# The Influence of Financial and Non-Financial Factors on Regional Government Financial Performance: Literature Review Study

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## Abstract

It is hoped that the construction of public facilities and infrastructure will open up accessibility and facilitate community activities, especially those related to the economy, which will be able to improve regional financial performance and good decentralization capabilities. The aim of this research is to look at regional financial capabilities to grow independently to regulate and increase regional financial potential both through financial and non-financial means. This research is a literature study that reviews 40 scientific articles related to financial performance from 2018 to 2023 using a descriptive analysis approach. The findings from this research show that in relation to the implementation of regional financial progress, the variables of regional original income and regional head competence have an influence on financial performance. Meanwhile, for several variables such as: balancing funds, opinions on regional financial performance reports and capital expenditure. Regarding capital expenditure, the government needs to pay attention to appropriate and in-depth analysis to determine funds that are capable of providing prosperity to the region so that it will be able to have a positive impact on regional finances.

**Keywords:** *Financial Performance, Financial, Non-Financial*

## INTRODUCTION

Governance between the central government and regional governments experienced quite significant changes after reform, especially in terms of authority and accountability. The shift in government governance from centralization to decentralization as stated in Law (UU) Number 32 of 2004, which was most recently revoked by Law Number 1 of 2022, has implications for the central government to provide the broadest possible rights, authorities and obligations for regional governments to manage resources. financial resources and their use for independent regional development. This granting of authority is known as regional autonomy.

It is hoped that the construction of public facilities and infrastructure can open up accessibility and facilitate community activities, especially those related to the economy, education and health, so that in the end it can increase regional government PAD. High PAD has implications for increasing capital expenditure allocations aimed at developing better facilities and infrastructure. Ultimately, it forms an interrelated cycle between spending and spending allocations originating from regional income.

Republic of Indonesia BPK Regulation Number 1 of 2017 explains that the audit of the management and responsibility of state finances is carried out independently, objectively and professionally by the BPK as an effort to create a government that is clean and free from corruption. From examining the accountability report, it will be seen whether it is in accordance with Government Accounting Standards or not. The more discrepancies found with the predetermined criteria, the more it will influence the opinion that will be given. Nonconformities found will be compared with the criteria and the level of materiality determined.

According to Law Number 15 of 2004, the BPK will issue an Audit Opinion as a professional statement by the examiner regarding the fairness of the financial information presented in the financial report based on the criteria that the financial report has been presented in accordance with accounting standards, adequacy of disclosure, compliance with regulations and System Effectiveness. adequate internal control.

Based on the results of the previous description regarding factors that influence regional government financial performance, there are still *research gaps* or differences in research results. Therefore, in this research we will examine further the influence of regional financial performance factors looking at it from the perspective of financial factors and non-financial factors. Financial factors are financial aspects consisting of PAD, Balancing Funds and Capital Expenditures which can influence regional financial performance. Meanwhile, non-financial factors consist of Audit Opinion and Competency of Regional Heads which can influence Regional Financial Performance as measured by the Regional Financial Independence ratio. In this way, it is hoped that this research will be able to see regional financial capabilities independently to regulate and increase regional financial potential , so that various financing to improve services in the community originating from PAD can run well. Based on the description above, research was conducted on the influence of financial and non-financial factors on local government financial performance through literature studies.

## THEORETICAL REVIEW

### Financial performance

Regional Financial performance is a measure of an organization's financial management which is linked to the responsibility center. According to Minister of Home Affairs Regulation Number 59 of 2007 concerning Amendments to Minister of Home Affairs Regulation Number 13 of 2006 concerning Guidelines for Regional Financial Management, it is stated that performance is the output or result of activities or programs. What will or has been achieved in relation to the use of the budget with measurable quantity and quality. Regional government financial performance is "a description of the level of achievement of financial management for implementing a policy program activity in realizing the goals, targets, vision and mission of regional government" (Mahsun, 2013: 25).

According to Sari et al., (2016) regional government financial performance is the level of achievement of work in the area of regional finance which includes regional income and expenditure using a financial system determined through a policy or statutory provisions during a budget period.

**Agency**

Agency TheoryAgency theory examines two parties with different access to information. One party, the principal, delegates authority to another party, the agent (Dewata et al. 2021). According to Putri & Amanah (2020) in some cases, government agents or officials are involved in fraud or corruption because of differences in their information. Agency theory assumes that the principal and agent have direct access to different information. To reduce the potential for fraud and corruption, believes that accountability should be distributed across different areas. This will help improve the efficiency of local government by implementing *checks and balances* in each region. Agency theory claims that local governments are aware of the interests of their communities as agents. However, it is believed that the public is unlikely to trust that local government is working in the best interests of the community. By reducing information asymmetry thanks to citizen feedback, it is believed that accountability between regions and regional governments will be balanced.

**Regional Original Income (PAD)**

Original Regional Income (PAD) is revenue obtained by a region from sources within its own territory which is collected based on regional regulations in accordance with applicable laws and regulations. (Asnidar and Hardi, 2019). The increase in local original income will have an impact in the coming period, namely increasing community productivity so that it can attract the interest of investors to invest in the area, which means it will also have an impact on increasing capital expenditure. Purwanto, (2013) in Arpani and Halmawati, (2020 ).

**Balancing Fund**

Balancing Funds According to Law of the Republic of Indonesia Number 1 of 2022 concerning Regional Government, Balancing Funds are funds sourced from the State Revenue and Expenditure Budget (APBN) which are allocated to regions to fund regional needs in the context of implementing decentralization.

**Capital Expenditures**

Capital expenditure is a regional government expenditure that influences the economic growth of a region. Regional governments should be able to rotate expenditure by increasing the allocation of capital expenditure in order to increase public trust and community productivity. Capital expenditure is regional government expenditure that has benefits beyond the fiscal year, increasing regional assets and increasing general operating expenditure. Public service capital expenditure is used to fund investment activities to improve public infrastructure where the results can be useful for the community. Capital expenditure is divided into agency capital expenditure, capital expenditure for irrigation buildings, expenditure on land, roads and bridges, as well as capital expenditure that can be used for public services as needed to improve services and welfare of the Setiawan community, 2019 (Bilqis and Priyono, 2023)

**Audit Opinion**

An audit opinion is an auditor's statement regarding the fairness of the financial statements of the audited entity. This fairness concerns materiality, financial position and cash flow. Opinions can be useful for the sustainability of companies or government agencies. Opinion is a professional statement as the examiner's conclusion regarding the level of fairness of the information presented in the financial statements. In formulating the opinion, the auditor refers to the State Financial Audit Standards (SPKN).

**Competence of Head of Government**

Government Regulation Number 31 of 2006 states that work competency is the work ability of each individual which consists of knowledge aspects, skill aspects and work attitude aspects that are in accordance with determined and established standards. Meanwhile, work competency standards are a formulation of work abilities which consist of three aspects, namely knowledge, skills or expertise and work attitudes relevant to the implementation of duties and terms of office that are determined and stipulated in accordance with applicable laws and regulations.

Priyono (2010) states that job specifications are prepared based on the job by referring to the characteristics, education, experience, etc. of the person who will carry out the job well. Job specifications are a description of the quality requirements for a person to be able to carry out a position well and competently. Improving the performance of regional government administration requires the competence of regional heads. One of them can be obtained from the background/level of formal education of the regional head. The higher the level of education a person has, the more complex the knowledge, skills and experience they have. In the research of Sebaa et al. (2009) in Widagdo (2017) stated that higher education will lead to increased performance.

## METHOD

The research in this paper is library research. Library research is a type of research used to collect in-depth information and data through various literature, books, notes, magazines and other references (Prasanti, 2020). The method in this research is to use a literature review. A literature review is a written summary of articles from journals, books and other documents that describe theories and information, both past and present (Rasdi & Kurniawan, 2019). Data is taken from references or reference materials from various scientific writing sources, such as research journals, books, bulletins, reports in published media, and credible websites that match the research topic. The number of scientific articles carried out in this research was 40 research articles related to regional financial performance (analysis carried out on November 29 2023).

## RESULTS AND DISCUSSION

### The Influence of Regional Original Income on Regional Financial Performance

There are research results that are in line with existing theories, where the results of this research are in line with Digdowiseiso et al. (2021) and Prastiwi & Aji (2020). Studies claim that regional income has an influence on the financial performance of local governments. The difference between these findings is explained by the level of independence that each region enjoys seen through the ability of LGs to utilize their potential wealth and resources which is higher than most regional income streams. In addition, a high amount of local original income can have a positive impact on the financial position of local governments. Exploring the potential for regional independence can only be achieved through good financial management. This potential can be utilized optimally to provide a positive impact on the region, one of which is independent funding for regional activities and needs. Agency theory emphasizes that regional original income comes from sources within the region. This means that local governments must demonstrate good financial management and responsibility. As an agent (government), we are required to ensure that people's needs and desires are met. This is done by collecting taxes and levies from the community in accordance with the duties of the regional government as an agent. However, this result is contradictory to Febrianto & Trisnawati (2018) and Nugraha & Trisnawati (2019). This study found that local original income had no effect on financial performance because Local governments continue to rely on money provided by the federal/central government because they have not been able to tap into their own local sources of wealth.

### The Effect of Balancing Funds on Regional Financial Performance

Several studies have been found which state that there is a significant negative influence on financial performance from balancing funds. This means that when more funds come from the center, local governments show a less favorable financial situation for local governments limited independence because regions do not have the freedom to use these resources. This supports agency theory, which is related to balancing funds. Although money from balancing funds can be useful for providing welfare and good public services, it often is not. The amount of money each region received was small and did not significantly improve their financial position. Plus local agencies or governments are very dependent on the center for financial support. As a result, transferring money from the center will reduce the financial performance of local governments. The results of this study are not in line with Nauw & Riharjo (2021) and Febrianto & Trisnawati (2018) who claim that the results of their study contradict the results that balancing funds have no effect on regional financial performance because the majority of money sent by the federal/central government is still used for expenses. employee. As a result, there are fewer resources available for public services, ensuring that the quantity of intergovernmental revenues has no effect on the financial success of local governments.

**The Effect of Capital Expenditures on Regional Financial Performance**

Capital expenditure is government expenditure used as investment to increase regional revenues. The research results prove that capital expenditure has no effect on local government financial performance. The results of this research are in accordance with signaling theory where local governments try to give good signals through capital expenditure. The realization of capital expenditure carried out by regional governments aims to ensure that the people can continue to support the government so that it can run well.

In this research, capital expenditure allocated by the government has not been able to attract public motivation to contribute to development. In addition, the realization of capital expenditure tends to be slow in the development of infrastructure and public facilities in various regions, causing capital expenditure to not have a significant impact in increasing regional revenues. This is why capital expenditure does not affect the financial performance of local governments. The results of this research are in accordance with (Leki, et al, 2018) which proves that capital expenditure has a positive and insignificant effect on the financial performance of local governments in West Halmahera Regency.

**The Influence of Opinions on Regional Government Financial Reports on Regional Financial Performance**

In connection with the research regarding BPK audits, there are problems or cases discovered by the BPK regarding regional government financial reports (LKPD) regarding violations committed by a region against the provisions of the internal control system and statutory provisions which resulted in regional losses. This finding will cause the BPK to carry out an examination of the LKPD. Thus, the greater or higher the number of audit findings, the lower the regional government's performance. Based on institutional theory, the government must follow the rules in accordance with one of the institutional pillars of institutional theory, namely the regulatory pillar. The government must try to follow the rules so that there are no weaknesses in the internal control system and non-compliance with legislation, resulting in significant audit findings. This finding is supported by previous research, namely Tama and Adi (2018), Wana et al (2021) and Ditasari and Sudrajat (2020) who said that audit findings have a negative effect on local government performance. Where the more BPK audit findings in regional government financial reports show the lower the regional government's performance.

**Analysis of the Influence of Regional Head Competency on Financial Performance**

The results of this research prove that there is an influence of human resource competency on the quality of financial reports, which means that the better the human resource competency, the higher the quality of the financial reports that will be produced. This is in line with the theory put forward by Widagdo (2017) which states that higher education will lead to improved performance. The results of this research are also in line with research conducted by Triwahyudi (2020) and Hartono & Ramdany (2020) and Yasin, Ratnawati and Andjarwati (2020) that there is a significant influence between human resource competency on the quality of regional financial reports.

## CONCLUSION

The aim of this research is to analyze and summarize the results of several empirical studies regarding regional financial performance from reputable journals obtained. There are research results that can be concluded from this research regarding the importance of developing regional financial performance. From several variables analyzed, there are findings that are in line with the theory used and also the journals used: the variables of regional original income and regional head competence which have an influence on financial performance. Meanwhile, for several variables such as: balancing funds, opinions on regional financial performance reports and capital expenditure. From capital expenditure, there is attention that the government must pay attention to in providing real welfare facilities that are in line with community needs so as to improve the financial performance of the region.

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