

## THE EFFECT OF PAD, BALANCED FUNDS, AND REGIONAL EXPENDITURES ON FINANCIAL PERFORMANCE OF REGIONAL GOVERNMENTS IN DISTRICT/CITY NORTH SUMATRA PROVINCE 2017-2020

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### Abstract

*The purpose of this study was to determine and analyze the effect of Regional Original Income (PAD), Balancing Funds, and Regional Expenditures on the Financial Performance of Regency / City Governments in North Sumatra Province. The population of this research is districts/cities in North Sumatra Province as many as 33 districts/cities in the 2017-2020 observation year. The type of sample in this study used a saturated sample where the entire population was sampled. The data was processed using panel data regression statistical tests with the help of SPSS software. The results of this study prove that Regional Original Income, Balancing Funds, and Regional Expenditures have a simultaneous effect on the Financial Performance of Regency / City Governments in North Sumatra Province. Partially Local Original Income, Balancing Funds, and Regional Expenditures have a significant positive effect on the Financial Performance of Regency/City Governments in North Sumatra Province.*

**Keywords: regional original revenue, balancing fund, regional expenditure, regional government financial performance.**

### 1. INTRODUCTION

North Sumatra Province is one of the provinces in Indonesia that implements regional autonomy. Regional autonomy gives government power and authority to regions with decentralized government in accordance with Law Number 23 of 2014 concerning Regional Governments to manage their own finances and in making decisions that are considered in accordance with interests, so that later it is expected to improve people's welfare.

Regional autonomy provides flexibility for the government to manage its resources according to the interests, priorities, and potential of the region itself. According to (Taras and Artini, 2017) the granting of regional autonomy will affect the economic growth of a region which will give the regional government the freedom to make their own financial plans. With the implementation of regional autonomy, there are financial aspects that are required to be better than the era before regional autonomy.

Assessment of local government financial performance is very important because the central government implements regional autonomy policies with the hope that local governments can be more independent in managing their regional finances with the aim that the development process carried out by the regions can be completed quickly without having to wait for funding assistance from the center. (Antari and Sedana, 2018). The results of the analysis of income and expenditure are components in analyzing regional finance. If income is greater than expenditure, there will be a budget surplus and if expenditure is greater than income, there will be a budget deficit. In this case, it is necessary to pay attention to the current financial condition and the trend in the coming years, so that the pattern of budget surplus and deficit can be predicted. In terms of

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income, successful regional finance is regional finance that is able to increase regional revenues on an ongoing basis in line with economic development without compromising the allocation of production factors and equity.

Viewed from the expenditure side, successful regional finance is regional finance that is able to spend the income received to then provide reciprocity for these expenditures. One of the tools that can measure financial performance is the efficiency ratio. Where by using the efficiency ratio can be compared with the output of the resulting input. In the context of the Regional Government, output can be explained as Regional Expenditures and Inputs as Regional Income. The financial performance of district/city governments in North Sumatra Province is still not optimal. This phenomenon can be seen from the graph of the development of the efficiency ratio below in the districts/cities of North Sumatra Province for the 2017-2020 period.

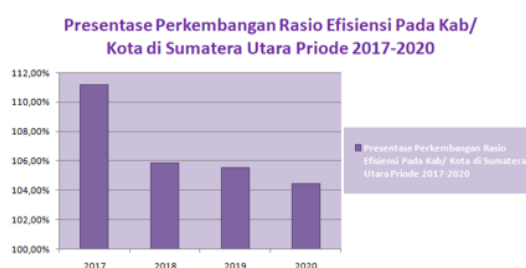


Figure 1. Development of Efficiency Ratio in Regencies/Cities in North Sumatra Province 2017-2020

The figure above shows that there is a fluctuation in the percentage of efficiency ratios in the districts/cities of North Sumatra Province in the 2017-2020 period. The fluctuations indicate that the financial performance of the Regency/City Governments in North Sumatra has not yet optimized revenues or allocated expenditures. (source: [www.bps.go.id](http://www.bps.go.id)). The financial performance of local governments can be influenced by several factors, including local revenue, balancing funds, regional size, regional expenditures, regional financing, and human resources. Regional original income is income derived from all regional revenues originating from regional original economic sources. PAD is the sum of Regional Taxes, Regional Levies, the results of separated regional wealth management and other legitimate regional original income. PAD from one region to another can certainly be different according to the economic resources of each region. The amount of PAD reflects the ability of a local government to finance it self.

The financial performance of a region can be influenced by the PAD of each region. The ability of a region to collect taxes and levies and utilize existing regional resources and wealth is collected in PAD. PAD will have a direct impact on the welfare and public services. Other regional revenues come from balancing funds. Balancing funds are funds sourced from APBN revenues that are allocated to regions to fund regional needs in the context of implementing decentralization, (Law Number 23 of 201). Balancing funds, also known as transfers, are carried out by the central government to support funding for the autonomy program. The Balancing Fund is intended to assist the regions in funding their authority and reduce the gap in government funding sources between the center and the regions as well as to reduce the gap in government funding between regions. Expenditures or Expenditures that are allocated properly have a role in supporting the economic growth of a country or region. In addition, regional spending also plays an important role in achieving economic stability.

Alexander (2016); Simanullang (2016); Young (2017); Mulyani & Wibowo (2017); Putri & Darmayanti (2019); Saragih (2019); Saleh (2019)]. The second is the Balancing Fund [Budianto & Alexander (2016); Young (2017); Putri & Darmayanti (2019); Saragih (2019)]. The third is regional spending [Susanti (2014); Febriana, (2014); Garini (2015); Kurniawati (2015); Subhiksa (2018)].

The objectives of this research are:

1. To determine the effect of PAD on the financial performance of local governments in districts/cities in North Sumatra Province.
2. To determine the effect of balancing funds on the financial performance of local governments in districts/cities in North Sumatra Province.
3. To determine the effect of regional spending on the financial performance of local governments in districts/cities in North Sumatra Province.

## 2. IMPLEMENTATION METHOD

### 1. Classical Assumption Test

#### a. Normality test

Based on the results of the Kolmogrov-Smirnov test, it shows that the significance of the residuals seen from Asymp. Sig. (2- tailed) of 0.278 ( $0.278 > 0.05$ ). So it can be concluded that the residual data used for the regression model is normally distributed (normally distributed).

#### b. Multicollinearity Test

Based on the results of the multicorrelation test, it shows that each of the PAD, Balancing Fund, and Regional Expenditure variables has a VIF value of 10, and has a Tolerance value of 0.10. So that it can be concluded that all variables are independent of the multicorrelation problem.

#### c. Autocorrelation test

The Durbin-Watson value of 1,832 has been obtained. The Durbin-Watson value according to the table with n (amount of research data) = 132 and k (number of independent variables) = 3 can be raised 1.762. This is in accordance with the provisions of  $du < d < (4-du)$  which is  $1.762 < 1.832 < 2.238$  which indicates that there is no autocorrelation between residuals.

#### d. Heteroscedasticity Test

Based on the results of the heteroscedasticity test, it shows that each of the PAD, Balancing Fund, and Regional Expenditure variables has a Sig value,  $> 0.005$ . So that it can be concluded that all variables are free from heteroscedasticity problems.

## 2. Hypothesis Test

### a. Independent Variable Hypothesis Testing and Dependent Variable.

Based on the proposed hypothesis, the multiple linear regression analysis model in this study.

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Tables. 1 Testing of Independent Variables and Dependent Variables

Pengujian Variabel Independen dan Variabel Dependen  
Coefficients<sup>a</sup>

| Model |            | Unstandardized Coefficients |            | Standardized Coefficients | T       | Sig. |
|-------|------------|-----------------------------|------------|---------------------------|---------|------|
|       |            | B                           | Std. Error | Beta                      |         |      |
| 1     | (Constant) | 10.468                      | .103       |                           | 101.270 | .000 |
|       | Sqrt X1    | 1.736                       | .000       | .507                      | 2.094   | .014 |
|       | Sqrt X2    | 2.109                       | .000       | .605                      | 3.084   | .003 |
|       | Sqrt X3    | 1.296                       | .000       | .526                      | 2.302   | .023 |

a. Dependent Variable: Sqrt\_Y

Source: research results (2021)

Based on the results of the independent and dependent hypothesis tests that have been carried out, the research model is as follows:

$$Y = 10,468 + 1.736 X1 + 2.109 X2 + 1,296 X3 + e$$

From the equation, it can be seen that the coefficient of the regional original income variable shows a positive value, which means that the greater the regional original income, the higher the financial performance. The coefficient of the balancing fund shows a positive value, which means that the relationship between the balancing fund and financial performance is positive. This means that the higher the balancing fund, the higher the financial performance. The coefficient of the capital expenditure variable shows a positive value, which means that the higher the capital expenditure, the higher the financial performance.

b. Simultaneous Significance Test (F Test)

This test is used to determine whether the independent variables together can affect the dependent variable. To test the hypothesis using the F statistic, the decision making is the significance level used = 5%, which means that the probability of error can only be smaller or equal to 5%. If it is greater then the variable is not feasible to use.

Table 2. Simultaneous Test (F Test)

Uji Simultan ( Uji F)

| Model |            | ANOVA <sup>a</sup> |     |             |       |                   |
|-------|------------|--------------------|-----|-------------|-------|-------------------|
|       |            | Sum of Squares     | df  | Mean Square | F     | Sig.              |
| 1     | Regression | .496               | 3   | .165        | 3.426 | .019 <sup>b</sup> |
|       | Residual   | 6.182              | 128 | .048        |       |                   |
|       | Total      | 6.678              | 131 |             |       |                   |

a. Dependent Variable: Sqrt\_Y

b. Predictors: (Constant), Sqrt\_X3, Sqrt\_X1, Sqrt\_X2

Source: research results (2021)

Based on the results from table 2, the calculated F value is 3.426 and a significant value is 0.019, while the F table at the 95% confidence level with 5% alpha is 2.67. because in the two calculations above, F count 3.426 > F table 2.67 and the significance level is 0.019 < 0.05, it can be concluded that PAD, Balancing Fund, and Regional Expenditures have a simultaneous effect on financial performance.

c. Individual Significance Test (t Test)

The t-statistical test basically shows how far one independent variable individually explains the variation of the dependent variable. The steps in making decisions for the t-test are to look at the

significant value, if the value of sig <0.05, it can be concluded that the independent variable partially has a significant effect on the dependent variable or the hypothesis is accepted, and vice versa.

Table 3. Partial Test (t Test)

Uji Signifikansi Individual (Uji t)

| Model |            | Coefficients <sup>a</sup>   |                           | T       | Sig. |
|-------|------------|-----------------------------|---------------------------|---------|------|
|       |            | Unstandardized Coefficients | Standardized Coefficients |         |      |
|       | B          | Std. Error                  | Beta                      |         |      |
| 1     | (Constant) | 10.468                      | .103                      | 101.270 | .000 |
|       | Sqrt_X1    | 1.736                       | .000                      | .507    | .014 |
|       | Sqrt_X2    | 2.109                       | .000                      | .605    | .003 |
|       | Sqrt_X3    | 1.296                       | .000                      | .526    | .025 |

a. Dependent Variable: Sqrt\_Y

Source: research results (2021)

It can be concluded that the results of the partial test (t test) of each independent variable are as follows.

1. Local revenue (Sqrt\_X1) partially has a significant effect on the dependent variable or the hypothesis is accepted.
2. The balancing fund (Sqrt\_X2) partially has a significant effect on the dependent variable or the hypothesis is accepted.
3. Regional expenditure (Sqrt\_X3) partially has a significant effect on the dependent variable or the hypothesis is accepted.

#### d. Coefficient of Determination

The coefficient of determination aims to measure how far the model's ability to explain variations in the dependent variable is.

Table 4. Coefficient of Determination

Koefisien Determinasi

| Model | Model Summary <sup>a</sup> |          |                   |                            |               |
|-------|----------------------------|----------|-------------------|----------------------------|---------------|
|       | R                          | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
| 1     | .671 <sup>a</sup>          | .450     | .473              | .39825                     | 1.832         |

a. Predictors: (Constant), Sqrt\_X3, Sqrt\_X1, Sqrt\_X2  
c. Dependent Variable: Sqrt\_Y

Source: research results (2021)

Based on the test results, the coefficient of determination shows the Adjusted R<sup>2</sup> of 0.473, which means that the variability of the dependent variable that can be explained by the independent variable is 47.3%. While the remaining 52.7% is explained by other variables that are not included in the regression model.

### 3. RESULTS AND DISCUSSION

#### 1. The Effect of PAD on Financial Performance.

Regional Original Income is income that comes from all regional revenues originating from regional original economic sources. The test results in this study indicate that PAD has a positive and significant effect on local government financial performance. The results of this study are in line with several previous research results, including the Malau research (2019) where PAD has a significant positive effect on the Financial Performance of the North Sumatra Regency/City Government in 2010-2017. Then Young Research (2017) where PAD has a significant positive effect on Regional Government Financial Performance with Capital Expenditure as Moderating.

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Sitorus' research (2016) which has similar results, namely PAD has a positive effect on Regional Government Financial Performance. However, the results of this study contradict the results of research conducted by Amrozi (2016) in his research that PAD has a negative influence.

## **2. The Effect of Balancing Funds on Financial Performance**

Balancing Fund is a fund consisting of general allocation fund, special allocation fund and tax revenue sharing fund. The results of this research test indicate that the Balanced Fund has a significant positive effect on the Regional Government's Financial Performance.

The results of this study are in line with the results of several previous studies including the Malau research (2019) where the Balancing Fund has a positive and significant influence on financial performance. According to him, the effect of the Balancing Fund on financial performance shows that local governments are still dependent on the central government. So that the balancing funds provided by the center are expected to be able to improve the financial performance of local governments. Another study conducted by Wulandari (2019) also showed the same thing. Balancing funds have a positive and significant impact on the financial performance of local governments. However, this is different from the research conducted by Khairunisa (2019) and Sitorus (2016) both proving that balancing funds have a negative effect on financial performance. Khairunisa (2019) argues that a high balancing fund reflects a low amount of PAD.

## **3. The Effect of Regional Expenditure on Financial Performance**

The test results in this study indicate that Regional Expenditures have a positive and significant influence on Regional Government Financial Performance. The amount of regional expenditure will affect the improvement of regional government financial performance. Regional spending according to the law is aimed at improving the quality of people's lives. This can be realized in the form of improving services to the community.

The results of this study are also in line with several previous studies. Research by Armaja et al (2015) revealed that there was a positive influence of regional spending on the financial performance of district/city governments in Aceh. In line with the research above, research conducted by Fatimah and Hasbullah (2020) also reveals the positive influence of regional spending on financial performance which is calculated using gross regional domestic growth in West Lombok Regency. However, different results were revealed by Saputri and Kurnia (2020) in their research on the effect of regional spending on financial performance in districts/cities in East Java. Referring to the research of Saputri and Kurnia (2020) regional spending has a negative effect on regional financial performance.

## **4. CONCLUSION**

1. Local revenue has a positive and significant impact on the financial performance of district/city governments in North Sumatra province.
2. The balancing fund has a positive and significant effect on the financial performance of the district/city governments in the province of North Sumatra.
3. Regional spending has a positive and significant effect on the financial performance of district/city governments in the province of North Sumatra.

4. Regional original income, balancing funds, and regional expenditures simultaneously have a significant effect on the financial performance of district/city governments in North Sumatra province by 47.3% and the remaining 52.7% is influenced by other factors.

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