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The Impact of Leverage, Wealth, and Audit Management on Local Government Performance

Dewi Amalia[1], Windy Novita Ariani[2], Suripto[3], Zahra Fitri Azizah[4]

[1,2,3] *Universitas Ahmad Dahlan, Yogyakarta, Indonesia*
[4] *Universitas Diponegoro, Semarang, Indonesia*

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Corresponding Author:
dewi.amalia@act.uad.ac.id
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ABSTRACT

This research examines the influence of government size, leverage, audit findings, audit follow-up recommendations, wealth, and capital expenditure on local government performance. This research using quantitative method with data from 154 local governments, with panel data regression to identify significant relationships. Researchers present a new analysis of the relationship between wealth, audit recommendations, and leverage on local government performance in Sumatra, Indonesia. The findings show that leverage has a significant negative impact on government performance, while variables such as government size, audit findings, follow-up recommendations, wealth, and capital expenditure do not show significant effect. This suggests that local governments with higher levels of debt experience difficulties in maintaining effective performance due to financial constraints and debt repayment burdens. Additionally, larger government size is not necessarily associated with better performance, perhaps due to the challenges associated with managing a larger bureaucracy. This study provides new insights into public sector financial management and contributes to the existing literature on local government performance, with potential implications for policy reform and management strategies.

INTRODUCTION

Decentralization and regional autonomy offer substantial opportunities for local governments to implement reforms and improve their performance (Rohma et al., 2023). Regional autonomy, as outlined in Law of the Republic of Indonesia Number 23 of 2014 empowers regencies and municipalities to independently manage governmental functions and address community needs. The primary objective of regional autonomy is to improve local government performance in delivering public services more effectively and efficiently while promoting sustainable local economic development (Febrianti & Rohma, 2023). The Regulation of the Minister of Finance Number 214/PMK.02/2017 on the Measurement and Evaluation of Performance in the Implementation of Work Plans and Budgets for Ministries/Agencies states that the Minister of Finance conducts budget performance evaluations as a performance-based budgeting instrument to ensure accountability and improve quality.

The accountability function aims to transparently and professionally account for government-managed budgets to stakeholders. In contrast, the quality improvement function focuses on measuring effectiveness and efficiency, while identifying supporting factors and constraints in improving performance. One of the key indicators of local government performance is the effectiveness of budget absorption, which reflects how well local governments can manage and utilize public budgets to achieve development goals (Bastian, 2020). Local governments with substantial assets or high wealth are expected to deliver superior public services. However, poor debt management (high leverage) and numerous audit findings often indicate managerial weaknesses that may impede performance improvements (Ara et al., 2016). Previous studies suggest that government size, leverage, and audit findings have the potential to influence local government performance, although the results remain inconsistent (Dasma et al., 2020 Puspitaari & Setyanta, 2020; Kurnia, 2020; Kiswanto & Fatmawati, 2019; Anggraini, et al., 2019; Andani et al., 2019; Mappiasse, 2018; Ara et al. 2016; Harumiati & Payamta, 2014).

Kiswanto & Fatmawati (2019) and Ara et al. (2016) found that government size positively affects performance, whereas Harumiati & Payamta (2014) and Anggraini et al. (2019) reported no significant effect. Similarly, audit findings were found to influence local government performance in studies by Harumiati & Payamta (2014); Ara et al. (2016); and Anggraini et al. (2019), while Dasmar et al. (2020) reported contrary results. These inconsistencies can be explained through the lens of stewardship theory. This theory emphasizes how agents (local governments) act in the best interests of principals (the public), providing a framework to understand how government size, leverage, wealth, and audit findings may impact local government performance.

This study is motivated by the need to gain a deeper understanding of the factors influencing local government performance, particularly in districts and cities across Indonesia, with a specific focus on the island of Sumatra. As one of the largest islands in Indonesia, Sumatra plays a vital role in the national economy, contributing 22.08% to Indonesia's GDP with a growth rate of 4.48% in 2024 (Badan Pusat Statistik, 2024). Moreover, Sumatra exhibits significant variations in wealth, economic structures, and local government characteristics. These disparities in budget absorption capacity provide an opportunity to analyze the influence of the examined variables on local government performance in regions with diverse characteristics (Badan Pusat Statistik, 2023).

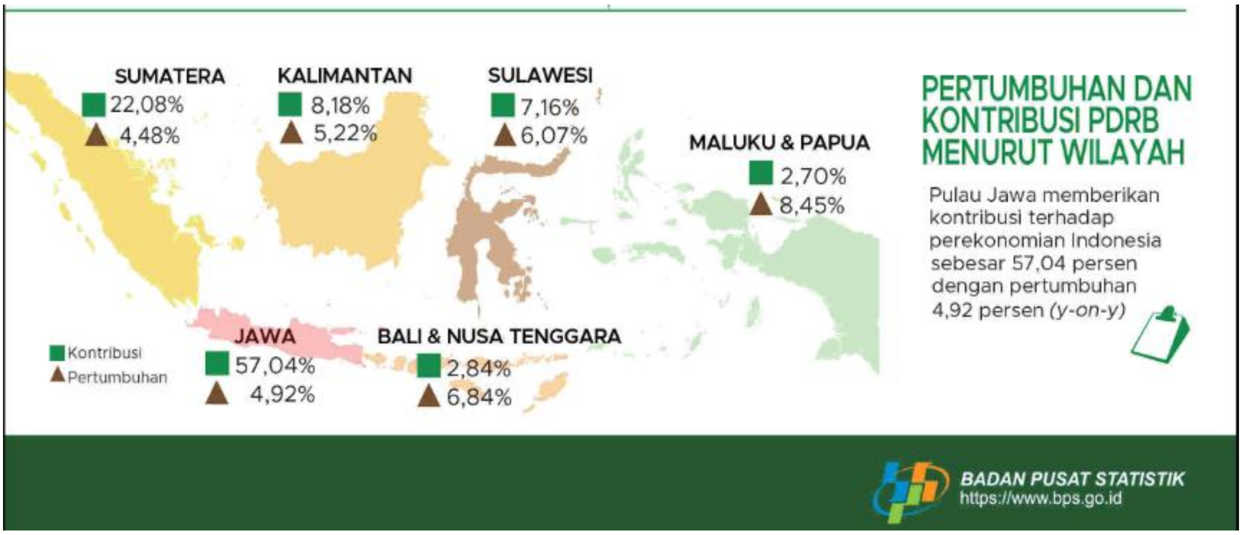

Figure 1. Infographic of Indonesia's Economic Growth in the Second Quarter of II 2024
Source: Central Statistics Agency, 2024

Building on the foundational work of Kiswanto & Fatmawati (2019) which examined the influence of regional government size, leverage, audit findings, and follow-up recommendations on performance, this study introduces two additional variables namely wealth and capital expenditure to further investigate their effects on performance outcomes. Wealth is the ability of a region to generate local original income. A high level of wealth will increase the infrastructure owned by the government in providing public services, thereby affecting government performance (Sudarsana & Rahardjo, 2013). Government Regulation Number 71 of 2010 states that capital expenditure is a budget expenditure for the acquisition of fixed assets and other assets that provide benefits for more than one accounting period. Large capital expenditures will improve government services which can improve the performance of local governments to the public (Ara et al., 2016).

This study aims to provide empirical evidence on the influence of size, leverage, audit findings, follow-up recommendations, wealth, and capital expenditure on the performance of local governments in districts and cities on Sumatra Island. This study employ quantitative method. The results of this study enrich the body of knowledge in accounting and serve as valuable input for policymakers when considering improvements to regional governance amid the evolving complexities of regional finances.

LITERATURE REVIEW

Stewardship Theory

Stewardship theory states that managers as trusted stewards and representatives of the principal will act according to the wishes of the principal or institution (Ghozali, 2020: 89). Stewardship theory explains that individuals in government tend to act as stewards or managers who are responsible for the public interest (principal) or the government as a whole. Government performance, in the context of stewardship theory, states that managers or individuals responsible for government performance are not only motivated by personal interests but also have an intrinsic orientation to achieve government goals optimally out (Rohma, 2023). Individuals in government see government success as part of personal success. Performance is the achievement of the results of operational activities that have been carried out (Lanita & Rachmawati, 2020). This stewardship theory can help explain how the performance of individuals or groups in a government tends to be higher if individuals have the trust and autonomy to make decisions for the long-term interests of the organization. Thus, stewardship theory will see performance as a reflection of the collective commitment of individuals to the success of the organization, without placing too much emphasis on incentives or strict supervision.

Hypotheses Development

According to stewardship theory, the government acts as a steward responsible for managing resources for the public interest, which acts as a principal (Ghozali, 2020: 89). In this context, the government is expected to use its resources wisely to achieve the main goal, namely improving public welfare through the provision of better public services and efficient asset management (Ara et al., 2016). Government size is often associated with the availability of resources, both financial, human, and asset resources. A larger government has a greater capacity to manage and utilize public assets, as well as provide adequate facilities to meet the needs of the community (Kiswanto and Fatmawati, 2019). A government that has more resources tends to be able to optimize asset management and budget allocation better, thus affecting the effectiveness and efficiency of budget absorption and regional government administration. Therefore, the hypothesis is:

H1: Government size has a positive effect on local government performance.

Stewardship theory states that the government, as a steward, is responsible for managing the finances wisely for the public interest (Ghozali, 2020: 89). A critical aspect of government financial management is the effective utilization of external resources to fund development activities and programs. However, high reliance on external debt or leverage can pose significant risks to the performance of local governments (Minarsih, 2015). High leverage means that the government should repay debts and interest. This obligation can burden the government budget because debt and interest payments must be prioritized before budget allocations for public services. As a result, the greater the leverage the government has, the fewer resources are available to be used in providing public services, infrastructure, and community welfare programs (Sesotyaningtyas, 2012). As leverage increases, the risk of failure to fulfill public responsibilities also increases, thus negatively impacting government performance. Therefore, high leverage is considered to hinder the government's ability to use resources effectively for public services (Adityaningrum, Widyaningrum, and Mahirun, 2024). Therefore, the hypothesis proposed is:

H2: Leverage has a negative effect on local government performance.

Stewardship theory emphasizes that the government as a steward is responsible for managing public finances with transparency and accountability for the benefit of the community as the principal (Ghozali, 2020: 89). In the context of regional financial management, compliance with applicable rules and standards is an important element of this accountability. When local governments fail to comply with financial regulations, this can be detected through audit findings that reveal non-compliance, inefficiency, or irregularities in budget management. Non-compliance with these financial regulations can have a negative impact on budget absorption and the quality of public services because funds that should be allocated for development programs are hampered by irregularities in management. In stewardship theory, the success of a steward is assessed by their ability to effectively fulfill responsibilities while maintaining public trust through transparent and accountable management.

The audit findings reveal irregularities or inefficiencies, it indicates a failure on the part of the government to meet its financial management responsibilities. These findings point to critical issues such as mismanagement, wasteful spending, or non-compliance with established regulations, which can undermine public trust and accountability in government operations. Audit findings can be seen as an indicator that the government is less able to carry out its steward role optimally because the public funds managed are not used in the best interests of the community (Kiswanto and Fatmawati, 2019). The more audit findings are revealed, the greater the possibility that local governments will experience a decline in performance. This occurs because inefficiencies in budget management cause low budget absorption and reduce effectiveness in providing public services and infrastructure development. Audit findings reflect weaknesses in financial management, which lead to inefficient use of the budget and hinder the achievement of optimal performance (Sudarsana and Rahardjo, 2013; Kurnia, 2020). Thus, the following three hypotheses are formulated:

H3: Audit findings have a negative impact on local government performance.

According to stewardship theory, the government as a steward is responsible for correcting weaknesses found in financial reports to improve public welfare (Ghozali, 2020: 89). Part of this responsibility includes the government's efforts to improve the limitations in financial management found through the audit process. The audit aims to identify areas that need improvement in the management of the local government budget and finances, as well as to produce recommendations to correct weaknesses. Follow-up on audit recommendations reflects the government's commitment to improve the limitations in financial management (Kurnia, 2020). Effective implementation of these recommendations is expected to increase the efficiency of budget manage-

ment, which will ultimately be reflected in increased budget absorption. When these recommendations are implemented effectively, the government will be better able to achieve better budget realization targets (Kiswanto & Fatmawati, 2019). In stewardship theory, a good steward not only manages resources wisely but also tries to correct existing weaknesses to better meet the public interest. Therefore, effective follow-up on audit recommendations is an important way for local governments to increase budget absorption, improve performance, and achieve budget realization targets. Therefore, the hypothesis proposed is:
H4: Follow-up of recommendations has a positive effect on local government performance.

Stewardship theory states that the government as an agent has the responsibility to manage economic resources with the main aim of improving community welfare (Ghozali, 2020: 89). In the context of local government, this responsibility includes managing Local Original Income (LOI) and other resources to support better development and public services. More wealth, as measured by higher LOI levels, means more resources can be allocated to public services. With increased fiscal capacity, local governments can finance more effective and comprehensive programs, which can directly improve local government performance in addressing community needs (Masdiantini & Erawati, 2016). The higher LOI allows local governments to fund infrastructure, health, and education, which will have a positive impact on performance indicators such as budget absorption and the success of development programs. In addition, regions with higher levels of wealth also tend to have better managerial capacity, which increases efficiency in budget management. In this case, good management of regional economic resources will increase the level of budget absorption, which is a proxy for local government performance. Regions with larger LOIs have wider fiscal space to support inclusive and sustainable development policies, which in turn contributes to improving government performance. Thus, governments with higher LOI have greater capacity to meet public needs and improve regional performance (Sudarsana & Rahardjo, 2013). Therefore, the five hypotheses of this study are:
H5: Wealth has a positive effect on local government performance.

Stewardship theory states that the government, as a steward, is responsible for managing its resources wisely and acting in the best interests of the community (Ghozali, 2020: 89). In the context of local government, one of the important resources that must be managed is capital expenditure, such as spending on infrastructure development and other public investments. An effective government will use capital expenditure to improve the quality of public services and create infrastructure that supports long-term and sustainable development (Harumiati and Payamta, 2014). Good capital expenditure management has a sustainable impact because strong infrastructure development can support long-term regional economic growth, increase public service capacity, and better meet community needs. Thus, larger and well-managed capital expenditure is expected to contribute to improving local government performance through optimal budget realization and tangible development results (Alvini et al., 2018). An effective government in capital expenditure management is likely to demonstrate superior performance, reflected in high budget absorption and the success of development programs. Therefore, the hypothesis is proposed:
H6: Capital expenditure has a positive effect on local government performance.

RESEARCH METHOD

This research method uses a quantitative approach that aims to test the influence of several independent variables on the dependent variable, namely local government performance. This research was conducted in district and city local governments on the island of Sumatra with an observation period of 2017-2021. Secondary data in this study were obtained from the Audit Result Report (*Laporan Hasil Pemeriksaan/LHP*) and Semester Audit Result Summary (*Ikhtisar Hasil Pemeriksaan Semester/IHPS*) by the Audit Board of Indonesia (*Badan Pemeriksa Keuangan/BPK*), as well as follow-up of recommendations data from the audit results. The research sample was determined using the purposive sampling method. The total sample that met the criteria was 154 local governments consisting of 120 districts and 34 cities, with a total of 770 observations.

The data is processed using the panel data regression method. Panel data regression analysis is a powerful statistical method used to determine the relationships between independent variables and a dependent variable by combining cross-sectional and time-series data. This approach allows researchers to account for individual heterogeneity and observe changes over time, leading to more robust and informative results. Data processing is carried out with EViews statistical software to produce an accurate and valid model that directly correlates with the research hypothesis. The panel data regression model in this study is: $Y = \alpha + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 + \beta 5X5 + \beta 6X6 + e$. Remarks: Y: Local government performance, α: Constanta, β1-β6: Regression coefficient, X_1: Size; X_2: Leverage, X_3: Audit findings, X_4: Follow-up recommendations, X_5: Wealth, X_6: Capital expenditure, e: Error

Table 1. Measurement of Variables

Variable	Measurement	Reference
Local government performance	$\frac{\text{Actual cost}}{\text{Budget Cost}} \times 100\%$	Noviwijaya &Rohman (2013)
Size	Total asset on the government balance sheet	Kiswanto & Fatmawati (2019)
Leverage	$\frac{\text{Liability}}{\text{Equity}}$	Sesotyaningtyas (2012)
Audit findings	$\frac{\Sigma \text{ Audit findings}}{\text{Cost budget}}$	Kiswanto & Fatmawati (2019); Harumiati & Payamta (2014)
Follow-up recomendation	$\frac{\Sigma \text{ Follow-up recommendation}}{\text{Total recommendation}}$	Kiswanto & Fatmawati (2019)
Wealth	$\frac{\text{LOI}}{\text{Total income}}$	Halim (2004)
Capital expenditure	Capital expenditure in the government's LRA	Ara et al. (2016); Harumiati & Payamta (2014)

Source: Processed data, 2024

RESULT AND DISCUSSION

Table 2. Descriptive Statistic

Variables	Mean	Max	Min	Std. Deviation
Performance	1.1505	11.2587	0.0011	0.6868
Size	24.1471	29.2246	16.1252	2.0988
Leverage	0.1838	23.0972	0.0001	0.8746
Audit findings	0.2611	15.7023	0.0000	0.7522
Follow-up recommendation	0.8245	556.4882	0.0000	20.1216
Wealth	0.4799	44.6797	0.0015	1.9414
Capital exp.	0.1788	9.5270	0.0010	0.3946

Source: Processed data, 2024

Table 2 shows the descriptive statistical analysis of the research data. It is known that the performance variable has a minimum value range of 0.0011 owned by Tanah Datar Regency in 2021 and a maximum value of 11.2587 owned by Way Kanan Regency in 2017. The mean performance value in 154 regencies and cities in Sumatra Island is 1.1505 with a standard deviation of 0.6868. When this relatively large standard deviation is compared to the mean, it shows that there is quite a large variation in performance among regencies and cities in Sumatra. The standard deviation value of 2.0988 which is relatively small compared to the mean of 24.1471 shows that the variable size of the district and city government in Sumatra Island which is the object of the study tends to be homogeneous, which means that the size of the government is not too large.

Leverage has a standard deviation of 0.8746 which is greater than the mean of 0.1838 which means a wide spread from the mean (heterogeneous) indicating significant variation in the use of debt by local governments in the sample. The standard deviation of the audit findings variable, which is greater than the mean (0.7522 compared to 0.2611) indicates a significant level of variability among local governments in their audit findings. The mean of the follow-up recommendation indicates that 82.45% of the issues were subsequently addressed by local governments. The standard deviation (20.1216) which is very large compared to the mean indicates that the follow-up of audit recommendations among local governments is very heterogeneous. The wealth variable shows a standard deviation of 1.9414 which is greater than the mean value of 0.4799 meaning that wealth data is heterogeneous, with very significant differences among the regions studied. A mean capital expenditure of 0.1788 reflects that in general capital expenditure issued by local governments in the sample is 17.88% of overall expenditure. The standard deviation of 0.3946, which is greater than the mean indicates that capital expenditure among local governments is quite heterogeneous, with significant variations in budget allocation across various regions.

The stages in this panel data analysis include regression model estimation; regression model selection; and hypothesis testing (Ghozali and Ratmono, 2017: 214). The approaches used to estimate the regression model in the first stage are the Common Effect Model (CEM), Fixed Effects Model (FEM), and Random Effect Model (REM) which are presented in Table 3. The CEM F-statistic value of 0.0201 indicates that this model is significant overall and the Durbin-Watson value of 1.3321 shows the possibility of autocorrelation problems in the residuals. Overall, this model is not strong enough to explain the relationship between variables. The FEM approach has an F-statistic value of 0.0000, meaning that the model is significant overall. Durbin-Watson of 2.2369 indicates that there are no autocorrelation problems in the residuals. The results of the regression test with the REM approach with a probability value of 0.0395 and a Durbin-Watson value of 1.8018. This means that the model with the REM approach is significant.

The second stage, which involves selecting a regression model through the Chow and Hausman tests. The Chow test looks for the best model between the CEM or FEM approaches. If the F value from the Chow test <0.05, then the FEM model is better used compared to CEM, and vice versa. Based on the Chow test presented in Table 3, it can be seen that F is worth 0.0000 (<5%) so the decision is to use the FEM approach. After selecting the FEM approach in the Chow test, the Hausman test continued to select the FEM or REM approach. Based on Table 3, the probability value of the Hausman test is 0.0164 (<0.05), which means that testing the research hypothesis is more appropriate using the FEM model.

The stages of hypothesis testing with the FEM approach are presented in Table 4. The adjusted R^2 of 0.5578 or 55.78% suggests that the variables of regional size, leverage, audit findings, follow-up recommendations, wealth, and capital expenditure simultaneously explain 55.7% of the variation in regional government performance. Meanwhile, the remaining 44.3% is explained by other variables that are outside the model in the study. The F-statistic value of 7.1005 indicates that the overall regression model is significant in explaining the dependent variable. The F probability value of 0.0000 shows that the independent variables simultaneously have a significant effect on regional government performance at a significance level of 1%.

Based on Table 4, it is also known that the t-test results for government size have a significance value of 0.0000 (<0.05) but the regression coefficient value is -0.0058 so the H1 is not supported in this study. Government size has a mean of 24.1471 with a standard deviation of 2.0988 which shows that the variability of government size is relatively low and does not have significant enough variation to explain differences in local government performance, thus supporting the finding that government size does not have a positive effect on performance. This is the same as the results of the study by Sari & Mustanda (2019). The results of the study show that size does not have a positive effect on local government performance, in contrast to the assumptions in Hypothesis 1. Based on agency theory, governments with larger sizes often face complex bureaucratic problems, thus hampering effective budget management.

Table 3. Regression Model Estimation

Variables	CEM (Coefficient)	FEM (Coefficient)	REM (Coefficient)	Chow Test (Probability)	Hausman Test (Probability)
Constanta	0.4761	13.0320	0.7881	-	-
Size	0.0285	-0.0058	0.0155	0.0000	0.0164
Leverage	-0.0454	-0.0471	-0.0456	-	-
Audit findings	-0.0084	-0.0012	-0.0068	-	-
Follow-up recommendation	-0.0001	-0.0001	-0.0001	-	-
Wealth	-0.0186	-0.0047	-0.0144	-	-
Capital expenditure	0.0277	0.0037	0.0219	-	-
Adjusted R^2	0.0073	0.5577	0.0010	-	-
Prob. (F-statistic)	0.0201	0.0000	0.0395	-	-
Durbin-Watson	1.3321	2.2369	1.8018	-	-
Cross-section Chi-square (Chow)	-	-	-	0.0000	-
Cross-section random (Hausman)	-	-	-	-	0.0164

Source: Processed data, 2024

Table 4. Hypothesis Test Results

Variables	β	Relation	Probability	
			Two tailed	One tailed
Constanta	1.3032		0.0000	0.0000
Size (X1)	-0.0058	+	0.0044	0.0022
Leverage (X2)	-0.0471	-	0.0000	0.0000
Audit findings (X3)	-0.0012	-	0.5490	0.2745
Follow-up recommendation (X4)	-0.0002	+	0.0000	0.0000
Wealth (X5)	-0.0047	+	0.0662	0.0331
Capital exp. (X6)	0.0038	+	0.6328	0.3164
Adjusted R^2	0.5578			
Probability F	7.1005			
Probability F	0.0000			

Source: Processed data, 2024

Larger bureaucracies tend to increase inefficiencies in the decision-making process and resource allocation so that budget absorption is not optimal. This theory questions the assumption used in hypothesis 1, which predicts that larger governments will have more resources to improve performance (Mappiasse, 2018). On the contrary, the bureaucratic inefficiency inherent in large governments reduces the government's ability to manage budgets and provide public services effectively, which ultimately reduces government performance. Thus, this result is in line with agency theory, which states that the larger the size of the organization, the greater the potential for agency problems that can reduce institutional performance (Ghozali, 2020: 86).

The leverage coefficient value of -0.0471 and the significance level of 0.0000 indicate that leverage has a negative and significant effect on local government performance. These results support H2, which means that the lower the leverage level, the higher the local government performance. A low leverage value indicates that the organization can control its dependence on external parties (Adityaningrum et al., 2024). The results of previous studies also obtained the same results, namely Kiswanto & Fatmawati (2019) and Anggraini et al. (2019). This negative effect can be explained by the fact that a high debt burden can reduce the government's financial flexibility to fund public service programs or important investments. In addition, increased leverage can increase fiscal risk, directing resources to debt payments rather than improving the quality of services or efficiency of local government performance. Stewardship theory supports this view because responsible managers are expected to be able to manage resources efficiently and minimize risks that could be detrimental to the public interest (Sesotyaningtyas, 2012; Minarsih, 2015; Adityaningrum et al., 2024).

The test results show an audit finding coefficient of -0.0012 with a significance of 0.2745, indicating that H3, which states that audit findings have a negative effect on performance, is not supported. A significance value greater than 0.05 indicates that audit findings do not have a significant effect on government performance. This means that although audit findings usually reflect weaknesses in financial management or procedural violations, the results show that the number of audit findings does not have a significant effect on local government performance. This is reinforced by descriptive data that has a mean audit finding of 0.2611 with a standard deviation of 0.7522, indicating high variability in audit findings but not yet significant enough to affect performance. Based on stewardship theory, individuals in government who act as managers have the responsibility to achieve the goals of the institution, including correcting weaknesses identified in the audit. This shows that even though there are audit findings, the government continues to maintain optimal performance by immediately correcting the weaknesses found (Lestari et al., 2019; Ghozali, 2020: 89). The results of this study are the same as Suheri et al (2018).

Table 4 shows the regression coefficient of follow-up recommendations of -0.0002 with a significance level of 0.0000, which means that H4 is not supported in this study. This means that although follow-up recommendations are expected to have a positive impact on local government performance, the results of the study show the opposite, namely that follow-up recommendations do not have a significant positive effect on government performance. This result is in line with Harumiati & Payamta (2014) shows that audit follow-up recommendations do not have a positive effect on performance. Based on agency theory, even though local governments carry out follow-ups, the possibility of a slow bureaucratic process or ineffective implementation can hinder improved performance. In other words, even though follow-up occurs, it does not always have a direct impact on increasing budget absorption or budget efficiency (Harumiati & Payamta, 2014; Ghozali, 2020: 86). This is reflected in the descriptive data which shows mean follow-up to recommendations of 0.8245 with a standard deviation of 20.1216 which shows that the follow-up to recommendations varies greatly in the local governments that are the objects of the study and does not have a significant influence on performance.

Table 4 presents the coefficient value of the wealth level of -0.0047 with a significance of 0.0331, which means that Hypothesis 5 is not supported in this study. Thus, the level of wealth does not have a positive effect on the performance of local governments in districts and cities on the island of Sumatra. The results of this study are similar to Mappiasse (2018) and Masdiantini & Erawati (2016). Based on the resource-based view theory, although more wealthy regions have more resources (regional income), managerial ability greatly determines the capacity to utilize resources effectively. Without effective management, this wealth will not automatically improve performance (Satria & Sari. 2018; Ghozali, 2020: 157). Descriptive statistical support shows a mean wealth of 0.4799 with a standard deviation of 1.9414, indicating significant variations in wealth, which can lead to inefficient resource allocation in some regions.

The regression coefficient of capital expenditure is 0.0037 with a significance level of 0.3164, which means that the H6 of this study is not supported. Thus, capital expenditure does not have a positive effect on the performance of local governments in districts and cities in Sumatra Island, because the significance value (0.3164) is greater than 0.05. In other words, the increase in capital expenditure carried out by local governments does not show a significant positive relationship to an increase in local government performance. Descriptive statistical data shows that the mean capital expenditure is 0.1788 with a standard deviation of 0.3946, indicating there is quite a large variability in the allocation of capital expenditure. This variation shows that even though there is a budget allocated, its impact on performance is not always positive. These results are in line with the research results of Nugroho & Prasetyo (2018); Qowi et al (2017) and Suryaningsih & Sisdyani (2016). Agency theory explains that even though the capital expenditure budget is large, inefficiency factors in bureaucracy can cause programs or activities budgeted in capital expenditures not to run according to target so that they do not have a significant impact on performance (Ghozali, 2020: 86).

CONCLUSIONS, LIMITATIONS, AND SUGGESTIONS

This study shows that the leverage has a significant negative effect on performance, while audit findings do not show negative results. In other words. the complexity of government size and high debt burden can be inhibiting factors in improving performance. This study enriches the literature on public financial management, especially in the context of leverage and capital expenditure. The findings of this study provide important implications for local governments to be more careful in the use of debt instruments and to improve the effectiveness and accuracy of targeting in capital expenditure allocation. Suboptimal financial management. especially in terms of excessive debt management and inefficient capital expenditure. can hamper the performance of local governments.

Therefore. policies are needed that focus more on the efficient use of public resources. as well as effective follow-up to audit findings to strengthen the accountability and transparency of local financial management. One limitation of this study is that it cannot capture the impact of policy changes or broader economic conditions. that can reduce the accuracy of describing long-term transformations in conditions. In addition, the limitations of the theories used namely stewardship theory and agency theory may not fully cover the complexity of external and internal factors that can affect local government performance. Suggestions for similar future research are to expand the scope of objects by involving other regions in Indonesia so that the results are more nationally representative. Further research can also explore other factors that potentially contribute to regional performance. such as audit opinions (Andani et al., 2019). intergovernmental revenue (Sesotyaningtyas, 2012; Minarsih, 2015), and legislative size (Ara et al., 2016). Further research is encouraged to integrate more comprehensive theories, such as institutional and resource-based theory to provide a broader and deeper perspective in understanding the factors that influence local government performance.

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