The effect of original LG revenue, balancing fund, and capital expenditure on LG financial performance in regencies in East Java Province

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ABSTRACT

Local Government (LG) financial performance is the level of work achievement in regional finance which is assessed using the state financial system stipulated in the statutory provisions. This study aimed to examine the effect of original local government revenue, balancing funds, and capital expenditure on LG financial performance. It used the population of all regencies in East Java Province. They were taken using saturated sampling method. The secondary data consist of all audited LG financial statements of 29 regencies in East Java Province period 2013 – 2017. The data were analyzed using multiple linear regression analysis with SPSS 23. The results showed that original LG revenue and balancing funds have a negative and significant effect on LG financial performance, while capital expenditure has no effect on LG financial performance.

ABSTRAK

Kinerja keuangan Pemerintah Daerah (LG) adalah tingkat pencapaian pekerjaan dalam keuangan daerah yang dinilai menggunakan sistem keuangan negara yang diatur dalam ketentuan perundang-undangan. Penelitian ini bertujuan untuk menguji pengaruh pendapatan asli pemerintah daerah, dana perimbangan, dan belanja modal terhadap kinerja keuangan pemerintah daerah. Ini menggunakan populasi semua kabupaten di Provinsi Jawa Timur. Mereka diambil menggunakan metode sampling jenuh. Data sekunder terdiri dari semua laporan keuangan Pemerintah Daerah yang diaudit dari 29 kabupaten di Provinsi Jawa Timur periode 2013 - 2017. Data dianalisis dengan menggunakan analisis regresi linier berganda dengan SPSS 23. Hasil penelitian menunjukkan bahwa pendapatan asli daerah dan dana perimbangan memiliki negatif dan signifikan berpengaruh pada kinerja keuangan Pemda, sementara belanja modal tidak berpengaruh pada kinerja keuangan Pemda.

1. INTRODUCTION

The enactment of Law No. 32 of 2004 concerning Local Government (LG) and Law No. 33 of 2004 on financial balance gives authority to Local Government (LG) to regulate all regional financial management in order to create comprehensive development and be able to improve services and welfare for all communities in the region according to the principle of autonomy. The implementation of an autonomy policy in a region causes local government to manage regional finance dependently so that they can complete the regional development process without waiting for funding assistance sourced from the center. Therefore, measuring the LG financial performance is very important (Mahsun et al ., 2007: 165).

Local Governments (LGs), consists of provincial government, regency government, and municipal government. They have full authority to improve and advance their territories based on funding and income from regional income in increasing regional budgets. If local governments are still dependent on the central government by expecting balancing funds from the central government, this can have a negative impact on government administration. As such, the services cannot run optimally because the apparatus expenditure

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cannot be financed using its own finance. In addition, the growth of positive added value encourages investment so that at the same time the investment will encourage improvements in regional infrastructure. Good regional infrastructure and high investment in a region will increase original LG revenue (Indonesia: Pendapatan Asli Daerah / PAD). In addition, balancing funds also increase the LG capital expenditure (Gideon, 2013).

This phenomenon occurred in the structure of the LG Budget (APBD) in Indonesia in 2016, particularly on LG revenue consisting of original LG revenue, transfer income, and other legitimate income. The high dependence on the role of the central government is caused by the high transfer rates. The realization of revenue in regencies / municipalities in East Java province decreased by 1.2% in 2016 compared to 2015, whereas the realization of expenditure actually increased by 1.2% (Statistics Indonesia, 2018). The size of the proportion provides an indication that regional economic development is strongly influenced by central budget position which causes the budget to experience a deficit.

Based on the background that has been explained above and the existence of research gaps from the results of previous studies, the researchers would like to conduct research on "The Effect of Original LG Revenue, Balancing Funds, and Capital Expenditures on LG Financial Performance in Regencies in East Java Province Period 2013-2017".

2. THEORETICAL FRAMEWORK AND HYPOTHESIS

Agency Theory
According to Jensen and Meckling (1976), agency relation is a contract between the principal and the agent related to the delegation of some decision-making authority to the agent. As an agent, the manager is morally responsible for maximizing the profits of the principal, on the other hand, the manager also has the interest of maximizing his own welfare. Agency theory can also be applied to the public sector. A democratic country has an agency relationship between the community and the government or the relationship between the local government and the central government.

The relationship between agency theory and this research is that the government, as an agent, must set a certain strategy in order to provide the best service to the community, as the principal. The principal always wants good performance from agents, in which the performance can be seen from financial statements and good services. Meanwhile, the financial statements and good services depend on the strategy implemented by the government. If the government's performance is good, the community will trust the government.

Regional Autonomy
According to Setyawan (2007: 88), autonomy is derived from two Greek words, autos (self) and nomos (rules) or law. Based on the theory of regional autonomy, it can be concluded that autonomy means the self-rules or the self-law which subsequently developing into self-government. Autonomy is a constitutional order, not just a state administrative order, and the implementation of the State based on law. Therefore, autonomy is self law or self-rule, and it is constitutional for the state to implement as based on law.

According to Law No. 32 of 2004, regional autonomy is the right, authority, and obligation of autonomous regions to regulate and manage their own government affairs and the interests of the local community in accordance with legislation. Regional autonomy has significantly changed governance from centralization to decentralization in various fields.

Statement of Government Accounting Standards (PSAP) Number 01, concerning the presentation of financial statements paragraph 14, states that government financial reports consist of two types:
1. Report on budget execution
    a) Budget Realization Report (LRA)
    b) Report on the change in accumulated budget surplus (LPSAL)
2. Financial Report
    a) Balance
    b) Change of Equity Report (LPE)
    c) Cash Flow Statement (LAK)
    d) Notes to Financial Statements (CaLK)

LG Financial Performance
Local Government financial performance is the level of work achievement in regional finance which includes LG revenues and expenditures assessed using the financial system established through a policy or statutory provision for a budget period. According to Minister of Home Affairs Decree No. 13 of 2006 which has now changed to Minister of Home Affairs Regulation No. 21 of 2011 concerning guidelines for management, accountability, supervision of regional finances, procedures

for the preparation of regional income and expenditure budgets, implementation of regional financial administration, and the compilation of Regional Budget (APBD) calculation, the performance benchmark is another component that must be developed for the basis of measuring financial performance in the performance budget system.

Original LG Revenue (PAD)

Original LG revenue is a source of local government income derived from the economic activities of the region itself. Original LG revenue is one of the pillars of independence of a region. According to Law Number 33 of 2004 concerning financial balance between the central and regional governments, the source of original LG revenue consists of regional taxes, regional levies, regional wealth management results, and other legitimate regional income, with the aim to provide flexibility to the region to explore funding in the implementation of regional autonomy as a manifestation of the principle of decentralization.

Optimization in the receipt of original LG revenue should be supported by the local governments' effort to improve the quality of public services. Excessive exploitation of original LG revenue will burden the community, become a disincentive for the region, and threaten the economy on a macro basis. From this understanding, it can be concluded that the original LG revenue is the amount of money received from the community/ sources in its own region during the calendar year. This is used to finance its routine expenditure, while the rest is used for development costs in accordance with applicable laws and regulations.

Balancing Fund

In Law No. 33 of 2004 concerning the balance between the Central Government finance and Local Government finance, balancing fund is defined as the fund originating from the State Budget (APBN) which is allocated to regions to fund regional needs in the context of implementing decentralization. Revenues included in the balancing fund are contained in Law No. 33 of 2004 concerning the balance between the Central Government finance and the Local Government finance consisting of:

1. General Allocation Fund (DAU) is to fund regional funding needs with the aim of equitable distribution of inter-regional financial capacity in the context of implementing decentralization.

2. Special Allocation Fund (DAK) is the fund originating from state revenues allocated to certain regions with the aim of helping fund special activities which are regional affairs and in accordance with national priorities.

3. Revenue Sharing Fund (DBH) is the fund originating from state revenues allocated to the regions based on a percentage number to fund regional needs in the context of implementing decentralization.

Capital Expenditure

Minister of Finance Regulation (PMK) No.91 / PMK.06 / 2007 concerning Standard Account Chart (BAS) states that capital expenditure is a budget expenditure that is used to obtain or add fixed assets and other assets that benefit more than one accounting period and exceed the minimum capitalization of fixed assets or other assets determined by the government. The fixed assets are used to operate the daily activities of a work unit, and not for sale.

According to Minister of Home Affairs Regulation No. 13 of 2006, capital expenditure is used for expenditures carried out in the context of purchasing/ procurement or constructing tangible fixed assets. These assets have a benefit value of more than 12 (twelve) months for use in government activities. The examples are in the form of land, equipment and machinery, buildings, roads, irrigation and networks, and other fixed assets.

The Effect of Original LG Revenue on LG Financial Performance

Original LG revenue can be interpreted as income originating from levies carried out by the local government based on applicable regulations that can be imposed on each person or business entity. They are both government and private because of the acquisition of services provided by the local government. Therefore, the local government can carry out levies in the form of tax receipts, levies and other legitimate receipts regulated in the law (Julitawati, et al. 2018).

The amount of original LG revenue generated by the local government can be a measure in assessing the LG financial performance because the amount of original LG revenue also shows that local government is able to utilize the existing resources and potential in its authority. It can be said that the higher the original LG revenue, the higher the LG financial performance. Results of

the studies conducted by Antari (2018), Sari (2016), and Gideon (2013) show that original LG revenue has a significant influence on LG financial performance. The hypothesis can be stated as follows:

H1: *Original LG revenue has an effect on LG financial performance*

The Effect of Balancing Fund on LG Financial Performance

The local government income transferred by the central government aims to reduce the imbalance of government funding sources between the center and the regions. If the realization of regional expenditure is higher than the regional income, there will be a deficit. According to Sari (2016), to cover the lack of regional expenditure, the central government will transfer funds in the form of balancing funds to local governments.

Balancing fund will be included in the local government income account, thereby increasing the total local government revenue. In this case, the local government still depends on the central government. The higher the balancing fund, the lower the financial performance of the local government. The research conducted by Yasin (2017), Sari (2016), and Gideon (2013) states that the variable of balancing fund has a significant influence on the LG financial performance. The hypothesis can be stated as follows:

H2: Balancing fund has an effect on LG financial performance

The Effect of Capital Expenditure on LG Financial Performance

Capital expenditure is the local government's expenditure in the context of purchasing or building fixed assets that have a benefit value of more than one period. This can provide services to the community that have both direct and indirect benefit. Large capital expenditure is the reflection of the many infrastructure and facilities implemented.

The more development carried out, the better the service provided to the community so that LG performance will be better. The higher the capital expenditure, the higher the LG financial performance. Research conducted by Antari (2018) states that capital expenditure has a significant effect on the LG financial performance. The hypothesis can be stated as follows:

H3: *Capital expenditure has an effect on LG financial performance*

Framework

This study was conducted to examine the effect of original LG revenue, balancing funds, and capital expenditure on LG financial performance (Figure 1).

3. RESEARCH METHOD

Sample Classification

This study used a population of all regencies in East Java province. The time period studied was 2013 until 2017. The sampling technique used is saturated sampling method, where "saturated sampling is a technique of determining the sample if all members of the population are used as samples" (Sugiyono, 2017: 85). The data used are all audited LG financial statements of 29 regencies in East Java Province. The reason for using regencies as the sample because there are differences in characteristics including: area size, population aspects, and limited data obtained.

Research Data

The research data used are secondary data. Secondary data can be in the form of historical report notes published or unpublished by the Statistics Indonesia of representatives of East Java Province. The data are published regency budget realization reports in East Java province that match the predetermined sample criteria.

Research Variable

The research variables used are the dependent variable (regional government financial performance) and the independent variables (regional original revenue, balancing funds, and capital expenditure.
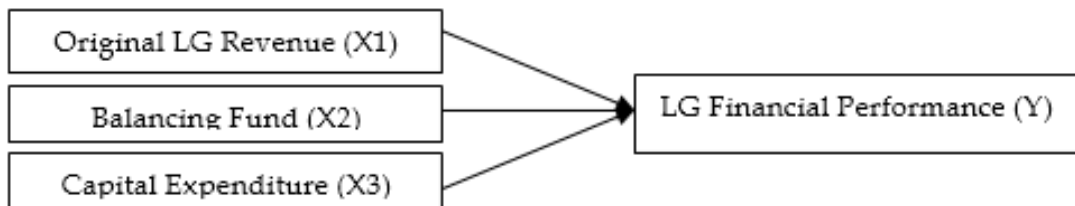

Figure 1
Framework

Operational Definition of Variables
Local Government (LG) Financial Performance
Measurement of LG financial performance is conducted using measures of efficiency. Performance is an illustration of the achievement of an activity in achieving the goals, vision and mission of an organization (Bastian, 2006: 117). An efficiency ratio is a ratio that describes the comparison between output and input or the realization of expenditure and allocations budgeted by the local government. The smaller the ratio, the more efficient, and vice versa. An activity is said to be efficient if the implementation of the work has reached the maximum (output) by using the lowest cost (input) or the minimum cost obtained from the desired result. If the financial performance is above 100%, it can be said to be inefficient, 90% - 100% is less efficient, 80% - 90% is quite efficient, 60% - 80% is efficient, and below 60% is very efficient (Juliawati, et al 2012). According to Ardirfa, et al (2016), the cost allocation is transformed into an efficiency ratio, that is, the calculation of efficiency ratio to financial performance is conducted using the efficiency ratio as follows:

$$\text{Eff LGFP} = \frac{\text{Real LG Exp.}}{\text{Real LG Rev.}} \times 100\%$$

Note:
Eff LGFP : Efficiency of LG Financial Performance
Real LG Exp. : Realization of LG Expenditure
Real LG Rev. : Realization of LG Revenue

Original Local Government Revenue
Original LG revenue, according to Law No. 33 of 2004, is revenue received by local governments from sources within their own regions that are collected based on regional regulations in accordance with the applicable laws and regulations. Original LG revenue is a source of revenue for the regions collected in the region to be used as the basic capital of the local government in financing development and local businesses to minimize dependence on funds from the central government. Original LG revenue is measured using a ratio scale with the following formula:

$$\text{OLGR} = \frac{\text{Real OLGR t-1}}{\text{Total LG Revenue t-1}} \times 100\%$$

Note:
OLGR : Original LG Revenue
Real OLGR t-1 : Realization of Original LG Revenue t-1

Balancing Fund
Balancing the fund, according to Law No. 33 of 2004, is the fund originating from the State Budget of Revenue and Expenditures (APBN) allocated to regions to fund regional needs in the context of implementing decentralization. Balancing fund is measured using a ratio scale with the following formula:

$$\text{B. Fund} = \frac{\text{Real B. Fund t-1}}{\text{Total LG revenue}} \times 100\%$$

Note:
B. Fund = Realization of Balancing Fund
Real B. Fund t-1 = Realization of Balancing Fund t-1

Capital Expenditure
According to Government Regulation Number 71 of 2010, capital expenditure is the budget expenditure for the acquisition of fixed assets and other assets that benefit more than 12 months or one accounting period. Capital expenditure includes capital expenditure for land acquisition, buildings, equipment, and intangible assets. Capital expenditure is measured using a ratio scale with the following formula:

Data Analysis Technique
The researcher used the data and analyzed analysis using multiple linear regression analysis and processed using SPSS 23 through the following stages:
1. Descriptive Statistics Test
2. Normality Test
3. Multicollinearity Test
4. Autocorrelation Test
5. Heteroscedasticity test
6. Coefficient of Determination (R^2) Test
7. F Statistic (Anova) Test
8. T Statistic Test
9. Multiple Linear Regression Analysis

4. DATA ANALYSIS AND DISCUSSION
Descriptive Statistics
Descriptive statistical analysis is used to describe data related to average (mean) value, standard deviation value, maximum value, and minimum value (Jogiyanto, 2015: 195).

Table 1
Descriptive Statistics Test Results

DESCRIPTIVE STATISTICS					
	N	Minimum	Maximum	Mean	Std. *Deviation*
LG Financial Performance	145	.56970323	1.08288143	.9330491123	.07450222027
Original LG Revenue	145	.01379496	.36313045	.1138468965	.06266675422
Balancing Fund	145	.40348793	.86286178	.6727740957	.08836890821
Capital Expenditure	145	.09275705	.45427083	.2290638474	.06615462167
Valid N (*listwise*)	145				

Source: Data Processed

The standard deviation value of the variable of LG financial performance for the period 2013-2017 is 7.47%, where the standard deviation shows the distance between one data and other data. The mean value of efficiency ratio of LG financial performance in the period of 2013-2017 is 93.37% (less efficient). The minimum value of efficiency of the LG financial performance in the period 2013-2017 is 56.97% (very efficient) owned by Jember Regency, while the maximum value is 108.29% (inefficient) owned by Pasuruan Regency.

The minimum value of the variable of original LG revenue in the period 2012-2016 is 1.38%, while the maximum value is 36.31% of total LG income. The mean value of the variable of original LG revenue in the period 2012-2016 is 11.38% of total LG income. The standard deviation value of the variable of original LG revenue in the period 2012-2016 is 6.27%. The standard deviation value shows the distance between one data and other data. The smallest original LG revenue ratio is IDR 227,120,525,358 owned by Tuban Regency with a total LG income of IDR 1,823,513,656,640.

The minimum value of the variable of balancing fund in the period 2012-2016 is 40.35%, while the maximum value is 86.29% of total LG income. The mean value of balancing funds in the period 2012-2016 is 67.28% of total LG income. The standard deviation value of balancing funds in the period 2012-2016 is 8.84% where the standard deviation shows the distance between one data and other data. The smallest balancing fund ratio is IDR 1,708,680,363,941 owned by Lamongan Regency with a total LG income of IDR 2,716,042,671,045.

The minimum value of the variable of capital expenditure in the period 2012-2016 is 9.27%, while the maximum value is 45.43% of total LG expenditure. The mean value of capital expenditure in the period 2012-2016 is 22.91% of total LG income. The standard deviation value of capital expenditure in the period 2012-2016 is 6.61%, where the standard deviation shows the distance between one data and the other data. The smallest capital expenditure ratio is IDR 110,848,141,315 owned by Ponorogo Regency with a total LG expenditure of IDR 1,396,914,654,794.

Classical Assumption Test
Normality Test

Table 2
Normality Test Results

Model	Collinearity	Statistic
	Tolerance	VIF
Original LG Revenue	0.637	1.569
Balancing Funds	0.671	1.490
Capital Expenditure	0.918	1.089

Source: Processed data (2018)

Based on the results of normality test results in Table 2, it can be seen that the tolerance values of original LG revenue is 0.637, balancing fund is 0.671, and capital expenditure is 0.918. The three independent variables in this study have tolerance values above 0.1, which means that there is no correlation between independent variables.

Multicollinearity Test

Table 3
Multicollinearity Test Results

	Unstandardized Residual
N	145
Kolmogorov-Smirnov Z	0.049
Asymp. Sig. (2-tailed)	0.200
Chi-square	Sig
6.341	0.169

Source: Processed data (2018)

Based on the results of the multicollinearity test in Table 3, it can be seen that the value

of Kolmogorov-Smirnov is 0.049, with the value of Asymp Sig (2-tailed) of 0.200, where the value is greater than the significance coefficient value of 0.05. This shows that the residual data of original LG revenue, balancing funds, and capital expenditure on the financial performance of local governments are normally distributed.

Autocorrelation Test

Table 4
Autocorrelation Test Results

Model	Durbin-Watson
1	1.800

Source: Processed data (2018)

From Table 4 above, it can be seen the DW value is 1.800. In searching for positive autocorrelation, the DW value of 1.909 < Durbin upper (DU) of 1.75663, so there is no positive autocorrelation. The value of (4 – DU) 2.25337 indicates that there is no negative autocorrelation. From this result, it can be concluded that there is no autocorrelation.

Heteroscedasticity Test

Table 5
Heteroscedasticity Test Results

Model	Unstandardized B	T	Sig.
(Constant)	-.051	-1.192	.235
Original LG Revenue	.143	1.889	.061
Balancing Fund	.110	2.108	.037
Capital Expenditure	.060	1.001	.318

Source: Processed data (2018)

The results of Heteroscedasticity test in Table 5 above show that the independent variable of original LG revenue has a significance value of 0.061 > 0.05 which means that there is no heteroscedasticity, the independent variable of balancing fund has a significance value of 0.037 <0.05 which

means that there is heteroscedasticity, and the independent variable of capital expenditure has a significance value of 0.318> 0.05 which means that there is no heteroscedasticity.

Model Test
Coefficient of Determination (R²) Test

Table 6
Results of Coefficient of Determination (R²) Test

Model	R²	Adjusted R²
1	0.099	0.079

Source: Processed data (2018)

In Table 6 it can be seen that the value of adjusted R² is 0.138, which means that 9.9% changes in the LG financial performance can be explained by the variables of original LG revenue, balancing funds, and capital expenditure, while the remaining 90.1% is influenced by other variables outside the model.

F Statistics Test (Anova)
In Table 7, it can be seen that a significance value of 0.002 is smaller than 0.05, the alternative hypothesis is not accepted. This means that the regression model can be used to predict the LG financial performance or can be related to the effect of the independent variables of original LG revenue, balancing funds, and capital expenditure on the dependent variable of LG financial performance.

T Statistics Test

Table 8
Results of T Statistics Test

Model	T	Sig.
Original LG Revenue	-3.006	0.003
Balancing Fund	-2.336	0.021
Capital Expenditure	-1.756	0.081

Source: Processed data (2018)

1. The First Hypothesis (H1) Testing
   The purpose of the first hypothesis testing is to examine the effect of original LG revenue on LG financial performance. Based on the

Table 7
Results of F Statistics Test (Anova)

Model	Sum of Square	Df	Mean Square	F	Sig
Regression	.079	3	.026	5.137	.002[b]
Residual	.721	141	.005		

Source: Processed data (2018)

results in table 8, the T value is -3.006 with a significance level of 0.003. The significance level of 0.003 is smaller than 0.05 (0.003 <0.05). It can be concluded that H1 is accepted, which means that the variable of original LG revenue has a significant effect on LG financial performance.

2. The Second Hypothesis (H2) Testing

The purpose of the second hypothesis testing is to examine the effect of balancing funds on LG financial performance. Based on the results in table 8, the T value is -2.336 with a significance level of 0.021. The significance level of 0.021 is smaller than 0.05 (0.021 <0.05). It can be concluded that H2 is accepted, which means that the variable of balancing fund has a significant effect on LG financial performance.

3. The Third Hypothesis (H3) Testing

The purpose of the third hypothesis testing is to examine the effect of capital expenditure on LG financial performance. Based on the results in table 8, the T value is -1.756 with a significance level of 0.081. The significance level of 0.081 is greater than 0.05 (0.081> 0.05). It can be concluded that H3 is rejected, which means that the variable of capital expenditure has no effect on LG financial performance.

Multiple Linear Regression Analysis
Based on the results in Table 9, the equation for multiple linear regression analysis is:

Y = 1,141 – 0.358 OLGR – 0.192 BF – 0.165 CE + e

The explanation of the equation above is as follows:
a) The constant value of 0.932 shows that if the values of the independent variables of original LG revenue, balancing funds, and capital expenditure are zero, the value of the variable of regional government financial performance will increase by 0.932.
b) The regression coefficient of original LG revenue indicates that every increase in one unit of original LG revenue, the LG financial performance will decrease by -0.358.
c) The regression coefficient of balancing fund indicates that every increase in one unit of balancing fund, the LG financial performance will decrease by -0.192.
d) The regression coefficient of capital expenditure indicates that every increase in one unit of capital expenditure, the LG financial performance will decrease by -0.165.
e) Error shows interfering variables other than the variables of original LG revenue, balancing fund, and capital expenditure.

Discussion
The results of the analysis of the effect of original LG revenue, balancing funds, and capital expenditure on LG financial performance in all regencies in East Java province with 29 samples in the period 2013-2017 show that original LG revenue has a significant effect on LG financial performance, balancing fund has a significant effect on LG financial performance, and capital expenditure has no significant effect on LG financial performance.

The Effect of Original LG Revenue on LG Financial Performance
The amount of original LG revenue generated by a region can be a measure in assessing LG financial performance because the local government is able to utilize the existing resources and potential in its own authority. It can be concluded that the greater the original LG revenue obtained, the higher the LG financial performance. The efficiency level of LG financial performance is determined by the amount of regional revenue obtained in the form of original local government (LG) revenue. Regency governments in East Java Province emphasize the results of original LG revenue mainly from local tax revenue sources and regional retribution because the two sectors are the biggest contributors to original

Table 9
Results of Multiple Linear Regression Analysis

Model	Unstandardized Coefficients		Stadardized Coeffecients	T	Sig
	B	Std. Error	Beta		
(Constant)	1.141	0.067		17.009	0.000
Original LG Revenue (OLGR)	-0.358	0.119	-0.301	-3.006	0.003
Balancing Fund (BF)	-0.192	0.082	-0.228	-2.336	0.021
Capital Expenditure (CE)	-0.165	0.094	-0.147	-1.756	0.081

Source: Processed data (2018)

LG revenue.

The greater the original revenue owned by the local government, the lower the value of the LG financial performance, which shows the better financial performance of the local government, with the understanding that the LG financial performance shows the local government financial efficiency in generating original revenue obtained. Therefore, the regional government is considered capable of managing the existing resources and potential so that the output (income) generated is higher and more efficient, and no longer depends on assistance from the central government. In accordance with the theory of regional autonomy, local governments are independently able to organize and manage their own government affairs for the public interest in accordance with laws and regulations.

Based on the results of statistical test, original LG revenue has a negative and significant effect on LG financial performance. Therefore, the firs hypothesis is accepted. Partially, the variable of original LG revenue has a negative and significant influence on LG financial performance in all regencies in East Java province in the period 2013-2017.

The Effect of Balancing Fund on LG Financial Performance

Balancing funds will be included in the LG income account so that the total LG revenue increases which can directly improve the efficiency of the LG financial performance, assuming that the local government is still dependent on the central government. The level of the LG's ability to collect income varies greatly depending on the condition of the local government. This is related to whether the LG has natural resource wealth or not, whether the LG has high or low economic intensity, and the obligation to maintain minimum service standards. A local government (LG) that has few resources will need subsidies or balancing funds from the central government in order to achieve the minimum service standard.

The higher the value of the balancing fund, the lower the value of LG financial performance which shows the better the efficiency level of financial performance, with the understanding that the LG financial performance shows the financial efficiency so that the local government can improve the financial performance by making use of the fund appropriately. But on the other hand, this can also show that the local

government has a high level of dependence on the central government. In accordance with agency theory, the local governments, as the agents, must be able to account for their duties to the central government, which means that the local governments must properly manage financial activities in the form of balancing funds provided by the central government, as principals, by establishing good strategies so that people trust them.

Based on the results of statistical test, the variable of balancing fund has a negative and significant effect on LG financial performance. So the hypothesis is accepted. Partially the variable of balancing fund has a negative and significant effect on LG financial performance in all regencies in East Java Province in 2013-2017.

The Effect of Capital Expenditure on LG Financial Performance

A good capital expenditure management, in terms of a manager in a government entity in the local government, is that the head of the local government must understand the applicable principles. Performance is used to assess the success of each activity managed orderly, law-abiding, effectively, efficiently, economically, transparently and responsibly. Meanwhile, the measure of success, in terms of capital expenditure, according to Halim, (2014: 229), consists of five rights: right quality, right amount, right time, right target, and right price.

The amount of funds allocated for capital expenditure will later be able to realize the creation of infrastructure and facilities that are getting better and more appropriate. The main purpose of the government in carrying out capital expenditure is not for returns, but for creating facilities and infrastructure for the community. The availability of good infrastructure can create efficiency in various sectors, can make the productivity of society increasingly high, and can increase the welfare.

Appropriate allocation of capital expenditure can contribute to improving the welfare of the community and can help the community in development. In accordance with agency theory, local governments must be able to account for and independently manage their activities in their own regions, in term of expenditure, by implementing a productive expenditure strategy, that is, capital expenditure, so that principals (community) can enjoy the good services in the form of facilities and infrastructure.

Based on the results of statistical test, the variable of capital expenditure has not effect on LG financial performance. So the hypothesis is rejected. Partially, the variable of capital expenditure has no effect on LG financial performance in all regencies in East Java province in 2013-2017.

5. CONCLUSION, IMPLICATION, SUGGE-STION, AND LIMITATIONS

The purpose of this study is to examine the effect of original LG revenue, balancing funds, and capital expenditures on LG financial performance in East Java province from 2013 to 2017. The samples used are all regencies in East Java Province with a total of 29 regencies. The total population used is 145 with the period 2013-2017 taken through saturated sample technique.

Base on the research results, it can be concluded that:

1. The size of the original LG revenue has a negative effect on LG financial performance, in which the higher the original revenue generated, the lower the value of LG financial performance which shows the better the level of financial performance efficiency. The amount of income generated by the management of local government has an influence on the LG financial performance.

2. The size of balancing fund has a negative effect on LG financial performance, in which the higher the balancing fund transferred by the central government, the lower the value of LG financial performance which shows the better the level of financial performance. Fund transfers from the central government to local governments in the form of balancing funds can cover and reduce the budget gap for regional governments that will be used to carry out economic activities to improve the LG financial performance.

3. The size of capital expenditure has no significant effect on LG financial performance. So, it can be concluded that the amount of expenditure carried out by the government, especially in the productive sector, in the form of capital expenditure, is the expenditure intended for services related to facilities and infrastructure from the government to the community.

Limitation

The test results of determination of coefficients show that the value of R^2 is less than 10%. This indicates that there are still other factors, outside the research, that can affect the dependent variable (Y).

Based on the research results and limitations explained above, it is suggested that further research add other variables, such as budget surplus, development expenditure, routine expenditure, size, and leverage.

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