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Financial performance in Central Java Provinces: the role of regional income and allocation funds during 2016-2020

Subjects
Accounting and Auditing

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ABSTRACT

Purpose: This study aims to test and obtain empirical evidence of the influence of local revenues, special allocation funds, and general allocation funds on financial performance in the Central Java region during the 2016-2020 period.

Methods: This study employed a purposive sampling method with a population consisting of 35 regencies/cities in Central Java for the period 2016-2020. Data analysis was conducted using multiple linear regression analysis with the assistance of SPSS version 23.

Findings: The results indicated that Regional Original Income and special allocation funds significantly affect regional financial performance, while the general allocation fund does not considerably influence economic performance.

Practical Implications: This study provides insights for local governments to focus on enhancing local revenue and effectively utilizing special allocation funds to improve financial performance. Governments should manage general allocation funds wisely to reduce dependence on these funds.

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Abstrak

Tujuan: Penelitian ini bertujuan untuk menguji dan memperoleh bukti empiris mengenai pengaruh pendapatan asli daerah, dana alokasi khusus, dan dana alokasi umum terhadap kinerja keuangan di wilayah Jawa Tengah selama periode 2016-2020.

Metode: Penelitian ini menggunakan metode purposive sampling dengan populasi yang terdiri dari 35 kabupaten/kota di Jawa Tengah untuk periode 2016-2020. Analisis data dilakukan menggunakan analisis regresi linier berganda dengan bantuan SPSS versi 23.

Temuan: Hasil penelitian menunjukkan bahwa Pendapatan Asli Daerah dan dana alokasi khusus berpengaruh signifikan terhadap kinerja keuangan daerah, sementara dana alokasi umum tidak berpengaruh secara signifikan terhadap kinerja ekonomi.

Implikasi Praktis: Penelitian ini memberikan wawasan bagi pemerintah daerah untuk fokus pada peningkatan pendapatan asli daerah dan memanfaatkan dana alokasi khusus secara efektif untuk meningkatkan kinerja keuangan. Pemerintah sebaiknya mengelola dana alokasi umum secara bijaksana untuk mengurangi ketergantungan pada dana tersebut.

Kata kunci: Dana Alokasi Umum, Dana Alokasi Khusus, Pendapatan Asli Daerah, Kinerja Keuangan.

1. Introduction

Considering the transition of the government system from centralization to decentralization and the increasing demands of the populace, government officials are encouraged to enhance their performance. This effort aims to achieve national objectives and fulfill the aspirations of the citizens, necessitating government administration principles that are both accountable and transparent. The government has instituted regulations mandating that every governmental agency, as a public organizer, must report on executing its responsibilities and functions.

This accountability reflects their governance over the management of available resources. Referring to Presidential Instruction No. 4 of 2011, which pertains to accelerating the enhancement of State Financial Accountability, and Presidential Instruction No. 1 of 2013, which addresses actions to prevent and combat corruption, the BPKP consistently oversees cross-sectoral programs and activities, as well as state and regional treasury functions, under the President's directive. Additionally, it is tasked with supervising regional financial accountability across all provincial areas in Indonesia, including Central Java Province.

Assessing Government Financial Performance is crucial, given that the central government enacts autonomy policies with the expectation that local governments will gain greater independence in managing their finances. The criteria for evaluating local government financial performance significantly differ from those used in corporate financial assessments. While both utilize budget-based measurements, local government finances do not aim to maximize profits or net income. Unlike companies focused on profit maximization, local governments have specific designations for the disparities between their revenues and expenditures (surplus or deficit).

One key criterion for assessing a region's capacity to manage its finances is its ability to handle regional financial matters. Regional economic performance refers to how effectively a region can generate and manage its financial resources to meet governmental needs, provide community services, and support local development without complete reliance on the central government. This involves having the flexibility to utilize funds under legal regulations (Alfarisi, 2015).

Analyzing financial performance aims to evaluate government efficiency, measure the potential for economic resources, assess financial stability, determine the government's capability to meet its obligations, and ensure that the budget is implemented effectively based on Mahmudi financial practices (2010: 142). A well-functioning government is crucial for building community trust and satisfaction, making citizens feel effectively served.

Several ratios are used to assess regional financial performance, including financial independence, effectiveness, and efficiency ratios. The economic independence ratio indicates a local government's ability to self-finance its activities and services. As defined by Mardiasmo (2013: 112), the effectiveness ratio measures how well local governments achieve their intended revenues relative to the targets set against regional potential. The efficiency ratio compares the costs incurred by the government to generate revenue with the actual revenue realized from the budget.

2. Theoretical Background & Hypotheses

The Regional Original Income (PAD) encompasses revenues from local taxes, regional asset levies, and the management of legitimate regional wealth. PAD is expected to encourage local governments to develop sound economic infrastructure, thereby improving regional income (Mardiasmo, 2002:146). Furthermore, the General Allocation Fund, according to Government Regulation Number 55 of 2005, is sourced from the State Budget (APBN) and aims to equalize finances among regions. This allocation is crucial for meeting expenditure needs as part of the decentralization initiative.

Transitioning to the Special Allocation Fund (DAK) serves as a financial transfer mechanism from the central government to regional authorities to enhance the provision of physical facilities and infrastructure in line with national priorities. DAK also plays a vital role in reducing disparities in growth rates and services between regions while ensuring accountability in providing basic services to the community (Subekan, 2016).

Finally, local governments' financial performance is assessed based on their achievement in managing regional finances, including revenues and expenditures. Mardiasmo (2002:121) states that the public sector performance measurement system aids public managers in evaluating strategic achievements through financial and non-financial metrics. This assessment uses financial ratios derived from regional accountability reports in the form of APBD calculations.

Abdullah, Dri Asmawati, and Febriansyah (2015) examined the effects of local income and General Allocation Funds from the central government on regional financial performance using financial independence ratios. The analysis revealed that local revenues significantly impact regional economic performance, while the General Allocation Fund had no notable effect.

In another research effort, Kadek & Indrawati (2019) focused on the Denpasar city government, employing a saturated sampling method to include all existing population samples. Their findings indicated that original income from the equalization fund negatively affects financial performance, suggesting a reliance on these funds could lead to adverse outcomes.

Yasin (2018) also tested the influence of Regional Native Income and Development Expenditure on financial performance, using the independence ratio as a measure. This study, which also implemented saturated sampling in East Java, found that regional native income and development spending negatively influence financial performance in Central Java.

Hypotheses

The influence of local revenue on financial performance

PAD is a source of income that continues to grow as it is managed effectively. If a region can increase the collection of its local revenue and manage its assets, it is expected to yield better performance. However, if a region holds significant assets but fails to manage them efficiently, introspection is required to identify the underlying issues and make necessary improvements. Research findings demonstrate a positive relationship between PAD and the financial performance of local governments, supported by the research of Sari et al. (2016).

Hypothesis 1: PAD influences local governments' financial performance.

The influence of special allocation funds on financial performance

DAK are intended to support the provision of physical facilities and infrastructure by national priorities. These funds must be well-managed by local governments to positively impact financial performance. Evaluating the effectiveness of DAK in enhancing economic performance is crucial, as it can affect the quality of services provided to the community. Ineffective management of DAK may lead to wastefulness and failure to achieve the intended goals.

Hypothesis 2: DAK influence the financial performance of local governments.

The influence of general allocation funds on financial performance

General Allocation Funds (DAU) are funds allocated from the national budget to equalize regional financial capabilities. While DAU aims to enhance regional finances and support regional autonomy, research indicates that its effectiveness in improving the financial performance of local governments remains a topic of discussion. Some studies, such as those conducted by Gafar (2019), suggest that DAU does not significantly impact financial performance.

Hypothesis 3: DAU influence the financial performance of local governments.

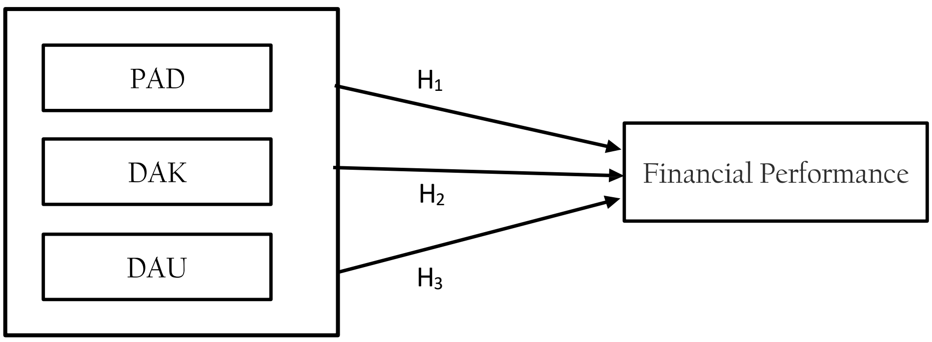

Figure 1. Conceptual framework

3. Methods

Population and Sample

In this study, the population consisted of all local governments within the regencies and cities of Central Java from 2016 to 2020, totaling 35 regencies and cities. The study employed a saturated sampling method for the research samples, utilizing the entire population of regencies and cities in Central Java from 2016 to 2020. Consequently, the sample included all 35 regencies and cities, amounting to 175 samples over the five-year study period.

Measurement

This study measures variables using a quantitative approach, calculating specific ratios and proportions according to each variable's nature. The dependent variable, Financial Performance, is measured based on the level of regional financial independence, which is calculated by comparing the PAD to the total regional revenue. This ratio reflects the extent to which a region can finance its needs without relying heavily on central government assistance.

The first independent variable, PAD, is measured by summing the components of local revenue, including regional taxes, regional retributions, revenue from separated regional assets management, and other legitimate local revenues by applicable regulations. Meanwhile, the variables DAK and DAU are measured based on government regulations. The DAK is calculated by referring to the provisions of the Ministry of Home Affairs and is typically used to fund specific national-priority activities. The DAU is determined using a particular formula of percentage from the total national DAU: 10% for provinces and 26% for regencies/cities after deducting personnel expenditure.

Data analysis technique

This study uses a descriptive method with a quantitative approach to explain current phenomena using numerical data. The purpose is to describe and analyze a situation supported by literature and variable indicator calculations presented in written form. The data used is secondary data obtained indirectly through other sources. These include published and unpublished documents from the Central Statistics Agency (BPS) https://www.bps.go.id and the Ministry of Finance http://www.djpk.kemenkeu.go.id.

4. Results and Discussion

Descriptive analysis

The descriptive statistical analysis summarizes the financial performance variables, as shown in Table 1. It reveals that the dataset comprises 175 observations, with the economic performance showing a minimum value of 0.09, a maximum of 0.98, a mean of -0.19, and a standard deviation of 0.12. For the PAD variable, the data also consists of 175 points, with a minimum value of 146,652, a maximum of 2,516,647, a mean of 343,598, and a standard deviation of 286,366. The DAU variable indicates a minimum value of 440,041, a maximum of 1,525,152, a mean of 988,552, and a standard deviation 254,154 across the 175 observations. Lastly, the DAK variable displays a minimum value of 0, a maximum of 543,730, a mean of 289,006, and a standard deviation of 127,745 based on the same number of observations.

Tabel 1. Descriptive analysis

	N	Minimum	Maximum	Mean	Std. Deviation
PAD	175	146652	3E+06	343598,9	286366,09
DAU	175	440041	2E+06	988552,6	254154,29
DAK	175	0	543730	289007	127745,09
Kinerja Keuangan	175	0,09	0,98	0,19	0,12
Valid N (listwise)	175				

Source: Results of data processing with SPSS version 25

Hypoyheses testing

The results shown in Table 2 reveal key insights from the regression analysis regarding the financial performance of the Central Java region. The constant value of 0.29 indicates that if the Regional Original Revenue, Special Allocation Fund, and General Allocation Fund remain unchanged, there will be an expected increase in profit management by 0.29. Specifically, the Regional Original Income has a regression coefficient of 4.191E-07. This means that a 1 percent increase in this income significantly boosts 4.191E-07 in financial performance, assuming other funding sources stay the same.

Tabel 2. Hypotheses Testing

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
Constant	0,29	0,01		28,59	0
PAD	4,19E-07	0	1	44,87	0
DAK	-2,28E-07	0	-0,48	-16,31	0
DAU	-4,27E-08	0	-0,05	-1,59	0,11
Adjusted R Square	0,92				

Source: Results of data processing with SPSS version 25, 2021

On the other hand, the Special Allocation Fund has a negative regression coefficient of -2.278E-07, which suggests that a 1 percent increase in this fund would lead to a decrease of 2.278E-07 in financial performance, given that the Regional Original Income and General Allocation Fund remain constant. Similarly, the General Allocation Fund also shows a decline in economic performance with a coefficient of -4.268E-08 for a 1 percent increase. Overall, the analysis reveals that the combined effects of Regional Original Income, Special Allocation Fund, and General Allocation Fund explain 92% of the variations in Regional Financial Performance from 2016 to 2020, with the remaining 8% influenced by other unexamined factors.

Discussion

The influence of local revenue on financial performance

The analysis indicates that the Original Regional Income (PAD) has a significant value of 0.00, less than 0.05. This finding implies a notable partial influence of PAD on the financial performance of the Central Java government during the years 2016 to 2020. These results corroborate Budianto and Alexander (2016) study titled "The Effect of PAD and Equalization Funds on the Financial Performance of the Regency/City Government in North Sulawesi Province." They concluded that higher PAD leads to enhanced regional financial performance, suggesting that the region's economic health improves as local revenue increases.

The influence of special allocation funds on financial performance

The test results show a significant value of 0.00 for the Special Allocation Fund (DAK), indicating a partial influence on the financial performance of the Central Java government from 2016 to 2020. However, this finding opposes the conclusions of a previous study by Abdullah and Dri, Asmawanti S (2016), which examined "The Effect of Regional Native Income, General Allocation Fund, and Special Allocation Fund on the Financial Performance of Local Governments in Southern Sumatra." Their research suggested that both the Special Allocation Fund and General Allocation Fund do not significantly impact the financial performance of local governments in that region.

The influence of general allocation funds on financial performance

The analysis revealed a significance value of 0.11 for the General Allocation Fund (DAU), which exceeds the 0.05 threshold, indicating no partial effect on the financial performance of the Central Java government for the years 2016 to 2020. This aligns with the findings of Abdullah, Dri Asmawati, and Febriansyah (2015), who concluded that the General Allocation Fund does not significantly influence local government financial performance. Their reasoning highlights that the DAU does not derive from the innovative efforts of local governments to generate regional revenue.

5. Conclusion

Based on the testing results, the researchers concluded several key points. First, there is a significant influence between local revenue and the financial performance of Central Java province during 2016-2020, indicating that all components of local original revenue play a significant role. Second, higher special allocation funds received by local governments correlate with lower financial performance. Third, general allocation funds do not affect the province's economic performance during the same period, meaning that the amount of these funds has no impact.

Following these conclusions, the researchers suggest that future studies consider factors influencing regional financial performance. They also recommend using a broader sample and a more extended observation period for more accurate results and encouraging local governments to optimize economic performance by leveraging existing potential and managing allocation funds more wisely.

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