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The Effect of Regional Original Income, Balanced Funds and Capital Expenditures on the Government's Financial Performance in The Regency/City of North Sumatra Province

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Abstract

The purpose of this study was to determine and analyze the effect of Regional Original Income, Balancing Funds and Capital Expenditures on the Financial Performance of Regency/City Governments in North Sumatra Province. The population of this research is districts/cities in North Sumatra Province as many as 33 districts/cities in the 2017-2021 observation year. The type of sample in this study uses a saturated sample where the entire population is sampled. The data is processed by using panel data regression statistical test with the help of Econometric Views (Eviews) software version 10. The results of this study prove that Regional Original Income, Balancing Funds, and Capital Expenditures simultaneously affect the Financial Performance of Regency/City Governments in North Sumatra Province. Partially Local Original Income, and Capital Expenditures have a significant effect on Financial Performance. while the balancing fund has no effect on financial performance. Regency/City Regional Government in North Sumatra Province.

Keywords

local revenue; balancing fund; capital expenditure; government financial performance

I. Introduction

The territory of Indonesia is divided into provinces. Where the provinces in Indonesia are divided into regencies and cities, where each province, district, and city have a regional government which is regulated by law as stated in the 1945 Constitution. Law Number 32 of 2004 applies Regions and Law Number 33 of 2004 concerning Financial Balance between the Central Government and Regional Governments, mark the management of regional government based on regional autonomy through decentralization of authority from the central government to regional governments. North Sumatra Province makes regional autonomy a reference in the implementation of public services that have clear goals and directions in providing services to the community. Development is a systematic and continuous effort made to realize something that is aspired. Development is a change towards improvement. Changes towards improvement require the mobilization of all human resources and reason to realize what is aspired. In addition, development is also very dependent on the availability of natural resource wealth. The availability of natural resources is one of the keys to economic growth in an area. (Shah, M. et al. 2020)

In line with the objectives of autonomy and outcomes, the preparation of the APBD aims to harmonize macroeconomic policies and available resources. The APBD reports in each region can be used as a reference and benchmark in the regional development process. Therefore, the government is obliged to provide a financial management accountability report in running a government in its area in order to achieve the principle of transparency from the reporting, so that the public can assess how the government's

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performance in managing finances is, whether the income and allocations are in accordance with the needs of the community.

In Rosemerry's research, he argues that the reason for implementing the autonomy policy in the regions is because the central government is not able to independently manage the success of regional development as a whole, therefore the central government delegates authority or power to local governments to regulate and manage the interests of their respective regions independently. Financial performance is one of the indicators used in assessing the performance of local governments. Where the definition of Financial Performance is the output or result of an activity or program that will be achieved or has been achieved in connection with the use of the budget with a measurable quantity and quality.

Measurement of financial performance will be used as a reflection for the assessment of accountability and regional financial capacity in the implementation of regional autonomy. During this period, the government is expected to be able to produce optimal performance with a predetermined and approved budget draft. To see the phenomenon of the regional government's financial performance in North Sumatra Province, it is seen from the ratio of regional independence for the period 2017 to 2021. The Regional Independence Ratio is calculated by comparing the amount of Regional Original Revenue (PAD) divided by the amount of transfer income from the central and provincial governments and loans area. The following is the ratio of the independence of the regencies/municipalities of the province of North Sumatra, which can be seen in the table below:

Table 1. Percentage Level of Regency/City Regional Autonomy Ratio in North Sumatra Province 2017-2021

NO	REGIONAL NAME	FINANCIAL PERFORMANCE				
		2017	2018	2019	2020	2021
1	Regency. sharpen	10.88%	12.15%	12.49%	14.87%	10.76%
2	Regency. Dairi	16.26%	9.41%	9.00%	12.44%	7.57%
3	Regency. Deli Serdang	42.73%	36.62%	41.25%	44.07%	30.76%
4	Regency. Karo	17.76%	16.91%	12.04%	11.65%	0.00%
5	Regency. Labuhanbatu	13.72%	17.53%	18.95%	20.10%	9.00%
6	Regency. Langkat	7.87%	7.93%	9.67%	10.98%	4.08%
7	Regency. Christmas Mandailing	7.71%	7.97%	8.67%	9.16%	15.37%
8	Regency. Nias	15.97%	14.59%	17.32%	18.94%	85.32%
9	Regency. Simalungun	15.30%	10.29%	11.72%	10.55%	6.12%
10	Regency. South Tapanuli	12.57%	14.90%	17.15%	15.85%	13.47%
11	Regency. Middle Tapanuli	8.56%	8.64%	10.24%	10.35%	7.30%
12	Regency. North Tapanuli	19.61%	12.17%	12.68%	16.47%	13.16%
13	Regency. Toba Samosir	7.28%	7.41%	9.25%	8.71%	8.86%
14	Binjai City	20.19%	19.02%	15.09%	16.86%	8.44%
15	Medan city	81.96%	75.85%	84.83%	73.41%	85.32%
16	Pematang Siantar City	14.48%	17.20%	15.91%	20.08%	12.82%
17	Sibolga City	21.14%	15.85%	13.80%	17.13%	11.40%

18	Tanjung Balai City	12.73%	14.18%	11.64%	12.98%	5.18%
19	Cliff City	19.97%	21.08%	19.23%	17.94%	12.83%
20	Padang Sidempuan City	16.29%	11.70%	12.60%	10.60%	6.28%
21	Regency. Mr. Bharat	6.84%	4.72%	7.33%	5.49%	3.41%
22	Regency. South Nias	2.40%	2.54%	2.99%	1.71%	2.38%
23	Humbang Hasundutan District	11.89%	13.60%	10.42%	10.45%	3.76%
24	Regency. Serdang Bedagai	10.13%	17.37%	13.29%	11.83%	7.66%
25	Regency. Samosir	11.39%	7.80%	9.53%	11.07%	7.87%
26	Regency. Coal	8.56%	8.20%	16.15%	22.91%	7.65%
27	Regency. Old Field	6.68%	6.72%	6.85%	6.53%	4.55%
28	Regency. North Lawas	10.51%	10.60%	5.63%	7.47%	3.36%
29	Regency. South Labuhanbatu	12.27%	7.31%	10.60%	8.70%	5.57%
30	Regency. North Labuhanbatu	6.28%	6.60%	8.58%	7.71%	5.68%
31	Regency. North Nias	3.62%	8.92%	8.79%	10.53%	2.97%
32	Regency. West Nias	7.15%	7.08%	3.26%	4.12%	2.57%
33	Gunungsitoli City	5.44%	5.34%	5.76%	4.82%	0.00%

Based on Table 1 above, it can be seen that the ratio of regional independence in North Sumatra Province is relatively low and fluctuates. This can be clarified by several descriptions of the data on districts/cities in North Sumatra Province. In Karo Regency in 2017, the independence ratio was 17.76%, then in 2018, 2019 and 2020 its financial performance continued to experience a percentage decline of 16.91%, 12.04% and 11.65%. In Binjai City, financial performance from 2017 to 2019 decreased by 20.19%, 19.02% and 15.09%, but in 2020 financial performance in Binjai City increased by 16.86% and drastically decreased again which is 8.44%. This also happened to the city of Sibolga,

Of the three districts/cities, in South Nias District from 2017 to 2020 the district has a high dependence on other areas, although from the data above the percentage of South Nias district fluctuates annually from year to year but the percentage of independence the lowest is in 2020, with a percentage of independence of 1.71%.

Meanwhile, the local government that has the highest percentage of independence is Medan City, where the percentage of Medan City has a fluctuating percentage, but in 2019 Medan City has an independence ratio of 84.83%. From this percentage, there is a gap between regions in terms of the independence of each region. So it is interesting for researchers to find out more about how the financial performance of local governments in North Sumatra Province, so further research needs to be done for more accurate conclusions.

In North Sumatra itself, the phenomenon of financial performance still reflects that the percentage of the independence ratio is still very low due to the inability of the district/city government of North Sumatra Province in increasing Regional Original Income, causing the district/city government of North Sumatra Province to depend on the central government. The table above shows that from 2017 to 2018 the financial performance of the independence ratio increased every year. However, from 2019 to 2020 financial performance in North Sumatra has a less stable ratio of independence.

Based on the background that has been explained by the researchers, it can still be seen that the financial performance of local governments is still poor and can be judged not to be good, therefore a study is needed on "The Influence of Regional Original Income (PAD), Balancing Funds and Capital Expenditures on Government Financial Performance. Regency/City in North Sumatra Province". One of the instruments to assess the performance of regional governments in managing regional finances is to perform the ratio of regional financial independence to the APBD that has been determined and ratified. so this research is entitled "The Influence of Regional Original Income, Balancing Funds and Capital Expenditures on Government Financial Performance in Regencies/Cities of North Sumatra Province"

II. Review of Literature

2.1 Locally-generated revenue

According to Law Number 33 of 2004 concerning Financial Balance between the Central Government and Regional Governments, Regional Original Revenue (PAD) is regional revenue sourced from regional taxes, separated regional wealth management results, and other legitimate PAD. Local revenue is used to realize decentralization which funds the implementation of regional autonomy which is authorized by the government. The income that continues to increase will affect the funds owned by the regional government to be higher.

2.2 Balancing Fund

In accordance with Law no. 33 of 2004 it is stated that the Balancing Fund is regional funding sourced from the APBN which is allocated to the regions to fund regional needs in the context of implementing decentralization. The Balancing Fund consists of DBH, DAU, and DAK. The Balancing Fund is not only intended to assist the Regions in funding their authority, but also aims to reduce the gap in government funding sources between the Center and the Regions as well as to reduce the gap in inter-regional government funding. The three components of the Balancing Fund are a system of transfer of funds from the Government and form a unified whole. Balancing funds are also called transfer funds or grants and are also called intergovernmental revenues. The following is the distribution of balancing funds between the Central Government and Regional Governments.

2.3 Capital Expenditure

According to PP No. 71 of 2010, "capital expenditures are budgetary expenditures for the acquisition of fixed assets and other assets that provide benefits for more than one accounting period". Capital expenditures are intended to obtain local government fixed assets, namely (a) expenditure on equipment and machinery; (b) land expenditure; (c) building and building capital expenditures; (4) road, irrigation and network capital expenditures; (d) and other fixed asset expenditures; (e). Capital expenditure is one component of direct expenditure used to finance investment needs. According to Halim, capital expenditures are expenditures whose benefits exceed one fiscal year and will increase regional assets or wealth and will have consequences for adding routine expenditures such as maintenance costs.

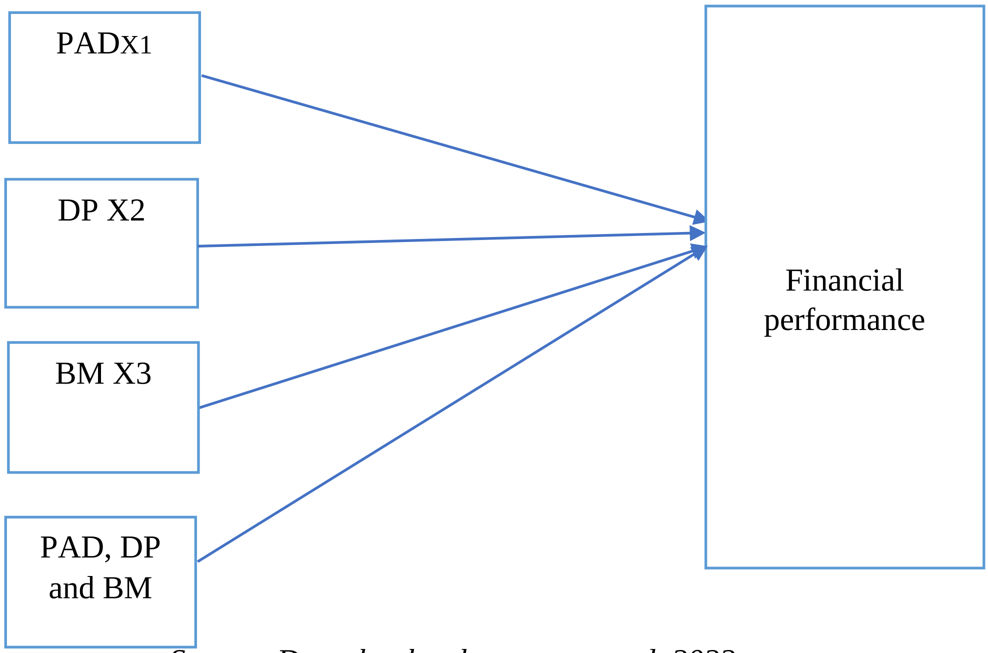
2.4 Financial performance

According to Halim, the financial performance of local governments is one measure that can be used to see the ability of the regions to carry out regional autonomy. Regional financial performance is a description of the achievement of the implementation of local government work activities in realizing the goals, vision and mission of the region which is assessed from the financial aspect seen from the financial reports that have been prepared by the regional government.

Performance measurement is a form of accountability where a higher rating is a demand that must be met and performance measurement data can be an improvement in the next program. Based on this understanding, in principle, the financial performance of local governments is a measure of the ability of local governments based on past performance in carrying out regional autonomy. In assessing the financial performance of local governments, financial ratio analysis is used in the realization of APBD management, which in this study uses the independence ratio (fiscal autonomy).

Regional financial independence shows the ability of local governments to finance their own government activities, development, and services to the community. In addition, it shows the extent of regional dependence on external funding sources. The higher the independence ratio means that the level of regional dependence on external parties (central and provincial governments) is lower, and vice versa. The independence ratio also describes the level of community participation in regional development. The higher the independence ratio, the higher the community's participation in paying regional taxes and levies which are the main components of local revenue.

The framework of thought in the research can be described as follows:



Source: Data that has been processed. 2022

Figure 1. *Framework for Thinking*

Based on the explanation of the literature review above, the researchers formed a conceptual framework that describes the simultaneous and partial relationship between the independent and dependent variables. The independent variables in this study are PAD, Balancing Fund and Capital Expenditure. while the dependent variable in this study is Financial Performance. The hypotheses in this study are as follows:

H1 : Regional Original Income partially has a significant effect on financial performance in the regencies/cities of North Sumatra province

H2 : The Balancing Fund partially has no significant effect on financial performance in the regencies/cities of the province of North Sumatra

H3 : Capital Expenditure partially has a significant effect on financial performance in the regencies/cities of the province of North Sumatra

H4 : Regional Original Income, Balancing Fund and Capital Expenditure simultaneously have a significant effect on financial performance in the regencies/cities of North Sumatra province

III. Research Method

This study uses quantitative methods. The data collection technique in this research is secondary data collection using documentation and literature studies. The technique used is saturated sampling, with the population and sample in this study being all districts/cities in the province in North Sumatra, which consists of 33 districts/cities during the period 2017 to 2021 available at the Directorate General of Fiscal Balance, Ministry of Finance.*www.djpk.kemenkeu.go.id*and the Central Statistics Agency*www.sumut.bps.go.id*.so the number of samples in the study 162 samples. The data analysis method in this study is panel data regression using Eviews 10 software. The panel data regression analysis equation used in this study is:

$$Y = + 1\ PADit + 2\ DPit + 3\ BMit + e$$

Information:
t: Year
Y: Local Government Financial Performance
: Constant
1-3: Regression Coefficient
PAD: Regional Original Income
DP: Balancing Fund
BM: Capital Expenditure
e: Error

IV. Result and Discussion

The discussion in this journal will discuss descriptive statistical analysis, panel data regression analysis and the effect for each variable. The following is the explanation: Descriptive statistics is a statistical method of data analysis used to describe the data that has been collected without the intention of drawing general conclusions from the data or generally describing the actual state of the data. The presentation of this data has the aim of being able to describe descriptively the research variables. The description of the data uses an explanation of the minimum value group, maximum value, and average value (mean). The results of the descriptive statistical test are as follows:

Table 2. Descriptive Statistics Test Results

	Financial Performance (Y)	Regional Original Income (X1)	Balancing Fund (X2)	Capital Expenditure (X3)
mean	11.03580	25.19784	27.30117	25.51210

median	7.450000	25.19500	27.29000	25.94000
Maximum	20.52000	28.24000	28.40000	27.63000
Minimum	2.200000	22.53000	26.18000	19.32000
Std. Dev.	5.605069	0.908953	0.451383	1.415356

Source: Eviews 10 Software Results, 2022

Based on the results of the descriptive statistical analysis test above in table 2. The minimum value of Regional Government Financial Performance is2.200000 i.e.the lowest during 2017-2021 was in 2020 in South Nias Regency. While the maximum value of Financial Performance is20.52000 i.e.the highest in 2019 in Medan City. This shows that the average value of Regional Government Financial Performance from 2017 to 2021 is11.03580 withstandard deviation of5.605069, this shows that there is a gap caused by differences in resources or potentials in the regencies/cities of North Sumatra Province. in 2019 to 2020 financial performance in North Sumatra has a less stable ratio of independence because in 2019 to 2021 in Indonesia, especially in the district / city government of North Sumatra Province, the economy experienced a decline caused by the Covid-19 virus.

The minimum value of local revenue is22.53000i.e. the lowest during 2017-2021 was in 2019-2020 in West Nias Regency, then the maximum value of regional original income was28,24000which is the highest in 2019 in the city of Medan. This shows that the average value of Regional Original Income from 2017 to 2021 is25.19784 withstandard deviation of0.908953, this indicates a gap caused by differences in the management of economic resources and the level of public participation in the payment of local taxes and levies.

The minimum value of the Balancing Fund is26.18000 i.e.the lowest during 2017 to 2021 was in 2017-2018 in West Pakpak Regency. Then the maximum value of the balancing fund is28,40000which is the highest in 2018 in Medan City. This shows that the average value of the Balancing Fund from 2017 to 2021 is27.30117, with a standard deviation of 0.451383This shows that there is a gap caused by differences in the fiscal gap or an imbalance in the fiscal capacity and fiscal needs of each region.

Minimum value for capital expenditure is19,32000, which is the lowest during 2017 to 2021 in 2020 in Tanjung Balai City. Then the maximum value of Capital Expenditure is27.63000, which is the highest in 2017 and 2019 in Medan City. This shows that the average value of Capital Expenditure from 2017 to 2021 is25.51210, with a standard deviation of 1.415356This shows that there is a gap caused by differences in regional development such as infrastructure development and the addition of regional assets or regional investment as well as caused by the Covid-19 virus.

Panel data regression analysis is a combination of time series and cross section data called panel data regression analysis. Where in determining the appropriate panel data regression in the study, first select the panel data regression estimation model whose tests consist of the Chow test, Hausman test and Lagrange multiplier test. The results of the selection of the panel data regression estimation model that have been carried out on the Chow test show that the profitability of the Chi-square cross-section is 0.9991 > 0.05, so it can be concluded that H0 is rejected and the model accepted by this study is the Common Effect Model. Furthermore, there is a Hausman test showing that the profitability value of a random cross-section is 0.0772 > 0.05, so it can be concluded that H0 is rejected and the model accepted by this study is the Random effect model. And the last test, namely the lagrange multiplier test, shows that the Breusch-Pagan profitability value is 0.0000 <0.05, so it can be concluded that H0 is rejected and a good model in this study is the common effect model. The following table 3 shows the results of the common effect test:

Table 3. Panel Data Regression Test Results

Dependent Variable: Financial Performance
Method: Least Squares Panel
Date: 07/20/22 Time: 13:29
Sample: 2017 2021
Periods included: 5
Cross-sections included: 33
Total panel (unbalanced) observations: 162

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	61.69575	31.19279	1.977885	0.0497
X1	1.750941	0.647683	2.703392	0.0076
X2	-2.445232	1.701903	-1.436763	0.1528
X3	-1.098388	0.424012	-2.590466	0.0105

R-squared	0.734619	Mean dependent var	11.03580
Adjusted R-squared	0.618188	SD dependent var	5.605069
SE of regression	5.263432	Akaike info criterion	6.183825
Sum squared resid	4377,187	Schwarz criterion	6.260062
Likelihood logs	-496.8898	Hannan Quinn Criter.	6.214778
F-statistics	8.192846	Durbin-Watson stat	1.888097
Prob(F-statistic)	0.000042		

Source: Data processed by Eviews 10. (2022)

Based on the table above, the panel data regression model equation can be formulated as follows:

$$Y = 61.69575 + 1.750941PAD + -2.445232DP + -1.098388BM + e$$

The explanation of the regression equation above is defined as follows:

1. The constant value is61.69575This means that if local revenue, balancing funds, and capital expenditures are considered constant, then the value of the local government's financial performance has decreased by61,69575 each region.
2. The regression coefficient value of the Regional Original Income (PAD) variable is1.750941, which is positive. This means that the Regional Original Revenue (PAD) has a positive effect on the financial performance of the local government in the Regency/City of North Sumatra Province. It is known that the value of Prob is0.0076. which is smaller than the 0.05 level of significance. Then the Regional Original Revenue (PAD) partially has a significant effect on the financial performance of local governments.
3. The regression coefficient value of the balancing fund variable is-2.445232, which is negative. This means that the balancing fund has a negative effect on the financial performance of the local government in the Regency/City of North Sumatra Province. It is known that the value of Prob is0.1528, which is greater than the 0.05 level of significance. So the partial balance funds have no significant effect on the financial performance of local governments.

4. The regression coefficient value of the capital expenditure variable is-1.098388, which is negative. This means that capital expenditure has a positive effect on the financial performance of the local government in the Regency/City of North Sumatra. It is known that the value of Prob is0.0105, which is smaller than the 0.05 level of significance. So capital expenditures partially have a significant effect on the financial performance of local governments.

Based on the results of table 3 above on the coefficient of determination (R2), it can be seen that the Adjusted Rsquared of the research model is0.618188or 61.8188%. Thus it can be concluded that the independent variables, namely local revenue, balancing funds and capital expenditures can explain the dependent variable, namely the financial performance of the government in the districts/cities of North Sumatra province for the 2017 and 2021 periods of 61.8188%, while the remaining 38.1812% is explained by other variables outside the model. In the F statistic test, it can be seen that the Prob (Fstatistic) is0.000042. Thus, it can be concluded that H0 is rejected, meaning that the independent variables in this study, namely local revenue, balancing funds and capital expenditures simultaneously have a significant effect on financial performance in the districts/cities of North Sumatra province for the period 2017 and 2021. t statistic The probability value (T-statistic) of local revenue is 0.0076 <0.05, it can be concluded that local revenue has an effect on financial performance, then the probability value (T-statistic) of balancing funds is0.1528> 0.05, it can be concluded that the balancing fund has no effect on financial performance. And the probability value of capital expenditure is0.0105 < 0.05,it can be concluded that capital expenditures have an effect on financial performance. Based on the results of table 3 above, the following is a discussion of the results of panel data regression tests on the variables of local revenue, balancing funds and capital expenditures on government financial performance in the districts/cities of North Sumatra province:

4.1 The Effect of Regional Original Income on Financial Performance

Regional Original Income obtained a probability value of0.0076<0.05, so it can be stated that the local revenue partially has a significant effect on financial performance. This means that the first hypothesis in this study is accepted. It can be interpreted that every increase in PAD will have an effect on the increase in Regional Government Financial Performance. . Besides, this research shows that the local government has succeeded in increasing PAD through the collection of regional taxes and levies. This also indicates the ability of the Regional Government to realize regional autonomy by increasing PAD which is in line with the increase in Regional Government Financial Performance. The results of this study are in line with the results of several previous studies including the research of Eve Ida Malau where PAD has a significant positive effect on the Financial Performance of the Regency / City Government of North Sumatra in 2010-2017.

4.2 The Effect of Balancing Funds on Financial Performance

Based on the results of the Balancing Fund's output, a probability value of0.1528> 0.05, so it can be stated that the balancing fund has no significant effect on financial performance. This means that the second hypothesis in this study is rejected. The Balancing Fund which includes Tax and Non-Tax Revenue Sharing Funds as well as DAU and DAK are transfer funds from the central government to regional governments with the aim of financing excess regional spending.

Alfarisi stated in his research that the greater the funds received from the central government, the stronger the local government's dependence on the central government to meet the needs of the region, resulting in a decrease in the financial performance of the regional government. The balance between the central government and local governments can be said to be ideal if each level of government can manage its finances to finance the duties and authorities of their respective regions. The size of the receipt of balancing funds greatly affects financial performance. The local government's high dependence on balancing funds makes the region not have the authority and freedom in terms of the use of revenue sources so that the principle of regional autonomy will be difficult to achieve if the regional government still relies on balancing funds.

This research is supported by the research of Andirfa and Budianto and Alexander which prove that balancing funds have a negative effect on the financial performance of local governments. The results of this study indicate that if the realization of regional expenditures is higher than regional revenues, there will be a budget deficit so that to cover the shortage of regional expenditures, a transfer of balancing funds from the central government is needed. The magnitude of the transfer of balancing funds indicates a declining financial performance of local governments. The negative influence generated by this study also supports the results of Yulitiawati et al.'s research, which proves that the balancing fund has a negative effect on the financial performance of the Regency/City local governments in South Sumatra in 2015-2019.

4.3 Effect of Capital Expenditure on Financial Performance

Capital expenditures are government expenditures that are used as investments to increase regional revenues. The results of the study prove that capital expenditure has a significant effect on the financial performance of local governments. With a probability value that is0.0105< 0.05. This shows that the third hypothesis in this study is accepted. Capital expenditures that have a positive and significant impact on financial performance are a positive signal made by local governments to show their ability to manage existing assets and increase revenue channels through capital expenditures outside of existing regional revenues. According to Halim, there are five measures of success in terms of capital expenditures, namely the right quality, the right quantity, the right time, the target, and the price. So that the amount of funds allocated for Capital Expenditures will later be able to realize the creation of better and more appropriate infrastructure and facilities.

This research is supported by research by Mulyani and Wibowo showing that partially the Capital Expenditure variable has a positive effect on the financial performance of districts and cities in Aceh Province. These results indicate that the reality of the Regional Government with the increasing allocation of capital expenditures, the higher the financial performance of districts and cities in Aceh Province. Capital expenditure is a regional government expenditure in order to provide services to the community whose benefits can be felt directly or indirectly by the community. The availability of good infrastructure can create efficiency in various sectors and higher community productivity and in turn can increase welfare growth.

V. Conclusion

Based on the results of the study, it is shown that simultaneously the independent variables of regional original income, balancing funds and capital expenditures have an effect on financial performance. Partially, only local revenue and capital expenditures have an effect on financial performance, while balancing funds have no effect on financial performance.

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