:

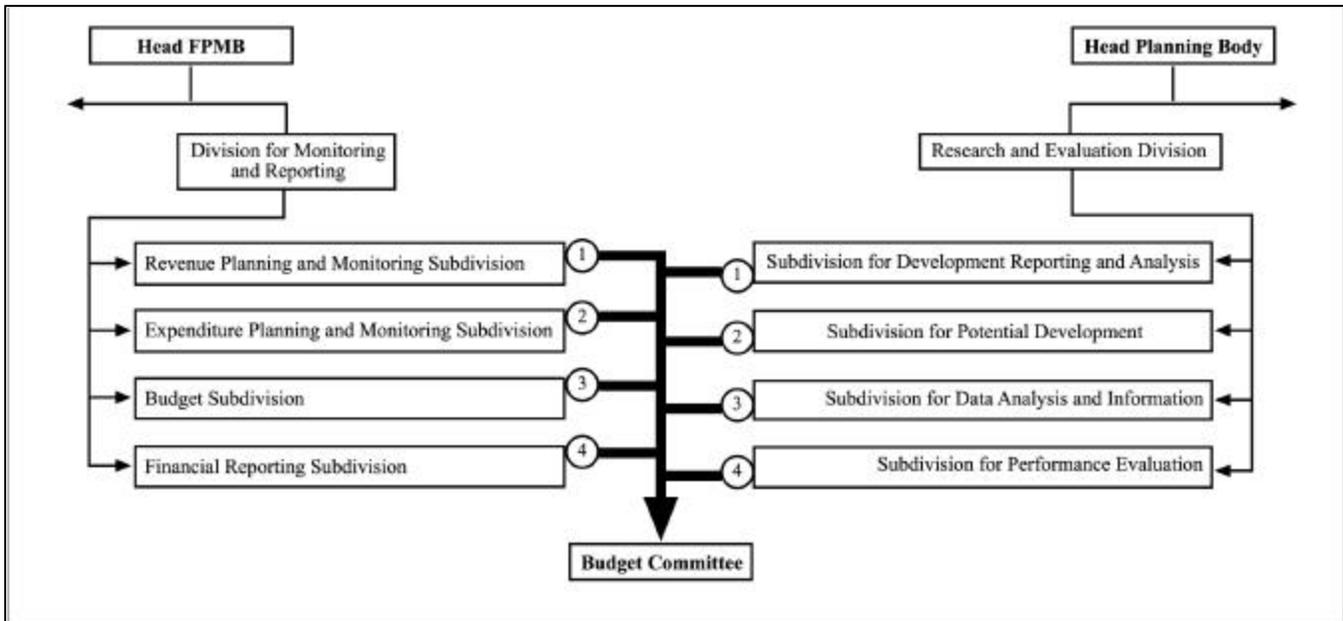
- **Subdivision for Reporting and Analysis of Public Services.** Conduct analysis and reporting on many aspects of development.
- **Subdivision for Potential Development.** Collect, process, and analyze data on potential development.
- **Subdivision for Data Analysis and Information.** Coordinate and carry out research and collect and process data related to a wide range of development activities.
- **Subdivision for Performance Evaluation.** Collect and process data, and evaluate development performance in relation to programs carried out by various agencies of the local government. Such evaluation relates specifically to the performance accountability report that the Mayor/Bupati must give to DPRD.

The latter two of these subdivisions—Data Analysis and Information, and Performance Evaluation—have a specific relationship to the budgeting process.

Understanding the impact of the “Alternate” structure recommendation using Figure 2. Please refer to Figure 2 for the following: the planning body updates the five-year plan and formulates the one-year plan as an annual slice for the coming year (steps 1 and 2 in Figure 2).

The one-year plan is then refined as the planning body oversees the “bottom-up planning” process (step 3).

Figure 4. Alternate Structure



The Financial Planning and Management Agency, supported by the Revenue Agency, prepares a preliminary budget allocation based on the analysis and projection of income and expenditures for each implementing agency (steps 4a, 4b, and 7).

The Budget Committee would then begin its formal work by issuing instructions to all implementing agencies on preparing performance budget proposals (step 5).

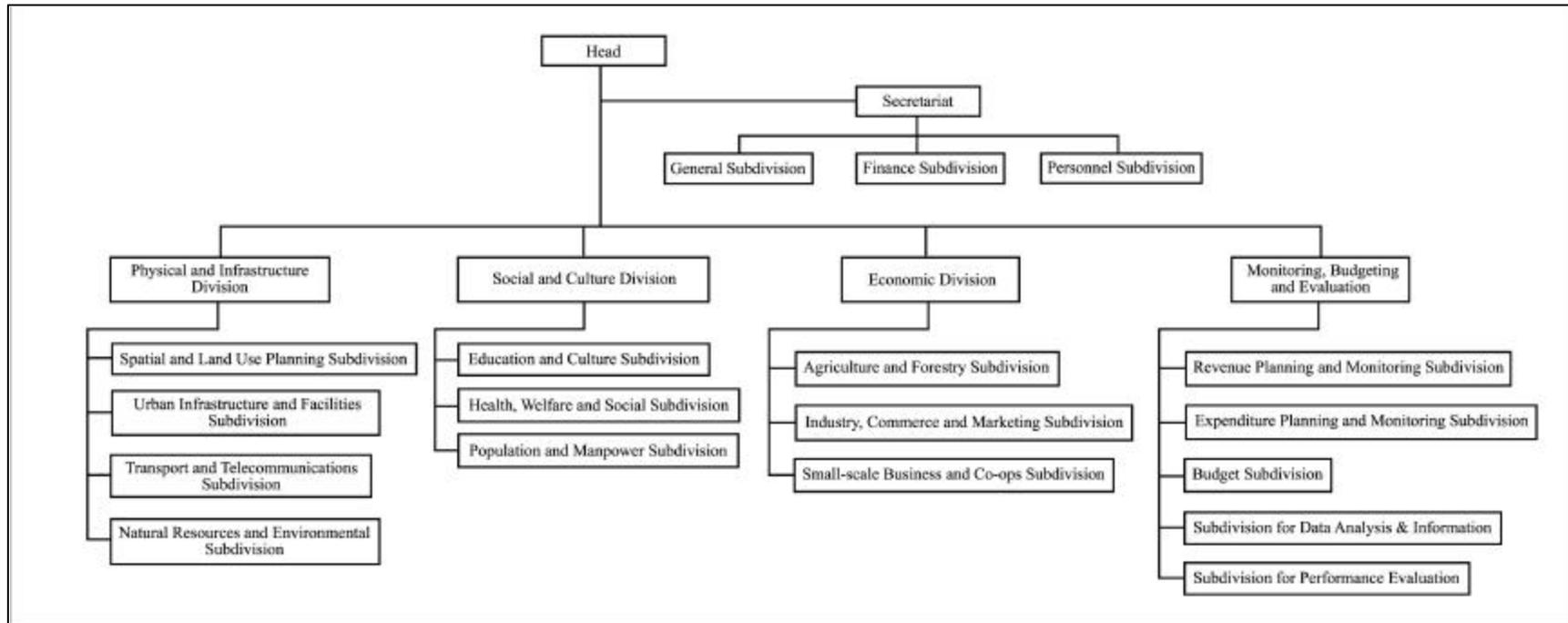
In the “Alternate” structure, the planning body would continue to be responsible for steps 1, 2, 3, and 6, as shown in Figure 2. The consolidated Financial Planning and Management Agency would be responsible for steps 4, 5, and 7; and the Budget Committee would be responsible for steps 10 and 11. Finally, the DPRD would continue to assume responsibility for steps 8, 9, 12, 13, and 14.

“Recommended” Structure

This is the structure that we believe is the most appropriate for Indonesian local governments. It is similar to a typical planning body except for the addition of budgeting within the Division for Monitoring, Budgeting, and Evaluation. Hence, the following four divisions are proposed (Figure 5):

- **Physical and Infrastructure Division.** Coordinate development planning of facilities and infrastructure, spatial and land use planning, transport, natural resources, and environment. This includes preparation of capital investment programs.
- **Social and Cultural Division.** Coordinate development planning activities in the fields of education, culture, health, welfare, population, and human resources.

Figure 5. Organizational Chart for Recommended Structure



- **Economic Division.** Coordinate development planning activities in the fields of agriculture, industry, trade, cooperatives, and other economic sectors.
- **Division for Monitoring, Budgeting, and Evaluation.** The fourth and final division shown here for the planning body represents the essence of the proposal in the “Recommended” structure: that of moving budget preparation from the Finance Division into the planning body. This Division for Monitoring, Budgeting, and Evaluation combines all subdivisions with the responsibility for annual budgeting. We believe that the budget decision-making process will be significantly strengthened by moving budget preparation into the planning body from the Finance Division.

New Monitoring, Budgeting, and Evaluation Division. This Division for Monitoring, Budgeting, and Evaluation combines all subdivisions with responsibility for annual budgeting. The first three subdivisions are identical to those found in the Financial Planning and Management Agency under the Monitoring and Reporting Division (see “Alternate” structure). The last two subdivisions are identical to those found in the planning body in the Research and Evaluation Division, also in the “Alternate” structure. While the five subdivisions are listed below, their tasks and functions are not repeated here, but can be referred to in the relevant sections of the “Alternate” structure. The subdivisions are:

- Revenue Planning and Monitoring Subdivision
- Expenditure Planning and Monitoring Subdivision
- Budget Subdivision
- Subdivision for Data Analysis and Information
- Subdivision for Performance Evaluation

Advantages, Disadvantages, and Discussion of “Recommended” and “Alternate” Structures

Following are the major advantages and disadvantages for the “Recommended” and “Alternate” structures identified in the interviews with the three local government partners. Also included is discussion of ways to overcome the disadvantages.

	Recommended	Alternate
Advantages	Allows for the full integration of financial and macro development planning functions at the LGU level. The planning body is in a better position to consider the budgets because of the planning functions; after all, the annual plan, including the annual budget, is only a piece of the longer-term planning process. For example, a better integration of annual budgeting with medium-term capital investment programming can be achieved by combining the financial and overall development planning functions into one agency. This would allow for better synchronization of BIGG’S concern for annual performance budgeting with PERFORM’s focus on medium-term capital investment programming (PDPP).	It is clearly desirable to integrate the major financial planning and management units of LGU, thus enabling better coordination of revenue projection and collection, budget allocation, and financial planning and management.

	Recommended	Alternate
Disadvantages	<ol style="list-style-type: none"> 1. There is a reluctance to create a Financial Planning and Management Agency with authority for both income and expenditure since this approach would place too much power in the hands of one agency. 2. Some interviewees believed that the “span of control” is too large when combining the macro planning functions of the planning body with the proposed Financial Planning and Management Agency. 3. The substantive focus of the planning body and the Financial Planning and Management Agency are different, with the latter concentrating on <u>management</u> of the budget and planning limited to the one-year budgeting process; whereas the planning body’s focus is on medium- to long-range <u>planning</u>. 4. The two bodies have different clients, with the Financial Planning and Management Agency largely dealing with LGU internal matters while the planning body’s clients are largely external (private sector and the community). 	<p>Some interviewees objected to combining the income and expenditure functions into one agency since this approach would place too much power in the hands of one agency.</p>
Discussion	<p>Site visit discussions in both Bogor and Bukittinggi revealed a reluctance to create a Financial Planning and Management Agency with authority for both income and expenditures. Only when the society’s standards of education, per capita income, honesty, and professionalism are raised will the problem of corruption be reduced in such cases, it was argued.</p>	<p>The objections to combining income and expenditure functions into one agency can be overcome by: 1) carefully choosing the head for his/her honesty, objectivity, and professionalism; 2) spelling out clear roles and functions for parts of the organization; 3) having a high standard of professionalism for all staff in the agency; 4) introducing computerization and better accounting practices; and 5) improving external controls of the local oversight body and other entities.</p> <p>The Minimum Changes of improved tasks and functions of the Budget Committee should also be incorporated into this structure. The “Alternate” Structure should be seen as cumulative, with the clarified tasks and functions of the Budget Committee combined with consolidation of the Finance Division and Revenue Agency.</p> <p>Clear responsibility for annual budgeting should be placed in one division and a limited number of subdivisions for both the new Financial Planning and Management Agency and the planning body. In addition, these responsibilities should be complementary so that they can merge at a later date into the “Recommended” structure.</p>

5.3 Finding 2: There is a general need for training and for upgrading the skills of current employees and the legislature.

The need for upgrading LGU personnel is not limited to training in the specific area of performance budgeting. Key local government officials interviewed identified needs in general areas such as financial planning and management and in the specific areas of accounting and

computer applications. Obviously, as the staff involved in the annual budget cycle develop more skills, the quality of both the process and product will improve.

During the intensive site visits to Sleman and Bukittinggi, data were obtained on existing personnel in the planning bodies and major financial agencies. Figure 6 summarizes the educational level of staff in the planning body and financial management body in Kabupaten Sleman; and in the Planning, Finance, and Revenue Agencies in Bukittinggi.

In both local governments there is a significant contrast in educational level between the planning and the financial agencies. In Kabupaten Sleman, while 61.7% of planning staff have university degrees, the comparable figure for finance is only 28.2%. Over half (59.4 %) of finance staff have high school diplomas or less. The contrast is essentially the same in Bukittinggi. While 69% of planning staff have university degrees, the comparable figure for finance/revenue combined is only about 20%. And again, over half (65%) of finance/revenue staff have high school diplomas or less.

Figure 6. Education of Existing Personnel in Selected Agencies Related to Budgeting Process

Level of Education	Kabupaten Sleman				Bukittinggi Municipality					
	Planning Body		Finance/Revenue Dept.		Planning Body		Finance Div.		Revenue Agency	
	No.	%	No.	%	No.	%	No.	%	No.	%
Elementary School	1	1.4	4	2.9	-	-	1	3.3	4	7.4
Junior High School	-	-	11	8.0	-	-	-	-	1	1.9
Senior High School	21	28.7	67	48.5	6	20.7	18	60.0	31	57.4
Diploma	6	8.2	17	12.3	3	10.3	7	23.4	5	9.2
Bachelors Degree	36	49.4	34	24.6	17	58.7	4	13.3	12	22.2
Masters Degree	9	12.3	5	3.6	3	10.3	-	-	1	1.9
Total Officials	73	100.0	138	100.0	29	100.0	30	100.0	54	100.0

Source : 2002 data from LGUs at time of site visits.

This striking difference in educational level between the planning and major financial agencies suggests that there may possibly be greater training needs in the financial agencies. The need for adding or upgrading personnel must be related to a rigorous analysis of skills required in connection with tasks, functions, and activities of the agencies. Such analysis of personnel supply and demand is beyond the realistic scope of this report.

Sub-finding 2a: There is a need for training in performance budgeting.

Although requiring the use of performance indicators in the budgeting process is a positive development in building good governance, all stakeholders will need training before such a complex process will run smoothly. In some LGUs the literal use of forms included in Decree MOHA No. 29/2002 has made the process overly complex.

Sub-finding 2b: There is a need for training in the local legislative council.

The general need for human resource development upgrading is not limited to the executive branch only. The local legislative (DPRD) members will also benefit considerably from more intensive training. Present shortcomings in the level of education and skills among DPRD members are frequently mentioned as a limitation to their participation in the use of more sophisticated budgeting systems or other decisions facing local governments.

5.4 Recommendations for Finding 2

Gaps and Required Upgrading of Personnel

Discussion with agency heads in Sleman and Bukittinggi revealed generally similar needs. Planning body heads in both LGUs felt there was a general need for training existing staff in more sophisticated analytical methods and tools, including tools for medium-term planning, annual budgeting, and evaluation.

Financial agency heads gave a more varied response. In Sleman, a major gap in the financial management body was revealed: two of the division heads are borrowed from other agencies; hence, there is a need to recruit specialists in accounting and asset management. In both LGUs, the financial agencies generally require more specialized skills, especially in accounting and computer applications. Also, as with the planning bodies, there is a need to train selected personnel in more sophisticated analytical tools, particularly those related to use of performance indicators in the annual budgeting process.

Figure 7 gives an estimate of the general types of skills needed by agency involved in the budgeting process, showing each of the three alternatives formulated in this report. The “Minimum Changes” structure shows Planning, Revenue, and Finance separately. The “Alternate” structure collapses Revenue and Finance into a single Financial Planning and Management Agency. And the “Recommended” structure shows only the planning body since it would have basic responsibility for budget preparation.

Figure 7 also shows a marked difference between human resource needs of the planning versus the financial agencies. The planning body’s needs are broader including planning, economics, public administration, community participation, and a range of sectoral areas such as engineering. The financial agencies’ needs tend to focus more narrowly on municipal and regional finance, statistics, accounting, and computer applications.

What conclusions can be drawn from this analysis? First, it appears to be difficult to proceed from such qualitative analysis to more rigorous quantitative estimates of required personnel by skill types. This is partly because the local governments vary greatly in population and geographic size, and in the organizational structure of their agencies. As a result, it is difficult to formulate quantitative estimates of personnel required by skill type in any given jurisdiction.

Secondly, there may be some indication that collapsing or combining financial agencies can lead to greater efficiency in human resources use, through some reduction in duplication or redundancy. However, this is based on very sketchy data. Returning to the cases of Sleman and Bukittinggi, it can be seen that the ratio of Planning to Finance staff in Sleman is $73/138 = 0.53$, whereas the ratio of Planning to combined Finance/Revenue staff in Bukittinggi is $29/84 = 0.35$.

Therefore, if Sleman were to have Bukittinggi’s ratio of 0.35, it would have approximately 210 staff in the consolidated Financial Management Agency. But this is extremely conjectural, and analysis of more LGUs will be needed before definite conclusions can be reached.

Figure 7. Types of Human Resources Needed by Agency

Types of Skills	Minimum Changes			Alternate		Recom- mended
	Planning Body	Revenue Agency	Finance Division	Planning Body	Financial Plng & Mgt Body	Planning Body
Urban and Regional Planning	✓			✓		✓
Urban and Regional Economics	✓			✓		✓
Civil Engineering	✓			✓		✓
Sanitary/Environmental Engineering	✓			✓		✓
General Management/Public Administration	✓			✓		✓
Social – Political	✓			✓		✓
Community Participation Facilitator	✓			✓		✓
Municipal and Regional Finance		✓	✓		✓	✓
Statistics	✓	✓	✓	✓	✓	✓
Accounting		✓	✓		✓	✓
IT/Computer Programming	✓	✓	✓	✓	✓	✓

Toward a Larger Framework for Assessing Human Resource Needs

In addressing the issue of LGU personnel required for organizational improvements in the budgeting process, it seems that a larger conceptual framework would be useful. Performance budgeting is only one of a range of essential inter-sectoral or non-sectoral activities carried out by local governments. There is a need to assess the level and quality of human resources required for all such “core” areas.

A recent study, entitled “Sustainable Local Government Capacity Building for Decentralization” (SLGCBD), may offer the basis for such a framework. In preparation for an Asian Development Bank loan, this technical assistance to the Ministry of Home Affairs provides a framework which includes introduction of performance monitoring and measurement systems (PMMS) and development of 10 core areas (inter-sectoral fields such as financial management and development planning). The technical assistance also offers a comprehensive program for institutional strengthening and human resources management, including a human resources inventory, training needs assessment, and menu of core training.

In further studying the issue of LGU personnel required for bringing about improvements in the budgeting process, it would be useful, among other things, to pursue possible linkages to the SLGCBD program. In addition, it is recommended that the analysis of local government organizational models, functions, and personnel that have been the subject of this report be broadened to embrace a larger sample of the pilot rural and urban districts covered by BIGG.