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The effect of pad, capital expenditures, government size, and budget changes on regional financial performance (in central java province in 2019-2021)

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ABSTRACT

The pandemic due to Covid19 has an impact on the budget policies of local governments of regencies/cities in Central Java which has resulted in a decrease in regional financial performance. The purpose of this study examines the effect of Regional Original Income, Capital Expenditure, Government Size, and Budget Changes on the Financial Performance of Regencies and Cities in Central Java Province in 2019-2021. The sampling technique used was saturated samples, so that 35 district and city governments in Central Java were obtained. The research method used is Quantitative. The analysis technique uses multiple regression analysis. The results showed that the Variables of Regional Original Income and Government Size had a positive effect on regional financial performance while the Capital Expenditure Variables and Budget Changes had a negative effect on regional financial performance.

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1. INTRODUCTION

Covid-19 has encouraged all local governments in the country to take budget policies that have an impact on their financial performance. One of the affected areas in Indonesia is cities and regencies in the Central Java region. The financial performance of local governments is the ability of regions that are measured based on their capabilities in exploring their potential, so that they can contribute to the growth rate of regional income. Financial performance from the aspect of regional independence in the average regencies and cities in Central Java Province in 2019 was 0.44%, and decreased to 0.38%, in 2020. The decline occurred due to a decrease in the amount of PAD obtained by the average City and Regency government in Central Java Province. Throughout the period from 2019 to 2020, the existing PAD funds decreased by 19,964 from the original amount of 27,175 in 2019, to 27,139 in 2020. The decline has an impact on the inability of regions to cover the lack of financing derived from transfer funds (DAU and DAK) which tend to fall. The two main components of the Transfer Fund in fiscal year 2019 were 71,136, but in 2020 it fell to 61,429. This is suspected to have caused a decline in financial performance as measured by the independence ratio (Himmati et al., 2021).

The PAD of several districts and cities in Central Java has decreased by 12.43%, one of the main causes is the existence of several PAD achievement targets that have decreased significantly, such as regional levy receipts which decreased by 25.93% which was also followed by a decrease in regional tax revenues by 10.66%. The reduction of the PAD budget reduction target is an effort to rationalize the budget to respond to the impact of the COVID-19 pandemic (Central Java Provincial Economic Report, 2020).

Furthermore, based on data from the City and Regency Budget in Central Java Province in fiscal year 2019, the decline in budget performance can also be seen from the average Capital Expenditure allocation which only reached 11.38% of the initial expenditure target in 2020, In aggregate, the total capital expenditure carried out by the City and Regency governments in Central Java decreased by 10.5% of the total capital expenditure in 2019 and was followed by an increase in the application for special allocation funds in 2020 as due to the inability of the regions to independently finance pandemic management (Center for Budget Studies DPR, 2020).

In response to the situation of the regional economy, which has experienced a decline in performance on average, the Central Government issued a Joint Regulation of the Minister of Home Affairs and Minister of Finance No. 07/2020 dated April 9 regarding *refocusing* activities and budget allocations for handling COVID-19. With these changes, it resulted in a cut of at least 50% of the budget. Through Governor Regulation no. 3 of 2020 which regulates the status of the COVID-19 disaster emergency response in Central Java Province, the Consequence is that the Government determines the transfer of the function of the COVID-19 handling budget which applies to all City and Regency Governments in Central Java. The total budget allocation diverted for unexpected expenditures for handling COVID-19 amounted to Rp 1.98 trillion. The fund is used to finance three activities, including: Health Handling with a budget allocation of IDR 426 billion, handling economic impacts of IDR 222 billion, and an allocation intended for social safety nets of IDR 1.3 trillion (Economic Report of Central Java Province, 2020). Furthermore, according to May 2020 data in the May 2020 Central Java Province Economic Report, the nominal collected from the reallocation of the regional budget amounted to Rp. 66.38 trillion. The infrastructure project financing budget in the apbd that can be converted for handling COVID-19 reaches Rp. 94.39 trillion.

However, there are still a number of major problems related to the reallocation of the budget. Among other things, based on the results of previous research, it leaves the problem of declining Financial Performance in terms of the level of regional independence. The results of the study owned by the Financial Audit Agency (BPK) which there are many regencies and cities in Central Java that are still categorized as not yet fiscally independent, especially during the pandemic. Of the 34 provinces in Indonesia, only one district can be considered to have fiscal independence independently, namely Badung Regency, Bali (Saputra, 2021). Another empirical study, obtained from the 2021 House budget review center, shows similar evidence.

Therefore, it can be seen that there are still problems with local governments (Pemda) in terms of budget dependence on the central government, especially during a pandemic where the flow of TKDD (transfers to regions and village funds) is getting bigger because of the inability of the regions to dig up PAD (Center for Budget Studies DPR, 2021). The burden on the regions is getting bigger because it is mandatory to refocus the budget (Haikal, 2021). In this case, the Ministry of Finance has made regulations that encourage local governments to refocus their budgets in the context of handling Covid-19. Any form of *refocusing* activity can have repercussions or consequences that must be faced (Equator, 2021).

Based on a review of the results of previous research, there are several factors that determine the Financial Performance of Local Governments (Sari & Mustanda, 2019), (Gusnaini et al., 2020) show results Government measures negatively affect regional financial performance, while research (Jauhari & Dewata, 2019), (Aulia & Rahmawaty, 2020) shows an influence on bound variables.

Another factor that becomes a determinant variable is PAD. (Equator, 2021) states that there is a positive influence of PAD on the Financial Performance of Local Governments. Different results were shown by (Putri & Darmayanti, 2019), PAD had no effect on regional financial performance.

Furthermore, another variable that affects is budget changes. Research (Neliyanti, 2016) shows a significant positive influence of budget changes. Different results were shown by (Amalia et al., 2022) which provided empirical evidence that there was no effect of Budget Changes on the Performance of Governments at the City and Regency levels in South Sumatra. Research from

(Onibala et al., 2021) and (Amal & Wibowo, 2022) during the Pandemic, showed different results, namely significantly positive during the Pandemic.

Another variable that determines the level of financial performance is capital expenditures. (Mulyani & Wibowo, 2017) shows that capital expenditure negatively affects regional financial performance. Meanwhile, the research conducted by (Onibala et al., 2021) showed the opposite result, namely a positive effect.

The differences in the results of the research above encourage the need to review the impact of PAD, capital expenditure, government size and budget changes on financial performance in Central Java in 2019-2021. The purpose of this study examines the effect of PAD, Capital Expenditure, Government Size and Budget Changes on Regional Financial Performance in Central Java Province.

2. RESEARCH METHOD

2.1 Theoretical Foundations

Stewardship Theory

The theory of *stewardshi*p as a theory of management behavior, explains that managers in acting always attach importance to the interests of the organization. This theory describes the existence of a strong correlation of organizational satisfaction and success. The philosophical assumption of *Stewardship theory* is that individuals can be trusted, have responsibility in acting (Rizal & Hermanto, 2019). The theory of *stewardship* has a broad realm of application. The application of stewardship theory in the area of public sector organizations views the pattern of government service as *an agent* to society as *a principal*. Based on this relationship pattern, every government policy making is always aimed at improving service quality, one of which is regional financial performance (Rizal & Hermanto, 2019).

2.2 Hypothesis Development

The Effect of PAD on Regional Financial Performance

PAD is the main source of local government funding. Revenue, which goes to local assets, comes from local resource management, regional events and programs (Azis & Hapsari, 2020). The results of previous studies, including the relationship between the influence of PAD on regional financial performance that have previously been carried out (Maulina et al, 2021), (Verawaty et al., 2020) and (Sari & Mustanda, 2019) which provide empirical evidence of PAD having a significant positive influence. This shows the significant contribution of PAD in financing development and community projects This research is consistent with the theory of *stewardship* where public institutions try to provide good services to the community (public) and can be accounted for publicly. The government will always try to put limits on its government to ensure the welfare of its citizens (Hardiningsih & Wakhidati, 2017). Based on these assumptions, the hypothesis that will be proven empirically is as follows:

H1 : PAD has a positive effect on Regional Financial Performance

Effect of Capital Expenditure on Regional Financial Performance

Capital expenditure is a local government expenditure whose value exceeds the budget for one year and includes regional assets or resources including routine expenses such as maintenance costs and general administrative costs. (Noahhirto, 2021).

The results of previous research on the relationship between capital expenditure and regional financial performance have been previously studied by (Sari & Mustanda, 2019), (Mohammed et al., 2015), and (Wahyudin Ihsan & Hastuti, 2020) which have the result of a significant positive influence of capital expenditure on regional financial performance. Theoretically, the right expenditure investment will increase capital. Productive money investments can ultimately create long-term financial wealth. This research is in accordance with *stewardship* theory which explains the close relationship between organizational satisfaction and success. Success in the organization can be achieved by increasing the value of directors and management (Hardiningsih & Wakhidati, 2017). Based on these assumptions, the hypothesis to be proven empirically is as follows:

H2: Capital Expenditure positively affects Regional Financial Performance

Effect of Government Size on Regional Financial Performance

The large size of the local government will have the ease of operational activities because the number of assets owned is adequate to carry out various financings. This has an impact on the ease of realizing public services without having to depend on the flow of central government funds. Flexibility in conducting these various funding ultimately affects the financial performance of the region, as well as increasing public accountability. (Kusumawardani, 2012).

Several previous studies from (Sumarjo, 2010), (Marhawai, 2015), (Masdiantini & Erawati, 2016), (Jauhari and Dewata, 2019), (Sari & Mustanda, 2019), (Mulyani and Wibowo, 2017), (Tama & Adi, 2018) and (Alvini, 2018) proved empirically the significant positive influence of local government measures on financial performance. The increasing burden on local governments encourages the bureaucracy to innovate in order to realize financial performance that is in line with the expectations of its constituents. This research is in line with the theory of *stewardship,* it can be done because of the high trust of the community as a leader and from the government as one who can show the community's response because it has a good position in good things. (Hardiningsih & Wakhidati, 2017). Based on these assumptions, the hypothesis that will be proven empirically is as follows:

H3: Government size positively affects regional financial performance

Effect of Budget Changes on Regional Financial Performance

Budget changes are the adjustment of the APBD to the development and changes of the current year so that the available funds can be adjusted to reduce the budget gap. These changes can be in the form of adding or subtracting budget stamps, spending at SKPD, moving between shopping posts and between shopping details, as well as replacing activities at SKPD (Abdullah et al., 2019).

Refocusing is another way to reduce the risk of economic collapse to ensure the stability of the national economy. A country can be careful to provide financial stability due to the global economic crisis and make the economic system collapse due to improper conditions or problems (Equator, 2021).

The budget reallocation policy carried out by local governments to regional directorates and companies has a great impact, so that the program plan will be recalculated properly and correctly, both in terms of production and program objectives. in the future. This budget reduction policy is in line with the increasing need for funding and efforts to increase state revenue sources during this pandemic (Rahmawati et al., 2021). Based on these assumptions, the hypothesis that will be proven empirically is as follows:

H4: Budget Changes Have a Positive Effect on Regional Financial Performance

The approach in this study is quantitative sourced from secondary data. The population used is all cities and regencies in the Central Java region. The study sample included 6 municipalities and 29 district governments. The sampling technique uses saturated samples. Secondary data is sourced from the Regional Government Financial Statements consisting of regional revenue and expenditure budget reports (APBD) and Regional Regulations in Central Java. The free variables in this study are PAD (X_1), capital expenditure (X_2), government size (X_3), and budget changes (X_4). The analysis used is Multiple Linear Regression which is intended to measure the influence of variables bound to partial free variables. The tested regression equation model is as follows:

$$Y = \alpha + \beta_1 PAD + \beta_2 BM + \beta_3 UP + \beta_4 PA + e$$

Operational Definition of Variables

Financial Performance (Y)

Regional financial performance is positioned as a bound variable that is proxied as regional independence which is the result of a survey designed to find out the extent to which local governments can carry out their duties and follow sound financial principles (Abdul Halim, 2007). The formula for calculating the ratio of independence of regions is:

$$RKDD = \frac{PAD}{Transfer\ Income} x\ 100\%$$

PAD (X_1)

Local revenue is an element of recognition that also plays a role in regional development to enhance the country's development. The huge potential of the area to generate income in the regions will also be converted into regional development to complement the regions (Mahmudi, 2010). The calculation formula is:

$$PAD = Regional\ Tax\ Results + Regional\ Levies + Income\ From\ Company\ Profits + Other\ Legal\ Income$$

Capital Expenditures (X_2)

Capital expenditures are defined as expenses made during one accounting period, and are of the nature of adding value to other assets or assets in the long term. Capital expenditure can be calculated by the formula:

$$Capital\ Expenditures = Land\ Expenditures + Spending\ On\ Machine\ Tools + Spending\ On\ Bulidings + Spending\ On\ Roads, Irrigation, Network\ and\ Fixxed\ Assets\ and\ others$$

Government Size (X_3)

Total assets are used to measure the area considering that fixed assets are more stable than net sales and capital markets. (Patrick, 2007).

Budget Changes (X_4)

Etymologically (from the beginning), the meaning of a budget change is to revise or reconsider the budget. Budget changes reapply budgets to activities that did not stem from budget changes initially. One of the other ways that the government must do in dealing with the national economic crisis to ensure the stability of the national economy is to rethink/adjust the budget (Equator, 2021). Budget changes can be measured by the formula:

$$Budget\ Changes = (Total\ Revenue - Total\ Expenditures) + Regional\ Financing\ Receipts - Regional\ Financing\ Expenditures$$

3. RESULTS AND DISCUSSIONS

Table 1. Descriptive statistical results

	N	Minimal	Maximum	Average	Standard Deviation
PAD	94	2385.00	23859.00	4642.6706	3452.19911
Capital Expenditures	94	287.00	10548.00	3181.9294	1596.71987
Government Size	94	21430.00	215337.00	50591.2588	34638.33340
Budget Changes	94	-1378.00	22411.00	1851.7089	3340.84179
Regional Financial Performance	94	.13	1.03	.2558	.14730
Valid N (listwise)	94				

Based on pad data, the lowest is 2385 from Banjarnegara Regency in 2020 and the highest is 23859 from Semarang city in 2021, and the mean value is 4642.6706 while the standard deviation value is 3452.19911.

Based on the lowest capital expenditure data of 287 from Purbalingga regency in 2021 and the highest 10548 from Semarang city in 2019, with a mean value of 3181.9294 while the standard deviation value is 1596.71987.

Based on data, the lowest government size is 21430 from Rembang city in 2019 and the highest is 215337 from Semarang city in 2021, and the mean value is 50591.2588 with a standard deviation value of 34638.33340.

Based on data, the lowest budget change of -1378 from Banyumas regency in 2021 and the highest 2241 from Sukoharjo city in 2020, with a mean value of 1851.7089 and a standard deviation value of 3340.84179.

Based on regional financial performance data, the lowest is 0.13 from Wonogiri regency in 2019 and the highest is 1.03 from Semarang city in 2021, with a mean value of 0.2558 while the standard deviation value is 0.14730.

Table 2. Multi linear regression test

Variable	Coefficient	Signification	T	Information
Constant	0.84	,000	9,575	Significant
PAD (X_1)	3,523	,000	13,932	Significant
BM (X_2)	-1,663	,000	-5,149	Significant
UP (X_3)	1,145	,000	4,698	Significant
PA (X_4)	1,871	,117	1,585	Insignificant

The regression equation model used is:

KKD= 0,084 + 3,523PAD + (1,663) BM+ 1,145 UP + 1.817 PA+ e

Discussion

Effect of PAD (X1) on Regional Financial Performance (Y)

Tabel above obtained a significance value of P AD of 0.000 < 0.05 and a calculated t value of 1 3.932 > t table 1.664 which means that P AD has a positive effect onFinancial Performance. Thus, the first hypothesis stating that PAD has a positive effect on regional financial performance, **Accepted**

The results of this research support the theory of *stewardship* where the government as a public institution seeks to provide good services to the community (public) and is responsible to the public. The government will always try to optimize its implementation to ensure the welfare of its citizens (Hardiningsih & Wakhidati, 2017). This result is also supported by the results of (Maulina et al, 2021), (Verawaty et al., 2020) and (Sari & Mustanda, 2019) which have the result that PAD has a positive effect on the financial performance of local governments. This shows that the higher the PAD grants used for urban development and employment, the higher the government's operating income.

Effect of Capital Expenditure (X2) on Financial Performance Daerah (Y)

The table above obtained the significance value of Capital Expenditure of 0.000 <0.05 and the calculated value of -5.149 < t table 1.664 meaning that Capital Expenditure negatively affects Financial Performance. Thus, the second hypothesis stating that Capital Expenditure has a Negative effect on regional financial performance, **is rejected**

The results of previous studies, conducted by (Antari & Sedana, 2018), show empirical evidence that capital expenditure has a negative influence on regional financial performance can be caused by several things. One of them is that funds are not spent on productive assets. The distribution of budgets for productive assets is considered very important because it will result in greater regional capacity, especially in the financial sector.

Effect of Government Size (X3) on Regional Financial Performance (Y)

The calculation results from the table above obtained the significance value of the government size of 0.000 < 0.05 and the calculated t value of 4.698 > t table 1.664 which means that the Government Measure has a positive effect on Regional Financial Performance, **Accepted**.

In theory, *stewardship* can be explained that along with the increasing assets owned by the region, then as a *steward*, the government will provide maximum service to the public through improving financial performance. The amount of assets owned by the regions will give more flexibility for local governments to finance independently. This is what ultimately has a positive influence on regional financial performance.

The research results are consistent with previous studies, namely (Sumarjo, 2010), (Marhawai, 2015), (Masdiantini & Erawati, 2016), (Jauhari and Dewata, 2019), (Sari & Mustanda, 2019), (Mulyani and Wibowo, 2017), (Tama & Adi, 2018) and (Alvini, 2018).

Effect of Budget Changes (X4) on Regional Financial Performance (Y)

The calculation results from the table above obtained the significance value of the Budget Change of 0.117 > 0.05 and the calculated t value of the < t table 1,664 which means that the Budget Change does not have a significant effect on Financial Performance. Thus, the hypothesis that the Budget Amendment had a Negative effect on the Financial Performance of the region **is rejected.**

The above results are empirically supported by research (Equator, 2021), which shows budget changes have a negative influence on regional financial performance. Program initiation, fund transfer and procurement of goods and services to improve Covid-19 control. However, the ability to change regional financial policies through a clear budget review, including the involvement of local leaders or senior management as the person in charge of budget and investment planning.

4. CONCLUSION

Based on the hypothesis test above, it can be concluded that PAD and Government Size have a positive effect on regional financial performance, while Capital Expenditure and Budget Changes have a negative effect on bound variables.

Limitations

The limitations in this study are as follows: (a) Testing the effect of capital expenditures and changes in capital on regional financial performance ignores the influence of moderating variables, namely the additional special allocation funds flowed by the central government to the regions as bailouts for handling covid to maintain the stability of regional financial performance during the pandemic, (b) Not taking into account the influence of the flow of National Economic Recovery (PEN) loan funds which functions to boost regional financial performance during the pandemic, which is suspected to be the cause of regional independence remaining stable during the pandemic.

Advice

Added Special Allocation Fund Variable as a moderating variable, Added the National Economic Recovery Fund Variable as an intervening variable.

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