

The Effect of Capital Expenditures and Audit Quality toward the Financial Performance of Regional Government of West Sumatera

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Abstract

This paper is aimed to investigate the effect of capital expenditure and audit quality to the performance of local governments in improving community welfare. The proposed sample is the all elements of the regional government of west sumatera province which consists of 1 (one) provincial government, 7 (seven) city governments, and 12 district governments which will be observed in years 2015 - 2017. The analytical tool to be used is a simple regression analysis and multiple regression analysis.

Keywords: Capital expenditure, audit quality; financial performance, regional government

Introduction

Decentralization as reflected in Law No. 23 of 2014 concerning Regional Government demands the acceleration of the realization of public welfare through the implementation of regional government based on good government governance (GGG). In the said Law, the assessment of performance (results of work) becomes important because in addition to evaluation the said law also provide for reward and punishment. The said Law also stipulates that one of the performance that will be evaluated is the accountability of the implementation of the APBD (Regional Budget and Expenditure) which is audited by the Supreme Audit Agency (BPK) which includes (1) budget realization report (LRA), (2) reports of changes in balances, (3) balance sheets, (4) operational reports, (5) cash flow statement, (6) report on changes in equity, and (7) notes to financial statements attached with an overview of the financial statements of BUMD (Regional Owned Enterprises). Akinbuli (2012) shows the importance of the preparation of interim financial reports and performance reports by the government institutions which will be announced for public criticism. Criticism from the public is normal because the basis of this behavior is the agency concept in which the community acts as principal and the government acts as an agency that controls information and which will make decisions for the principal (Jensen & Meckling, 1976). Decentralization demand the regional government to be able to organize the regional governance under the GGG principles, which includes (a) legal certainty, (b) orderly administration of the state, (c) public interest, (d) transparency, (e) proportionality, (f) professionalism, (g) accountability, (h) efficiency, (i) effectiveness, and (j) justice.

Furthermore, the budget function in the premises of government in Indonesia significantly affects the accounting and financial reporting, partly because the budget provides a basis for assessing government performance. Kanbur & Squire (1999) explained that most of the East Asian countries have successfully decreased the number of poverty when the government uses public spending on education and health. In other words, the effect of regional government performance in using its funding sources is closely related to public welfare. One indicator of welfare is the Human Development Index (HDI) which consists of 3 (three) basic dimensions, namely: (1) long and healthy life, (2) knowledge and (3) decent living standards. The use of government-owned resources will affect the welfare of the community in these 3 (three) basic dimensions. Therefore, Mangkunegara (2015) and Prasetyaningsih (2014) adopted the HDI as a proxy of the financial performance of regional government. Further, Sarjono (2016) also discovered that regional financial performance had a significant positive effect on people's welfare. Thus, the authors propose the regional government's financial performance to be assessed by using the HDI.

One of the financial resources owned by the local government is the budgeting which may be used for capital expenditure. Capital expenditures or capital spending are allocations which is planned (in the budget) to make purchases / repairs / replacements of everything categorized as company assets. The definition of capital expenditure according to Government Regulation Number 71 of 2010 concerning Government Accounting Standards is budget expenditure for the acquisition of fixed assets and other assets that benefit more than one accounting period. Another definition, government capital expenditures are expenditures incurred by the government on certain projects to improve and promote the ease of life and comfort of its citizens for a long period of time, usually more than one year (Ayinde, Kuranga, & Lukman, 2015). In Indonesia, capital expenditures are presented in the LRA which consists of: (1) Capital Expenditures for Land, (2) Capital Expenditures for Equipment and Machinery, (3) Capital Expenditures for Building and Construction, (4) Capital Expenditures for Road, Irrigation and Network Capital, (5) Capital Expenditures for Other Fixed Asset, and (6) Capital Expenditures for Other Asset. All of these capital expenditures will be capitalized and add government fixed assets recorded in the balance sheet and can be used for government activities or utilized by the general public. The positive impact of capital expenditure is economic growth (Ayinde et al., 2015). Thus, capital expenditure will be able to improve services to the public and at the same time give an impact to the comfort of the community. Mangkunegara (2015) used one of the elements of the financial statements, namely capital expenditure presented at the LRA, to predict its effect on the financial performance of regional governments in improving the welfare of the community. Research conducted has found that capital expenditure does not have a significant effect on the performance of regional governance (Artha, Basuki, & Alamsyah, 2015) and capital expenditure has a significant effect on local government performance in realizing the public welfare (Mangkunegara, 2015 Sari & Supadmi, 2016; Antari & Sedana, 2018; Astiti & Mimba, 2016; and Ayinde et al., 2015). Thus, capital expenditure should have an impact on the financial performance of local governments in improving the welfare of the community.

As previously described, the accountability of the implementation of the APBD is audited by the BPK. This audit is carried out in accordance with the mandate of the 1945 Constitution of the Republic of Indonesia. In such mandate, the BPK is also authorized, among others, to determine the period of audit. However, BPK must submit an Audit Result Report (LHP) no later than 2 (two) months after the financial report (unaudited) is received from the local government. In addition, information on the length of audit time is indeed presented in the LHP of BPK, in contrast to the independent auditor's report on the private sector that did not present such information. In its implementation, audit quality from the result of audit must be applied in a quality control standard. Audit quality is defined as the combined probability of two conditions, namely the finding and reporting of violations by the auditor in the client's accounting system (DeAngelo, 1981). Audit quality plays an important role in determining financial performance (Hassan & Farouk, 2014 and Ogbodo, 2017). Previous study found that there was a significant effect of audit quality on financial performance (Hassan & Farouk, 2014 and Ogbodo, 2017) and audit quality had no significant effect on company performance that was proxied by Return on Assets (Sayyar, Basiruddin, Rasid, & Elhabib, 2015). Therefore, audit quality can improve local government performance from credible and reliable financial reporting quality through the auditor's role because it will reduce misleading information. DeAngelo (1981) argued that the period of audit assignment will improve audit quality since knowledge about the client is obtained after repeated audits are carried out. Mislinawati (2017) found that the length of the audit period affected audit quality. Furthermore, Johnson, Khurana, & Reynolds, 2002 did not found a relationship to decreased in the quality of financial reporting for a longer audit period. Thus, the authors propose to use the length of audit time as a measure of audit quality because audit quality should affect local government financial performance.

Based on the description above, the hipotesis can be delivered as follow:

H₁: Capital expenditures influence financial performance

H₂: Audit quality influences financial performance

Thus, the conceptual framework can be described as follows:

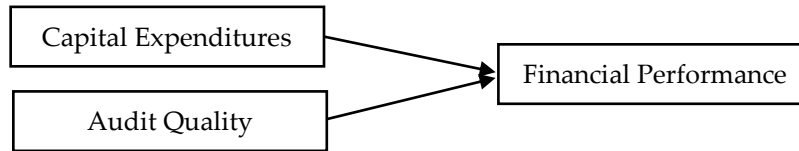


Figure 1 Conceptual Framework

The aim of this paper is to provide theoretical and methodological advice to guide future research on the topic of the effect of capital expenditure and audit quality on the financial performance of local governments in improving people's welfare.

Methods

The type of research is quantitative comparative research that aims to test hypotheses that explain the causal relationship between variables using the design of Mangkunegara (2015). The population of this study is all local governments in West Sumatra Province consisting of 1 (one) West Sumatra Provincial Government, 7 (seven) City Governments, and 12 District Governments or as many as 20 entities that have submitted financial statements (audited). The sampling method is total sample with a 3-year observation period, 2015 to 2017, and hence the sample consists of 60 observations.

The type of data in this study is secondary data. Capital expenditure and audit quality data are obtained from secondary data, namely data which was previously documented in the form of BPK LHP.

Documentation data collection techniques which may be used is manual search of the document, namely from the Representative Office of West Sumatra Province.

Definition of Operational Variables

The dependent variable used are the same with those used by Mangkunegara (2015), namely the financial performance of local governments as proxied by the HDI (Human Development Index). The independent variables used are capital expenditure variables and audit quality. The operational definition of these variables can be explained in the following Table 1:

Table 1 Definition of Operational Variables of The Study

No.	Variable	Variable Operational Definition	Indicator	Source
1	Financial performance (HDI)	Show the financial performance of the local government in improving people's welfare.	Index numbers with the following formula: $HDI = \text{Number IPM}$	Mangkunegara (2015)
2	Capital expenditures	Shows the amount of spending that is intended to increase regional assets and can be used by the community.	Rupiah value of Capital Expenditures is defined with the following formula: $\text{Capital expenditure} = \frac{\text{Total Capital Expenditure in LRA}}{\text{Total Capital Expenditure in LRA}}$	Mangkunegara (2015)
3	Audit quality (the length of audit assignment)	Shows the number of days given to the audit assignment.	Total number of audit days used.	Mislinawati (2017)

Data Analysis Technique

The data used in this study is panel data, namely data combined between time series data and cross section data. The data analysis techniques performed in this study are: (1) descriptive statistics, (2) classical assumption test, and (3) hypothesis test, using regression hierarchy analysis in order to determine the proportion of power affecting variable Y (with simple regression). The first stage of testing is testing each independent variable (capital expenditure and audit quality) on the dependent variable (local government financial performance).

$$IPM_{it} = \alpha + \beta_1 LnX_{1it} + e_{it} \dots\dots\dots(1)$$

$$IPM_{it} = \alpha + \beta_2 LnX_{2it} + e_{it} \dots\dots\dots(2)$$

Next, data panel regression testing was estimated generalized least square (EGLS) / ordinary least square (OLS). Based on the research hypothesis and research schemes that have been compiled, the research model used for this study uses the research model used by (Mangkunegara, 2015). Hypothesis testing uses multiple regression analysis as follows:

$$IPM_{it} = \alpha + \beta_1 LnX_{1it} + \beta_2 LnX_{2it} + e_{it} \dots\dots\dots(3)$$

Information:

IPM = Human Development Index (dependent variable/Y)

α = Constant

β = Coefficient

LnX_1 = Logarithm Natural Capital Expenditures (independent variable)

LnX_2 = Logarithm Natural Length of Audit Assignment (independent variable)

e = error

Further testing of hypothesis testing are (1) comprehensive or simultaneous significance test (F-Test), (2) determination coefficient test (R^2), and (3) individual or partial significance test (t-Test).

Conclusion

The hypothesis for the research proposed in future research is capital expenditure and the length of audit assignment affects the performance of the government in realizing public welfare. However, how much influence of capital expenditure and the length of audit time on the financial performance of local governments in realizing public welfare needs to be studied also in subsequent research. This paper is expected to also be able to assist stakeholders in taking policies that lead to improved community welfare.

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