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Analysis of government financial performance: allocation of capital costs

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ABSTRACT: The study aims to analyze the financial performance of local government to the allocation of capital expenditure. Variable financial performance used consists of the ratio of regional financial independence (RFI), the ratio of the effectiveness of local revenue (ELR) and the degree of contribution of Regional Owned Enterprises (DCROE). The research was conducted in all regencies/cities in East Java Province Indonesia, with the observation period in 2013-2017. The data analysis was quantitative and using multiple linear regression analysis with SPSS version 21 software. The result of analysis obtained in this research indicates that the ratio of local financial independence affects the allocation of capital expenditure, the ratio of the effectiveness of the original revenue affects the allocation of capital expenditure (ACE) and the degree of contribution Regional Owned Enterprises has no effect on capital expenditure allocation.
Keywords: financial performance, allocation of capital expenditure, local government.

1 INTRODUCTION

Agency theory explains the relationship of agents and principals Jensen & Meckling 1976, which in this study local government acts as an agent. The community is represented by the House of Representatives as principal. Regional autonomy by adopting a decentralized system motivates local governments to improve financial performance. Decentralization is a determinant of the proportion of the public budget aimed at capital expenditure Alegre 2010. The ratio of the degree of decentralization has a positive effect on determining the number of resources that can be spent on capital expenditure Manurung et al 2015. Decentralization affects the composition of capital expenditures that are set for the public interest in the long term Jennifer & Prota 2015. The political process in the budget contains a description of the strategy used by various stakeholders in the budgeting process to achieve a goal Davis et al 2012.

An increase in government consumption slows economic growth, while an increase in government investment increases economic growth Roy 2012. Decentralization spending affects government budget spending Arze et al 2016. Expenditure on the accumulation of human capital has a negative impact on economic growth. Increased government spending on infrastructure has a significant positive impact on economic growth Paparas et al 2015. Intergovernmental fiscal transfers are vital to reducing local fiscal deficiencies and funding local public services Duan & Zhan 2016. Budget preparation based on the previous year's budget and the incremental method Davis et al 2012.

Fiscal decentralization economically increases productive public investment, especially infrastructure Kappeler & Valila 2008. The level of fiscal dependence negatively affects the amount of capital expenditure that can be determined by the local government Rochmatullah et al 2016. Fiscal capacity has a positive impact on local financial independence and the ratio of local financial independence has a positive effect on capital expenditure for regional development Simanjuntak & Mukhlis 2017.
Governments in developing countries have misused public spending by supporting capital expenditure Devarajan et al 1996. Fiscal decentralization is important to know the amount and composition of government spending. Decentralization of smaller public sector tax revenues is less than public sector decentralization spending. This is due to a reduction in so-

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cial security and an increase in government consumptionFiva 2006. Increased government consumption and increased government investment have a differential effect on real exchange rates and relative prices Galstyan & Lane. Consensus on the relationship between fiscal decentralization and government size is achieved Golem 2010. Being optimistic and positive about the impact of the decentralization system. The decentralization process has been well designed and implemented. Work needs to be done on how to improve the design and implementation of the fiscal decentralization system Martinez-Vazquez et al 2015. Fiscal decentralization increases inequality in developing countries but reduces inequality in developed countries. The case appeared because there was an economic scale in the provision of some local public services.

2. RESEARCH METHODS

The research was conducted in all districts / cities in East Java Province, Indonesia with an observation period in 2013-2017. Data analysis was quantitative and the hypothesis was tested using multiple linear regression analysis with SPSS version 21 software. The data processed was 190 data. Data in the form of financial statements of local government accountability. Independent variables of financial performance were measured by regional financial independence, Effectiveness of regional income, Degree of the contribution of Regionally Owned Enterprises. While the dependent variable is capital expenditure allocation.

The ratio of local financial independence was measured through the comparison between Local Revenue with total central government transfer revenue, provincial government transfers along with local loan. The effectiveness ratio describes the ability of each local government in mobilizing Local Revenue (LR) in accordance with the previously set targets. The contribution rate of Regional Owned Enterprises (ROE) describes the revenue share of ROE compared to the receipt of Local Revenue. Capital Expenditure Allocation Ratio is the budget expenditure allocation for the acquisition of fixed assets and other assets that provide a value of more than one accounting period compared to the total expenditure of the region.

3. RESULTS AND DISCUSSIONS

From Table 1, it can be seen the results of descriptive statistical analysis of the variables of financial performance and expenditure allocation. Table 1 shows that N = 190 signifying 190 districts / municipals data obtained during the 2013-2017 observation period. Financial performance variable in this research consists of financial independence, LR effectiveness ratio, and contribution of ROE.

Table 1 Descriptive Statistics

Caculation	RFI	ELR	DCROE	ACE
Mean	0,1978	0,2768	1,2975	0,0574
Std Deviation	0,4683	0,2507	0,1661	0,0531
Kolmogorov Smirnov Z	3,774	1,369	2,569	1,169
Asymp. Sig (2 Tailed)	0,062	1,047	0,146	0,130
N	190			

From Table 2, it can be seen the ability of independent variables to influence the dependent variable simultaneously.

Table 2 Simultaneous Testing

Model	Sum of Square	df	Mean Square	F	Sig
Regression	0,073	3	0,024	13,332	0,0001
Residual	0,341	186	0,002		
Total	0,414	189			

The results of the F statistic test in Table 2 above shows a significance value of 0.000 that is smaller than the significance level of 0.05 (Sig. <0.05) so that it can be concluded that all financial performance variables used in the regression model simultaneously affect the allocation of capital expenditure.

From Table 3, it can be seen the independent variables in influencing the dependent variable partially.

Table 3 Coefficient Linear Testing

Model	Unstandardized Coefficient Beta	t statistic	p value	Description
Constant	0,077	2,899	0,004	
RFI	0,066	5,247	0,000	Significant
ELR	0,080	4,147	0,000	Significant
DCROE	-0,017	-0,293	0,770	Not Significant

The regional financial independence ratio has a regression coefficient value of 0.066 and a significance level of 0.000 that is smaller than 0.05 (0.000 <0.05), thereby it can be said that the regional financial independence had a positive effect on capital expenditure allocation.

The results of financial performance in the form of regional financial independence affect the allocation of capital expenditure. Financial independence demonstrates the ability of district and city governments to self-finance tasks and tasks in various local government activities, regional development and public services to the community by using more LR revenues and is not entirely dependent on transfers provided by the central government and the provincial government and loan receipts and bonds area. The results of this study indicate that the regional financial independence had a positive effect on capital expenditure allocation which means there is a unidirectional relationship, namely the higher the regional financial independence, the higher the capital expenditure budget allocated by the district and city governments in East Java Province. The lower the regional financial independence, the lower the capital expenditure budget allocated by the district and city governments in East Java Province.

Achieving optimal financial performance through high financial independence, district and municipal governments in East Java Province have sufficient financial capability to finance capital expenditure needs. This condition has greatly increased LR and is able to reduce dependence on financial assistance from various external parties in financing its capital expenditures, mainly from central and provincial governments. These results support research conducted by Sularso and Restianto (2011) that state the ratio of local financial independence positively affects the allocation of capital expenditure for public services.

The variable of LR Effectiveness ratio has a regression coefficient value of 0.080 and a significance level of 0.000 is smaller than 0.05 (0.000 <0.05), thus it can be said that LR effectiveness positively affects the allocation of capital expenditure.

The results of LR effectiveness testing affect the allocation of capital expenditure. The LR effectiveness ratio illustrates the ability of local governments to realize the amount of targeted LR in accordance with the potential of the region's financial resources. The results of this study indicate that the LR effectiveness ratio positively affects the allocation of capital expenditure. The positive influence indicates a direct relationship between the effectiveness of LR and the allocation of capital expenditure, i.e., the higher the effectiveness ratio of LR generated, the higher the allocation of capital expenditure set by the district and municipal governments in East Java Province. Similarly, the lower the effectiveness of LR generated, the lower the allocation of capital expenditure determined by district and city governments in East Java Province.

The high LR effectiveness ratio is shown by the high realization of LR revenues and exceeds the targeted LR revenue budget. The high ratio of LR effectiveness shows that district and city governments are able to reach and exceed the amount of LR revenue realization that has been targeted. The higher achievement of the LR effectiveness ratio indicates that the more effective the performance of district and city governments in realizing higher LR earnings than the amount of local revenue (LR) budgeted in the Regional Revenue and Expenditure Budget (RREB). In addition, achievement of revenues from revenue exceeding the target could be due to the district and municipal governments in East Java that are able to explore, manage and utilize various LR potentials available in their respective regions by identifying potential sources of tax revenue and user charges to remind LR revenues and to expand the business of ROE, both bank and non-bank financial institutions, in order to improve the results of separated regional wealth management which will further increase the amount of LR so that the realization of LR can exceed the previously established LR budget.

Based on agency theory perspective, the high effectiveness ratio of LR has an impact on increasing the financial capacity of district and city governments supported by the high number of LR realization so that district and city governments as agents have managed LR effectively by exploring and utilizing potential LR sources and available in the area so that the amount of LR can exceed the LR target set. With the more effective realization of LR, the district and city governments have larger funds to be able to increase the portion of the capital expenditure budget allocation in the RIEB to fulfill the objective of improving the quality of public service facilities and infrastructure.

The degree of contribution of ROE has a regression coefficient value of -0.017 with a significance level of 0.770 greater than 0.05 (0.770 <0.05), so it can be concluded that the degree of ROE contribution does not affect the allocation of capital expenditure.

The results of financial performance in the form of a ratio of the degree of contribution of ROE does not affect the allocation of capital expenditure. Source of income from the local government in large amounts funded other than ROE funds. The results of this study do not support research conducted by the school and Sugarso Restianto (2011).

In the perspective of agency theory, district and city governments as agents can be said to have been able to optimally manage LR with maximizing the sources of revenue from LR derived from the share of operating profits and dividend distribution from ROE. The high profit generated by ROE will increase the amount of LR revenue and increase the achievement of financial performance in the form of a high degree of contribution of ROE so that in this case, the district and city government has a high LR fund from the ROE operating income and can be allocated by the district and city governments to finance the capital expenditure budget in the RIEB so as to stimulate capital expenditure activities in improving the quality of facilities and infrastructure of public services for the community.

4. CONCLUSION

Regional financial independence had an effect on the allocation of spending because local governments are able to finance capital expenditures by using more local revenue and are not dependent on funds from central and provincial governments. The Effectiveness of the Original Regional Income affects the allocation of capital expenditure because the performance of local government revenue of Original Regional Revenue can be used to finance capital expenditure budget. The degree of contribution of Regional Owned Enterprises has not affected the allocation of capital expenditures, since the profits earned by Regional Government Enterprises are not able to support the revenue of the Regional Original Income, so as not to increase the allocation of capital expenditure.

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