

ANALYSIS OF FINANCIAL RATIOS TO ASSESS LOCAL GOVERNMENT FINANCIAL PERFORMANCE IN LABUHAN BATU DISTRICT, NORTH SUMATRA, INDONESIA

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Abstract: This study is to determine the performance of regional financial ratios in the Labuhan Batu District and whether there is transparency in financial statements managed by the local government. According to financial accounting standards, financial statements are part of financial reporting. Complete financial statements usually include balance sheets, income statements, and statements of changes in financial position, as well as explanatory materials that are an integral part of financial statements; the purpose of this study is to measure and analyze the degree of fiscal Decentralization in Labuhan Batu District during 2015 to 2020 as well as analyze the relationship of Gross Domestic Product (GDP) with the level of fiscal Decentralization during the same period. GDP is one of the methods for calculating national income. Documentation techniques carry out data collection. The data analysis technique used is a financial statement analysis technique based on the budget realization report from 2015 to 2020. The results of the study show that the level of regional authority and responsibility in implementing decentralization, which is related to regional development is at a moderate level, this is because the amount of original local government revenue is still relatively small compared to the total regional income, still very dependent on financial assistance from the central government/ external parties.

Keywords: Fiscal Decentralization, Regional Financial Dependency Ratio, Regional Financial Independence Ratio, and Growth Ratio

1. Introduction

Financial accountability is accountability regarding financial integrity, disclosure, and compliance with laws and regulations. The target of this responsibility is financial statements and applicable laws and regulations, including the receipt, storage, and expenditure of money by government agencies (Arfan & Manaf, 2016; Donny & Sulistyowati, 2021; Yuliati et al., 2019). The Government is asked to report the results of the program that has been implemented so that the public can judge whether the Government has worked economically, efficiently, and effectively or not. Accountability can be seen from an accounting perspective, a functional perspective, and an accountability system perspective. Accountability requires the Government to be responsible for its financial statements starting from budget planning, usage, and complete budget reporting (Basri & Siti, 2016).

In Indonesia, the implementation of the performance budget is supported by several policies, such as Law Number 23/ 2014 concerning local governments (Muhtar et al., 2021). The implementation of regional autonomy, which is intended to carry out its household affairs in local Government, is expected able to motivate to develop the existing potential further to carry out government tasks in an integrated manner so that every current development follows priorities that can improve community welfare (Usman, 2002). Analysis of the regional financial statements helps describe the performance of local governments. Performance measurement is an essential part of the management control process for both public and private organizations (Sitorus et al., 2019). Performance measurement is used to assess the accountability of organizations and managers in public services, which is not just the ability to show that public money has been spent but includes the ability to show that the money has been spent efficiently and effectively (Omurgonulsen, 2002). The following is table 1.1 regarding the

Audit Opinion of the Audit Board of the Republic of Indonesia, Labuhan Batu District.

Table 1 Opinion of Audit Audit Board of the Republic Indonesia In Labuhan Batu District

| Year | Opinion |
|------|-------------------|
| 2015 | Qualified Opinion |
| 2016 | Qualified Opinion |
| 2017 | Qualified Opinion |
| 2018 | Qualified Opinion |
| 2019 | Qualified Opinion |
| 2020 | Qualified Opinion |

Source: Audit Board of the Republic of Indonesia in 2021

One of the problems that arose later was knowing that there were several weaknesses in the financial reporting of local governments, especially regarding financial control, accounting weaknesses, and financial reporting (Furqan et al., 2021; Yaya & Suprobo, 2019). This will make it challenging to prepare local government financial statements to form financial reporting quality (Bimo et al., 2019). This is a big problem for local governments in terms of compliance with laws and regulations; organizations that do not comply with the law have much bigger financial reporting problems (Adeniyi et al., 2020). So, this financial performance analysis is critical because it can be used as a guide for performance improvement in the future, showing the direction of achieving predetermined performance targets, monitoring and evaluating performance, and helping to reveal and solve existing problems (Lapuenta & Van de Walle, 2020).

2. Literature Review

2.1. Stewardship Theory

Stewardship theory is the theory used in this study. Stewardship theory (Donaldson & Davis, 1991). This theory describes the situation of services where it is related to organizations within the government. The implications of stewardship theory in this research can explain the existence of local governments (stewards) as an institution that can be trusted to act following the public interest by carrying out their duties and functions appropriately, making financial accountability for economic purposes (Cristine et al., 2007; Keay, 2017). In this theory, the government is a steward who serves the existing stakeholders, namely the community and creditors (Davis et al., 1997). The public and creditors need the information to monitor the government's running. The government is obliged to carry out the disclosure of its financial statements following applicable standards (Nazaruddin & Sita, 2019). Local government financial reports are one of the efforts to realize the implementation of good governance (Pramita & Dharma, 2018). To achieve this goal in making local government financial reports, local governments must disclose in detail related to accounting data and other information in a relevant manner. The government makes local government financial reports (Rayegan et al., 2012).

2.2. Performance

Performance is an overview of the level of achievement of an activity, program, or policy's implementation in realizing the goals, objectives, vision, and mission of an organization owed in formulating an organization's strategic scheme (Jonjo et al., 2018; Tarifi, 2021). Regional financial performance is the level of achievement of work in regional finance, which includes regional revenues and expenditures using financial indicators determined through a policy or statutory provisions during one budget period (Haryanto, 2018; Oktalina, 2020). The form of performance is a financial ratio formed from the elements of the regional head accountability report in calculating the regional budget (Korompot & Warongan, 2017; Mangantar, 2018).

2.3. Fiscal Decentralization Analysis

Fiscal decentralization transfers fiscal authority from state authorities to autonomous regions (Yushkov, 2015). Until now, the impact of fiscal decentralization on economic development is still a topic of debate in various development literatures (Setiawan & Aritenang, 2019). It is also expected to stimulate economic growth in the

region. It is expected that fiscal decentralization can have a significant impact on various economic sectors, such as increased consumption employment (Kim et al., 2021). There is a lot of literature which states that fiscal decentralization provides significant changes to welfare and economic benefits (Chen et al., 2022). Stated that the implementation of decentralization in Indonesia is one of the largest transfers of financial resources to local governments, this is important to ensure that this budget is managed effectively to contribute to poverty reduction (Saad, 2001; Shoesmith et al., 2020). Regional financial performance is the financial relationship between the central and regional governments which can be determined by using the indicator of the degree of fiscal decentralization (Irwanto et al., 2018). The financial capacity of the region can be measured by calculating the ratio (in percent) between original local government revenue which consists of regional taxes, regional levies, profits from regional-owned enterprises, and other regional original revenues to total regional revenues (Halim, 2007; Lestari & Utama, 2019).

Table 2 Fiscal Decentralization Level

| Percentage | Fiscal Decentralization Rate |
|---------------|------------------------------|
| 0,00 – 10,00 | Very Less |
| 10,01 – 20,00 | Less |
| 20,01 – 30,00 | Average |
| 30,01 – 40,00 | Medium |
| 40,01 – 50,00 | Good |
| > 50.00 | Excellent |

Source: Team R&D Ministry of Home Affairs – Physipole UGM, 1991

2.4. Regional Financial Dependency Ratio

In the implementation of regional autonomy, local governments are expected to be able to explore the potential that exists in the area in order to increase local revenue, so that financial dependence on the central government can be reduced (Curristine et al., 2007). The regional economic dependence ratio is calculated by comparing the amount of transfer income received by regional revenues with total regional revenues (Ma, 1997). The higher this ratio, the greater the level of dependence of the local government on central and provincial government revenues (Charles et al., 2021; Wingender, 2018).

Table 3 Regional Financial Dependency

| Percentage | Regional Financial Dependence |
|---------------|-------------------------------|
| 0,00 – 10,00 | Very Low |
| 10,01 – 20,00 | Low |
| 20,01 – 30,00 | Average |
| 30,01 – 40,00 | Medium |
| 40,01 – 50,00 | High |
| > 50.00 | Very High |

Source: Team R&D Ministry of Home Affairs – Physipole UGM, 1991

2.5. Regional Financial Independence Ratio

Rasio independence describes the dependence of the region on external funds. The higher the self-reliance ratio, it means the level of support of areas for external financial assistance (especially the central and provincial governments) is lower (Charles et al., 2021). Regional financial independence is indicated by the size of the original local government revenue compared to regional income derived from other sources such as central government assistance (central transfer) and loans (Halim, 2007). As a guideline in looking at the pattern of a relationship with regional capabilities can be seen in the following table:

Table 4 Relationship Patterns and Regional Capability Levels

| Ability Regional Finace | Ratio Independence | Relationship Pattern |
|-------------------------|--------------------|----------------------|
| Very Low | 0 – 25 % | Instructive |
| Low | 25 – 50 % | Consultative |
| Moderate | 50 – 75 % | Partisipatory |
| High | 75 – 100 % | Delegative |

Source: Halim, 2007

2.6. Growth Ratio

The growth ratio measures how much the Local Government is capable of maintaining and enhancing its success that has been achieved from one period to the next (Indriaty et al., 2019). If the growth ratio shows a positive number, it describes an increase in financial performance and vice versa. The income growth ratio can be formulated as follows:

$$\text{Growth Ratio Original Local Government Revenue (PAD)} = \frac{\text{PAD} (n) - \text{PAD} (n-1)}{\text{PAD} (n-1)} \times 100\%$$

Source: Halim, 2007

3. Research Methods

Researchers obtained data on the Inspection Results Report and Financial Statements of the Regional Government of Labuhan Batu District, budget 2015-2020 from the Audit Board of the Republic of Indonesia.

Table 5 Variable Operations

| Variable | Indicators |
|---------------------------------------|---|
| Financial Performance | The level of criteria of each Ratio |
| Fiscal Decentralization Analysis | $\frac{PAD}{\text{Total Regional Revenue}}$ |
| Regional Financial Dependency Ratio | $\frac{\text{Transfer Income}}{\text{Total Regional Income}}$ |
| Regional Financial Independence Ratio | $\frac{PAD}{\text{External Funding Source}}$ |
| Growth Ratio | $\frac{PAD (n) - PAD (n - 1)}{PAD (n - 1)}$ |

4. Results and Discussion

4.1 Fiscal Decentralization

Fiscal Decentralization is the transfer of budgetary authority and responsibility from a higher or central government to the level of government below it or in the region (Yushkov, 2015). Fiscal Decentralization can also be interpreted as giving power to areas to explore sources of income, the right to receive transfers from higher governments, and determining routine spending and investment. In short, local governments can choose budget regulations (Curristine et al., 2007). Fiscal Decentralization m to economic growth directly and through regional financial performance (Hanif et al., 2020). Local governments have the authority to manage finances both in terms of receipts and expenditures of regional budget funds where local governments have not been able to optimize the funds available for the benefit of the public/community, or the funds available in the receipts and expenditures of regional budget funds are still widely absorbed for indirect/ employee expenditures so that there are development

programs that are not on target in their implementation (Wanggai et al., 2021). In the future, the policies in the preparation of the receipts and expenditures of regional budget funds budget are more for public sector/community financing so that the results can be felt and touch the community (O. A. Saputra, 2021). Thus, so far, most of the government expenditure is still very dependent on the central government (Gonschorek et al., 2018; Wiryawan & Otchia, 2022), and also shows that the government's ability to increase original local government revenue, such as regional taxes, levies and others, is still relatively low so that regional financial performance is still considered very low (Awwaliyah et al., 2019; Kii & Sumtaky, 2022).

4.2 Regional Financial Dependence

In the context of implementing regional autonomy, a region can be said to be capable if the region can explore sources of revenue or income for the region so that dependence on assistance from the central government can be minimized (Usman, 2002). This confirms that regional financial capabilities cannot be separated from every government activity in financing regional development. There is a main character that shows that a region is capable of concretely, namely lies in the financial capabilities of its region (Athukorala & Narayanan, 2017). The percentage of local revenue to the district's total regional income from 2015-2020 fluctuated. Adequate local revenues will have a good impact on the regions in carrying out all development programs in their regions, while also being able to cut or minimize the dependence of local governments on assistance from the central government (Lestari & Utama, 2019). In addition, with adequate local revenues, the area will become an independent area in terms of finances, so that the area can carry out all development programs, community services, and other government activities properly (Qichun & Shufang, 2016).

4.3 Regional Independence Ratio

Based on the results of the calculation of the regional independence ratio in 2015-2020, it was obtained that the level of regional independence is still very low, is at a level below 25% of the total regional income, or is included in the pattern of instructive relationships (B. Saputra et al., 2021). It can be concluded that the level of financial independence of all districts is still at a low level, where the Regional Government is still unable to independently finance government activities in terms of services to the community (Lahan, 2020; Martati et al., 2020; Yoda & Febriani, 2020). Then this also means that the active role of the community in supporting development in their area is still very low, which in this case is in the form of public awareness in paying taxes and levies (Savitri & Musfiandy, 2016). In addition, the Regional Government is also still unable to optimize the levy for tourist attractions located on the island of Sumatra, so the potential of a original local government revenue cannot be relied on as a source of income for the region (Gustanto & Muda, 2019). Based on these results, it can be said that the performance of local governments is still not optimal because more than 50% of regional funding needs are still financed by external funding, namely government assistance (transfers) and loans (Wijaya & Solikhi, 2022).

4.4 Growth Ratio

Based on the results of the analysis of the budget realization report of all districts in 2015-2020, it was obtained that the average growth rate of original local government revenue is still in fluctuating condition. Labuhan Batu Regency experienced positive regional original income growth. However, in the year the decline again decreased and then increased. This situation illustrates those efforts to increase original local government revenue are still not optimal. Obstacles to increasing original local government revenue are usually caused by several things such as regional original income management which is carried out not optimally, incompatibility of human resources with the potential of original local government revenue, and updating original local government revenue object data that has not been effectively carried out by the regional apparatus organization manager (Putri et al., 2020). Based on the explanation above, it can be said that the performance of the local government is still not good because the local government has not been able to increase or at least maintain the number of regional original income acquisitions in the region. One of the components in achieving regional independence is the need to increase original local government revenue in an area (Widilestariningtyas, 2020). Original local government revenue growth is needed to improve the economy and become an effort to prosper the people in the regions (Cingano, 2014). Commitment and support from all parties are needed, such as the right local government in determining and implementing original local government revenue management strategies and also communities that actively contribute to the payment of local taxes and levies as well as supervision of the implementation of local government activities (Nasution, 2017). The provision of optimal services and the improvement of good public

facilities will encourage the growth of original local government revenue and if original local government revenue grows, the goal of regional autonomy to create independent regions will be realized (Putri et al., 2020).

5. Conclusions and Suggestions

From the discussions carried out, judging from the average fiscal decentralization ratio, average regional financial dependency ratio, average regional independence ratio, and original local government revenue growth from 2015-2020, it was concluded that the degree of fiscal decentralization shows that the level of regional authority and responsibility in organizing decentralization, which is related to regional development is at a moderate level, this is because the amount of original local government revenue the area is still relatively small compared to the total income of the region. The regional financial dependence ratio illustrates that it is still very dependent on financial assistance from the central government/external parties. The ratio of regional financial independence shows that the level of regional independence in financing government affairs, development, and services to the community is still relatively low. This condition is due to the relatively smaller amount of original local income compared to the number of regional revenues derived from the balance fund. In the growth of regional original income, this case illustrates that the effort to increase original local government revenue is still not optimal. Local governments are expected to be able to improve and increase their financial performance to the maximum extent possible so as to be able to produce more optimal performance and local governments are expected to be able to manage the state budget wisely, to be able to minimize their regional budgets for routine expenditures, and to be able to allocate their regional budgets for development expenditures, so that people's welfare guaranteed by the availability of economic facilities and infrastructure.

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