

Financial Management, Reporting, and Oversight

Village Law Policy Note

October 2019

Summary

Between 2015 and 2018, there has been a 130% increase in the size of village expenditures. The majority of village funds are spent on general government and public works. Most villages are selecting smaller projects, and in some cases even distributing funds equally between hamlets (*dusun*). The central government's focus on disbursement conditions and budget absorption necessitates fast implementation which forces villages to choose small projects.

Village governments' upward accountability¹ has improved significantly, and the overall corruption rate (0.18%) is low. However, there are some areas where the government can further strengthen systems to ensure better utilization of village funds, including:

1. Harmonize guidance on village fund prioritization, in line with RPJMN cycle and priorities.
2. Clarify operational guidelines on inter-village and village-district projects, including jurisdictional authority, asset ownership, and operations and maintenance (O&M) responsibilities.
3. Strengthen financial controls, including audit, consolidated reports on village budgets

(*APBDes*), and simplified village financial reporting templates.

4. Develop a consolidated joint village financial management oversight plan that links community social accountability tools with strengthened formal financial control mechanisms.

How to Ensure Transparent and Effective Financial Management

Between 2015 and 2018, there has been a 130% increase in the size of village expenditures.² The Government of Indonesia has transferred IDR 188 trillion (USD 14 billion) of Village Funds (*Dana Desa*) and the districts provided an estimated of IDR 138 trillion (USD 10.3 billion) of Village Funds Allocation (*Alokasi Dana Desa*) to around 75,000 villages. However, the increase in funds transferred to villages also means an increased risk of misuse related to village-level finances.

**This note was prepared jointly by the World Bank and KOMPAK at the request of Bappenas, to inform policy discussion related to Village Law. The note is based on available data as of October 2019, including forthcoming assessments and studies. It is one of five briefs: 1) How to improve the delivery of Village Law, 2) Effective support from Local Governments to Villages, 3) Delivering Quality Rural Infrastructure with Village Funds, 4) Putting communities at the center of Village Law implementation, and 5) Financial management, reporting and oversight.*

The majority of village funds are spent on general government and public works. Villages spent a disproportionately high share of their revenue on the general government *urusan* category (39 percent), with nearly 80 percent going to salaries and allowances (SiLTAP) and village administration and operations.³ Only 43 percent of the villages complied with the mandated 30 percent cap on SiLTAP and administrative spending set out in the Village Law regulatory framework. Recent efforts of Government of Indonesia to increase the base salary of village apparatus to the equivalent of level A2 in the civil service will likely further increase administrative costs at the village. Strikingly, villages were more likely to spend a greater proportion of their revenue on SiLTAP and administration and operations as their total spending increased.

Most villages are selecting smaller projects. In some cases, as found by Sentinel Villages study, the funds are being equally distributed between hamlets (*dusuns*). The average nominal value of infrastructure projects sampled in a recent study range from IDR 29 million (USD 2,160) to IDR 78 million (USD 5,820).⁴ Village heads give equal share of funds to each hamlet to avoid perceptions of favoritism rather than necessarily identifying projects with the highest rate of return.⁵

The central government's focus on disbursement conditions and focus on budget absorption necessitates fast implementation which forces villages to choose small projects.⁶ Disbursement of Dana Desa in three tranches requires significant administrative efforts at villages and district level. This at times has caused delay in activity implementation,

because the first tranche is not adequate to finance major activities, such as infrastructure.⁷ The third tranche can be received as late as December, thus making it difficult for villages to spend it effectively. This issue is further complicated by MoV's annual guidelines for the prioritisation of funds, which are often issued late in the year and after villages hold their village consultation meetings (*musdes*).

Village governments' upward accountability has improved significantly, but can be further strengthened by formal audits, consolidation of reports, and a formal sanctions system. Villages have become much more responsive to requests for reports from higher levels of government, which control the transfer of resources. Nearly all villages have adopted the use of Siskeudes (now linked to OMSPAN), which unified budget classifications, digitized financial reporting, and prevents unauthorized changes to village budgets and financial records. These accountability mechanisms can be further strengthened through formal audits by the Supreme Audit Board, consolidated budget reports, and a formal system for sanctions.

According to the World Bank assessment of media mentions of corruption under Village Law, the overall corruption rate has been low (0.18%);

"In Kalikromo we distribute development activities equally among hamlets. Each hamlet gets about the same amount, and each activity is roughly about IDR 50-60 million. We first decided how much each hamlet got, then we agreed on what the activities were. Otherwise there would be disagreements."

- Village head of Kalikromo, Wonogiri, Central Java

however, a number of governance and implementation issues have been reported. Areas which could be further improved include: synchronizing policies and regulations both at central and local levels; clarifying authority structures and poor coordination between key players, especially MOV and MOHA; improving community facilitation; synchronising and connecting management information systems (MIS); and capacity building for key stakeholders at all levels (central, local, and village). The World Bank, in its review of reports by online media of corruption cases in Village Law between 2015 and 2017 found the following:⁸

- 629 fraud and corruption cases were reported
- IDR 447.5B (USD33.2M) was misused because of fraud or corruption.
- 0.18% of IDR 246 trillion (USD18.2B) was leaked during transfers to villages.
- 77% of the cases identified are in litigation (police, attorney or court).
- 80% of the cases involved Heads of Villages, but accounted for only 32% of funds misused.
- 73% of cases were reported by the community and Village Councils, indicating that communities play a significant role in overseeing villages.

Policy Recommendations

1. **Bappenas to coordinate with MOV to update guidance on village fund prioritization, in line with RPJMN cycle and priorities, to:**
 - a. Change guidance on village spending from annual to a multi-year (five year) cycle to ensure clarity

and prevent delays that can be caused by annual changes in priorities.

- b. Update facilitation guidelines to task facilitators with development of village programs and budgets based on local needs and aligned with district priorities.
2. **In order to encourage larger, more impactful investment, MoHA would need to clarify operational guidelines on inter-village and village-district projects**, including jurisdictional authority, asset ownership, and O&M responsibilities.
 3. **In order to improve the quality of spending**, Bappenas to coordinate with MoHA to strengthen the following financial controls:
 - a. **Give districts a target percentage of villages to be audited** based on a standard TOR and a standard report format using Siskeudes data.
 - b. **Kabupaten to consolidate and submit one report on APBDs**
 - c. **Simplify village financial reporting templates**
 4. **Bappenas to convene MoHA and MoV to develop a consolidated joint village financial management oversight plan** that links community social accountability tools with strengthened formal financial control mechanisms, and a formal complaint handling system.

¹ Defined as systems that improve oversight by upper-level institutional structures.

² World Bank, Update on Village Corruption, August 2018 (unpublished assessment of cases reported through media)

³ World Bank, Village Public Expenditure Analysis (ViPER), 2017

⁴ World Bank, Sentinel Village Study

⁵ World Bank, Sentinel Village Study

⁶ World Bank supervision missions

⁷ World Bank supervision missions

⁸ World Bank, Update on Village Corruption, August 2018

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