

## EFFECTIVENESS OF FINANCIAL PERFORMANCE OF PROVINCIAL GOVERNMENTS IN INDONESIA: EVIDENCE DURING COVID-19

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### ABSTRAK

Jumlah nominal dari kasus ketidakhematan, ketidakefisienan, dan ketidakefektifan menunjukkan peningkatan signifikan yang mencerminkan kinerja keuangan pemerintah dalam mengelola keuangan. Penelitian ini bertujuan menganalisis kinerja keuangan pemerintah provinsi di Indonesia, yang diukur melalui indikator belanja modal, pendapatan asli daerah (PAD) dan dana perimbangan pada periode awal Covid-19 (2019-2020) dan periode peralihan COVID-19 (2021-2022). Sebanyak 133 laporan realisasi anggaran pemerintah daerah di Indonesia dianalisis menggunakan regresi data panel. Hasil penelitian menunjukkan pada dua periode tersebut PAD berpengaruh positif signifikan terhadap kinerja keuangan pemerintah daerah, namun dana perimbangan hanya berpengaruh signifikan pada masa awal COVID-19. Belanja modal berpengaruh negatif dan tidak signifikan terhadap kinerja keuangan pada masa awal dan peralihan. Hasil penelitian ini memberikan gambaran tentang dampak COVID-19 pada kinerja keuangan pemerintah daerah provinsi di Indonesia.

Kata Kunci: Belanja modal, PAD, dana perimbangan, kinerja keuangan pemerintah daerah

### ABSTRACT

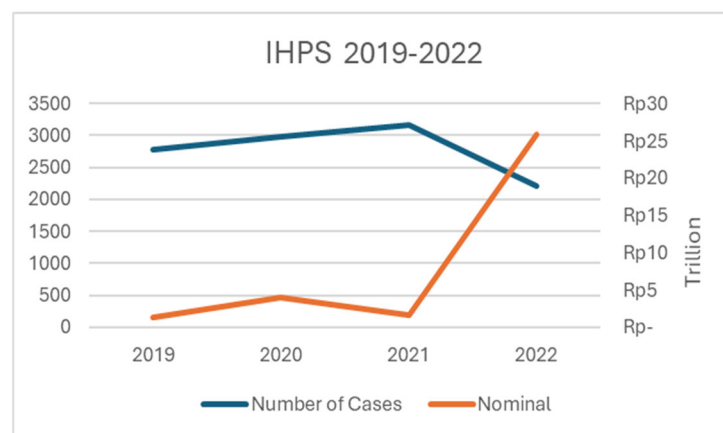
*The nominal number of cases of inefficiency, inefficiency, and ineffectiveness shows a significant increase, reflecting the government's financial performance in managing finances. This research aims to analyze the financial performance of provincial governments in Indonesia, which is measured through indicators of capital expenditure, local revenue, and balancing funds in the initial period of COVID-19 (2019-2020) and the transition period of COVID-19 (2021-2022). 133 local government budget realization reports in Indonesia were analyzed using panel data regression. The research results show that local revenue significantly affected the local government's financial performance in these two periods. However, balancing funds only had a substantial impact during the early period of COVID-19. Capital expenditures negatively and insignificantly affect financial performance during the initial and transition periods. The results of this research provide an overview of the impact of COVID-19 on the financial performance of provincial and regional governments in Indonesia.*

*Keywords: Capital expenditure, local revenue, balancing funds, regional government financial performance*

## 1. Introduction

The World Health Organization (WHO) formally classified the coronavirus, also known as Covid-19, as a pandemic in March 2020. At the close of 2019, the first incidence of COVID-19 was reported in Wuhan, China. On March 2, 2020, the first COVID-19 case was reported in Indonesia. President Jokowi said on May 7, 2020, that citizens must coexist with COVID-19 for a while until the new normal notion is put into place. Indonesia is going through a transitional period because of the new normal, and things will start to get better in 2021 when vaccinations commence, which will also mark the beginning of the nation's total economic recovery. Consequently, the economy can be divided into two distinct periods: the early COVID-19 period in 2019–2020 and the COVID-19 pandemic transition period in 2021–2022.

During this situation, local governments must be able to provide services and facilities for the needs of the citizens. So local governments must be able to manage their finances effectively and efficiently for the needs of their citizen during this time. The government's success in managing these finances can be seen from its financial performance. An evaluation of a local government's financial performance over a budgetary period is based on how well it managed its finances, including local revenue and expenses, in compliance with relevant laws or rules. A local government's high financial performance indicates that its financial management is good. On the other, inadequate financial performance indicates that the local government's financial management is not as effective as it could be (Ardelia et al., 2022).



Source: Ikhtisar Hasil Pemeriksaan Semester (IHPS) (Processed Data), 2024  
Figure 1. The Overview of Semesterly Audit Results 2019–2022

The Indonesian Audit Board (BPK) identified issues with the internal control system (SPI), non-compliance with legal requirements, and inefficiency, inefficiency, and ineffectiveness (3E) based on the Overview of Semester Audit Results (IHPS). The 2019–2022 3E problems are shown in Figure 1. The 3E problem's nominal amount and number of cases fluctuate annually, whereas, in 2022, the nominal worth of the case reached significantly compared to the number of cases, which declined from the previous year. In 2022, there were 2,205 problems with the nominal value grew to IDR 11.20 trillion. It indicates that government institutions, including provincial, and city/district governments, proceed having problems with managing their finances.

The financial performance can be influenced by various things. Financial performance may be impacted by capital investments, local revenue sources, and equalization funds the size of the local government (Maulina et al., 2021). Furthermore, research by Digdowiseiso et al. (2022) indicates that capital investment, local revenue sources, and balancing funds can impact local governments' financial performance. There was a significant decrease in the realization of all three of these factors in 2020. However, it started increasing during the transition period of COVID-19 (2021–2022), indicating that local governments' financial performance experienced an impressive increase.

Capital investment is used to acquire fixed assets and other assets that provide benefits for more than one budget period. The greater the allocation of capital investment indicates that the local government is more productive in carrying out development in its area (Digdowiseiso et al., 2022). The more capital that local governments allocate, the higher their financial performance might be (Sari et al., 2020). Capital investment has a significant positive effect on financial performance (Digdowiseiso et al., 2022). Meanwhile, Padang & Padang (2023) state that capital investment does not affect financial performance.

Local revenue is coming from sources of income within its region which is used for regional development and operations. So, each region must be able to optimize to be as intensive as possible in obtaining it (Fernandes & Putri, 2022). Local revenue sources are obtained to be used as a benchmark for analyzing the financial performance, because the higher the local revenue sources show that the local government can manage the wealth in its area optimally (Ramahdani & Trisnaningsih, 2022). The results of research by Digdowiseiso et al. (2022), state that local revenue sources have a significant positive with financial performance. These results differ from the research results of Andjarwati et al. (2021) which state that local revenue sources have a negative insignificant to financial performance.

Fiscal balance transfers from the central government to regions is an explanation of equalization funds. Equalization funds are to assist local governments in financing development and have the aim of reducing inequality or dependence on financing between the center and the regions. The greater the transfer of equalization funds, the higher the dependence of local governments on the center so that it can be reflected in the financial performance that is still not successful (Padang & Padang, 2023). Based on the results Padang & Padang, 2023) stated that the equalization fund has a significant positive relationship with financial performance. These results contradict the results of research conducted by Nugroho et al. (2023) which states that equalization funds have a significant negative relationship with local government financial performance.

This study aims to analyze the factors that affect financial performance such as capital investment, local revenue sources, and equalization funds using the effectiveness ratio measurement. The research focuses on provincial governments in Indonesia because provincial governments are representatives of the central government. Based on previous research, no one has compared the financial performance of local governments during the early period (2019-2020) and the transition period (2021-2022) of Covid-19. So that this research can contribute to improving and maintaining the stability of the financial

performance of local governments for the following year so that the nominal and the number of cases of ineffectiveness, and inefficiency do not increase in the following year.

## **2. Literature Review and Hypothesis Development**

Stakeholders (individuals or groups) that both affect and are influenced by the organization are referred to as stakeholders. According to Mahajan et al. (2023), this idea was put forth by Freeman (1984). It states that the goal of organizations is to provide a range of advantages to diverse stakeholders, including customers, suppliers, government agencies, shareholders, and communities. The community is viewed as stakeholders and the provincial government is the organization when the stakeholder theory is applied in a public sector setting. One of the many ways that the government is required to serve the community is by efficiently carrying out its responsibilities to improve societal well-being. The implementation of stakeholder theory in public sector organizations, with the province government serving as an organization and the community as a stakeholder. The government must give several advantages to society, one of which is to carry out its obligations and activities correctly, hence enhancing people's well-being. One of the tasks is to manage funds by making the most use of available resources. It may be shown in government financial management through optimal local financial performance (Digdowiseiso et al., 2022).

The financial performance of provincial governments is one of the measures that can demonstrate the ability of local governments to comply with the regulations and provisions in place while exercising local autonomy (Halim, 2014). The financial serves as an indicator of work achievement related to policy implementation in the local financial sector (Ramahdani & Trisnarningsih, 2022). The measurement of the financial performance of the provincial government is used as an evaluation tool to determine policies aimed at enhancing the quality of the public sector (Sari & Halmawati, 2021).

Financial ratio analysis is used to evaluate and compare the financial performance in managing their finances. Financial ratio analysis is performed on the local budget (APBD) that has been developed and executed (Ningrat & Supadmi, 2019). Several financial ratios can be used for evaluating financial performance, including the ratio of local financial independence, the degree of decentralization, the ratio of local financial dependence, the ratio of effectiveness and efficiency of local revenue, and the ratio of effectiveness and efficiency of local taxes (Nugroho et al., 2023).

Local government expenditures are classified as either direct or indirect in the Local Revenue and expenditure budget. Maulina et al. (2021) state that direct spending includes capital investment. Capital investment is a normal cost for capital formation in the region (Angelina et al., 2020). States that budgetary expenses for the purchase of fixed assets and other assets that yield benefits across many accounting periods are referred to as capital investments. Purchasing land, buildings and other structures, machinery, and intangible assets are a few examples of capital investments (Government Regulation Number 71 of 2010).

Local development that strives to enhance community welfare and services is financed through capital investments (Sari & Mustanda, 2019). The financial performance has improved because of this development, which has increased municipal revenues from

taxes, levies, and outside investment (Padang & Padang, 2023). Local governments will be more successful in implementing development in their regions if there is a larger allocation of capital spending (Digdowiseiso et al., 2022). The higher the realization of capital investment indicates that the local government has managed finances well to improve infrastructure and facilities for its people so that the financial performance of the local government will also increase. The results of studies by Ratnasari & Meirini (2022) and Yuliansyah et al. (2020) indicate that capital investment has a noteworthy favorable impact on financial performance.

H<sub>1a</sub>: During the early period of COVID-19 (2019–2020), capital investments had a positive effect on financial performance.

H<sub>1b</sub>: During the transition period of COVID-19 (2021-2022), capital investments had a positive effect on financial performance.

Local revenue sources are local wealth or resources owned by the region and managed by the local government to provide services to its citizens (Nugroho et al., 2023). According to Law Number 1 of 2022 of the Republic of Indonesia concerning Financial Relations Between the Central Government and Local Governments, local revenue sources include any money received through local taxes, levies, distinct local wealth management, and other sources of local revenue sources that are legitimate under applicable laws.

Local revenue sources are the fundamental capital that may be utilized to support local development and local government policies aimed at increasing the welfare and quality of services for the region's residents (Nugroho et al., 2023). Local revenue sources increasing year after year indicate the improved financial performance of provincial governments in managing their local finances (Padang & Padang, 2023). According to Nugroho et al. (2023), a higher level of local revenue sources can reduce the dependency of local governments on central government funds, thereby positively impacting financial performance. The higher the local revenue sources, the more the government can use it for its local needs without having to rely on funds from the central government. This indicates that the local government has been optimal in managing its revenue so that it will have an impact on improving the financial performance. The researchers hypothesize that local revenue sources have a positive impact. This is consistent with Fernandes & Putri (2022) and Digdowiseiso et al. (2022) that local revenue sources have a significant positive impact on the financial performance of provincial governments.

H<sub>2a</sub>: During the early period of COVID-19 (2019–2020), local revenue sources had a positive effect on financial performance.

H<sub>2b</sub>: During the transition period of COVID-19 (2021-2022), local revenue sources had a positive effect on financial performance.

The fiscal balance transfer from the central government to regional governments is defined as the equalization of funds. This is Indonesia's primary mechanism for transferring budget support funds from central regional governments. Equalization funds are funds transferred by the central government to maintain the financial balance between the central and local governments. This fund provides additional funding for local governments to carry out local autonomy (Maulina et al., 2021). The purpose of these is to support the implementation of government affairs that fall under the purview of the

regions, and they are allocated and given to them for management. The equalization fund is comprised of three funds: regular allocation fund, specialized allocation fund, and revenue sharing fund.

Equalization funds are provided by the central government to local governments as additional local revenue because not all regions have the same potential or local revenue sources (Maulina et al., 2021). However, the greater the local government receives equalization funds, the lower the financial performance (Digdowiseiso et al., 2022). This is because local governments will become less efficient in generating local revenue and will begin to rely on the central government's equalization funds to carry out local development. The higher the equalization funds received by the local government indicates that the local government is still less than optimal in managing its financial performance because it still depends on funds from the central government so that financial performance is not optimal. This is consistent with Yuliansyah et al. (2020) and Ratnasari & Meirini (2022) that equalization funds have a significant negative impact on the financial performance of provincial governments.

H3a: During the early period of COVID-19 (2019–2020), equalization funds had a negative effect on financial performance.

H3b: During the transition period of COVID-19 (2021-2022), equalization funds had a negative effect on financial performance.

### **3. Research Method**

The research uses quantitative methods with secondary data. The data utilized in the budget realization report provincial government from 2019-2022 is sourced from <https://djpk.kemenkeu.go.id>. Panel data regression model analysis was used in this research as the descriptive statistics data analysis method. The budget realization reports from all provinces in Indonesia from 2019 to 2022 make up the research population. Purposive sampling, which is based on predetermined criteria, is the sampling approach used. The sample of the research criteria are shown in Table 1.

**Table 1. The Research Sampling Criteria**

<b>No.</b>	<b>Criteria</b>	<b>Amount</b>
1.	Province in Indonesia	37
2.	Provinces that do not report APBD realization reports	(3)
3.	Number of Samples (n)	(34)
4.	Research Year (t)	4
5.	Number of Research Samples (n × t)	136
6.	Data Outlier	(3)
7.	Total Data	133
	Consists of:	
	a. Number of Samples for the Early Period of Covid-19 Data for 2019-2020 (2×34)	68
	b. Number of Samples for Covid-19 Transition Period Data for 2021-2022 (2×34)	65

Source: Data Processed, 2024

Table 1 shows the 34 provinces in Indonesia for the years 2019–2022, with 136 sample data sources. However, during data analysis, the expected sample data show up as outliers. 68 samples from the early period of COVID-19 (2019–2020) and 65 samples from the COVID-19 transitional period (2021–2022) total the final number of data used, which is 133 sample data.

**Table 2. Measurement of Variables**

No	Variables	Measurement
1.	Financial Performance (Y)	(Realization of Local revenue sources / Target of Local revenue sources) × 100 %
2.	Capital Investment (X <sub>1</sub> )	Land Expenditure + Structures and Buildings + Irrigation, Roads, and Networks + Equipment and Machinery + Other Fixed Assets + Construction in Progress + Other Asset
3.	Local Revenue Sources (X <sub>2</sub> )	Local Tax + Local Levy + Separated Local Wealth Management Results + Other Legal Local Revenue Sources
4.	Equalization Funds (X <sub>3</sub> )	General Allocation Fund + Profit Sharing Fund + Special Allocation Funds

The focus of this study is to determine how the independent variable impacts the dependent variable. The panel data regression analysis approach used in this study is conducted through the application of the Eviews 12 analysis program. A study that combines time series and cross-sectional data is called panel data regression (Pandoyo & Sofyan, 2018: 236). This study offers two regression panel data models: (1) the first model represents the early period (2019-2020), and (2) the second model represents the transitional period of the Covid-19 (2021-2022). In this research, the mathematical equation model tested is as follows:

$$FP_{(2019-2020)} = \alpha + \beta_1 CI + \beta_2 LRS + \beta_3 EF + \varepsilon \dots\dots\dots (1)$$

$$FP_{(2021-2022)} = \alpha + \beta_1 CI + \beta_2 LRS + \beta_3 EF + \varepsilon \dots\dots\dots (2)$$

Where:

- FP = Financial Performance
- CI = Capital Investment
- LRS = Local Revenue Sources
- EF = Equalization Funds
- α = Constant value
- β = Coefficient
- ε = Error

#### 4. Result and Discussion

Descriptive statistical data for this research variable, which consists of minimum, maximum, mean, and standard deviation values, are presented in Table 2 below.

**Tabel 3. Descriptive Statistics**

Explanation	Financial Performance (%)	Capital Investment	Local Revenue Sources	Equalization Funds
Mean	101%	1.173.1	4.404.5	4.412.6
Maximum	216%	11.552	45.707.4	16.897.7
Minimum	61%	176.3	345.2	1.268.8
Std. Deviasi	19%	1.106.8	6.815.7	3.427

\*(in billions of rupiah)

Sources: Data processed (2024)

Table 3 indicates that the financial performance ranges from a minimum of 61% to a maximum of 216%. 11.552 and 176.4 are the highest and minimum capital investment values. The maximum and minimum values of local revenue sources are 45,707.4 and 345.2. The maximum and minimum values of the equalization fund are 16,897.7 and 1,268.8. If the average of all the variables is higher than the standard deviation, then variables of financial performance and local revenue sources are homogenous. While the data variable capital investment and equalization funds are heterogeneous.

Panel data may be estimated using three different methods: the random effect model, the fixed effect model, and the common effect model (Pandoyo & Sofyan, 2018: 238-251). Before choosing a panel data model, three tests must be finished: the Chow, Hausman, and Lagrange multiplier (LM) tests. For selecting between the common and fixed effect models, the Chow test is utilized. The selection between the random and the fixed effect model is chosen utilizing the Hausman test. Lastly, between the random and common effect models, the LM test is utilized to select a method. By calculating the cross-section F's probability value, the Chow test is used to identify whether the strategy is preferred: the common or fixed effect model. The panel data regression model uses the common effect model or accepts the null hypothesis ( $H_0$ ) if the cross-section F-probability value  $> 0.05$ .

**Table 4. Result of Chow Test**

Period Information	Effects Test	Statistic	d.f	Prob.
Early Period of the Covid-19 Pandemic (2019-2020)	Cross-section F	1.568230	(33.31)	0.1056
	Cross-section Chi-square	66.766207	33	0.0005
	Cross-section F	3.520191	(32.29)	0.0005
Transition Period of the Covid-19 Pandemic (2021-2022)	Cross-section	103.09234	32	0.0000
	Chi-square	0		

The Chow test results are shown in Table 4. Although the cross-section chi-square probability value is  $0.0005 < 0.05$  for the early period of COVID-19 (2019–2020), the null



hypothesis ( $H_0$ ) is rejected. Then the Chow test results for the transition period Covid-19 (2021–2022), the value of cross-section chi-square probability is  $0.0000 < 0.05$ , resulting in the rejection of the null hypothesis ( $H_0$ ). Therefore, the Hausman test should be applied next. Hausman Test is a decision between the random and fixed effect model. Either the null hypothesis ( $H_0$ ) is accepted, or a fixed effect model is used in the panel data regression model if the value of cross-section chi-square probability  $< 0.05$ .

**Table 5. Result of the Hausman Test**

<b>Period Information</b>	<b>Test Summary</b>	<b>Chi-Sq. Statistic</b>	<b>d.f</b>	<b>Prob.</b>
Early Period of the Covid-19 Pandemic (2019-2020)	Cross-section random	8.818047	3	0.0318
Transition Period of the Covid-19 Pandemic (2021-2022)	Cross-section random	8.664804	3	0.0341

Table 5 shows the results of the Hausman test. While the null hypothesis ( $H_0$ ) has been accepted for the early period of COVID-19 due to the value of cross-section random probability  $0.0318 < 0.05$ , the fixed effect model is the most acceptable panel data regression method. Furthermore, the cross-section random probability value for the model related to the transition period of COVID-19 is  $0.0341 < 0.05$ , indicating that the null hypothesis ( $H_0$ ) is accepted. thus, in this situation, the fixed effect model (FEM) is the appropriate regression model to utilize.

**Table 6. Result of Classic Assumption Test**

<b>No</b>	<b>Classic Assumption Test</b>	<b>Test Measurement</b>	<b>Test Result</b>	<b>Conclusion</b>
1.	Multicollinearity	Centered VIF	Capital Investment 2,387 Local Revenue Sources 7.145 Equalization Funds 4.819	The multicollinearity test showed a centered VIF value $< 10$ , indicating the absence of multicollinearity in this study.
2.	Heteroscedasticity	Prob. Chi-Square	Prob. Chi Square 0.3194	The heteroscedasticity was not observed in this study, because the chi-square probability value $> 0.05$ .

The classical assumption test, according to Pandoyo & Sofyan (2018:222), is used to determine whether the regression model utilized in the study is appropriate for testing. None of the classical assumption tests employed in panel data regression are the heteroscedasticity and multicollinearity tests (Basuki & Prawoto, 2016: 298). To find out if

the independent variables in the regression model have any association with one another, do the multicollinearity test. The independent variables in a decent regression model shouldn't be correlated. The multicollinearity test requirements state that multicollinearity is absent if the VIF value < 10 (Pandoyo & Sofyan, 2018). The heteroscedasticity test is used to assess if the residuals of different variables in the regression model have unequal variance. Heteroscedasticity test criteria: if the F probability value > 0.05, then heteroscedasticity is not present.

Model selection studies have shown that panel data research in the early period (2019–2020) and transitional period of covid-19 (2021–2022) is most appropriate for the application of Fixed Effect Models (FEM). The panel data regression shows the following:

**Table 7. Summary Result of Fixed Effect Model**

<b>Early Period of The Covid-19 Pandemic (2019-2020)</b>					
<b>Variables</b>	<b>Predicted Sign</b>	<b>Coefficient</b>	<b>Std. Error</b>	<b>t-Statistic</b>	<b>Prob.</b>
C	-	0.687466	0.525098	-1.309214	0.2001
Capital investment	-	6.63E-14	8.09E-14	-0.819345	0.4188
Local revenue sources	+	1.78E-13	8.24E-14	2.164201	0.0383*
Equalization funds	+	1.92E-13	7.11E-14	2.699828	0.0111*
Adjusted R- squared	0.301866				
R- squared	0.676983				
Prob (F- statistic)	0.048594				
F- statistic	1.804724				
<b>Transition Period of The Covid-19 Pandemic (2021-2022)</b>					
<b>Variables</b>	<b>Predicted Sign</b>	<b>Coefficient</b>	<b>Std. Error</b>	<b>t-Statistic</b>	<b>Prob.</b>
C	+	0.653347	0.182539	3.579224	0.0012
Capital investment	-	4.49E-14	8.55E-14	-0.524439	0.6040
Local revenue sources	+	1.02E-13	3.23E-14	3.172277	0.0036*
Equalization funds	+	1.01E-14	1.70E-14	0.593074	0.5577
Adjusted R- squared	0.568208				
R- squared	0.804344				
Prob (F- statistic)	0.000561				
F- Statistic	3.406276				

Note: \*significant at probability value 5% (0.05).

Table 7 presents a summary of the results of panel data regression testing using FEM; the predictive ability of the model can be seen through the R-squared that reflected coefficient determination. The coefficient of determination value according to R-squared for the early period of COVID-19 (2019–2020) is 0.676983 or 67.6%. That indicates that 67.6% of the fiscal performance of locals can be explained by local revenue sources, equalization funds, and capital investment; the remaining 32.4% was influenced by variables or other factors not included in the study. Regression coefficients should be tested collectively since the F test aims to jointly ascertain the impact of the independent factors on the dependent variable (Pandoyo & Sofyan, 2018). Simultaneous test is if the

probability value of  $F < 0.05$ , then the independent variable simultaneously affects the dependent variable. According to the results, capital investment, local revenue sources, and equalization funds simultaneously impacted provincial governments' fiscal performance during COVID-19. The probability value for the early period of the Covid-19 (2019–2020) is  $0.048594 < 0.05$ . The value of the coefficient of determination for the transition period of COVID-19 (2021–2022) is based on R-squared. The value of the coefficient of determination is 0.804344, or 80.4%. The study finds that 80.4% of the fiscal performance of provincial governments during the transition period of the COVID-19 pandemic can be explained by a variable independent; the remaining 19.6% is determined by other variables or factors not covered in the research. Moreover, the F probability value during the transition period of the COVID-19 pandemic (2021–2022) is 0.000561, a value less than 0.005, which shows the goodness of fit of the regression model.

To determine the significance of each independent variable in influencing changes in the dependent variable, partial tests are utilized. If the probability value  $< 0.05$ , the independent variable has a significant impact on the dependent variable. Table 7 indicates that capital investment during the early and transition periods of COVID-19 had a negative and insignificant impact on financial performance. As a result, both hypotheses  $H_{1a}$  and  $H_{1b}$  have been rejected. These findings contradict the findings of previous research (Ratnasari & Meirini, 2022; Yuliansyah et al., 2020), which discovered that capital investment improves financial performance. Local governments utilize capital investments to construct local facilities. Although it has no significant impact, it might be suggested that increasing capital investment will result in an improvement in financial performance during COVID-19. It indicates that financial performance has been effective throughout COVID-19 since local governments utilize less capital investment for building local infrastructure because government funds are being utilized for social needs impacted by the pandemic. Capital investment uses revenues received by local governments, and capital expenditures' benefits cannot be felt directly. The results of the study, capital investment has a negative effect on effective financial performance. The higher the use of capital investment, the lower the effectiveness of financial performance because local revenue will be reduced.

In the early period and the transition period of COVID-19, local revenue sources positively affected the financial performance. With a probability value of  $< 0.05$ . As a result, both hypotheses,  $H_{2a}$  and  $H_{2b}$ , have been accepted. These findings are consistent with studies by Fernandes & Putri (2022) and Digdowiseiso et al. (2022), indicating a positive correlation between local revenue sources and financial performance. Thus, the financial performance will improve with increased local revenue sources from the government. The potential that the local government may achieve is reflected in the local revenue sources. The region's reliance on funding from the central government has decreased as local money is generated. The amount of local revenue sources during the early and transition periods of COVID-19 gives insight into the financial performance. The more local revenue sources are collected, the better the financial performance. This is because local government financial management and regulation remains unfettered by the

central government. The explanation is that financial performance will be improved since they have the authority to utilize funds for local development.

During the early period of COVID-19, the equalization fund had a positive significant effect on financial performance, while during the transition period, the equalization fund had an insignificant positive impact, as presented in Table 7. The equalization fund transfers fiscal balance from the central government to regions. The results contradict the arguments raised by Yuliansyah et al. (2020) and Ratnasari & Meirini (2022) that equalization funds hurt financial performance. In summary, the arguments presented by H3a and H3b, based on which the financial performance is negatively impacted by equalization funds, are rejected. Because a region's potential for original revenue varies, the central government funds local governments, referred to as equalization funds. The research indicates a significant positive correlation between the equalization fund and the financial performance during the early period of COVID-19. Therefore, financial performance will improve in proportion to any increase in equalization funds provided to them. This suggests that local governments could make the most effective use of the funds that remain to support social development and other requirements during the early period of COVID-19. The equalization fund nevertheless has an insignificant but positive impact on financial performance throughout the transition period of the COVID-19 pandemic. Probably not as much as there previously were, equalization funds nevertheless have an effect. One of the reasons for this is that local governments are now using more local revenue sources than equalization funds because of the growth in local revenue.

## **5. Conclusions, Implications, and Limitations**

This study analyzes the effect of COVID-19 on the effectiveness of local government financial performance by using budget realization data in the early period (2019-2020) and the COVID-19 transition period (2021-2022). Based on the results, the coefficient of financial performance in the early period of COVID-19 is negative, which indicates that economic performance during this period has decreased. Meanwhile, during the transition period, the coefficient of financial performance becomes positive, suggesting that regional income improves economic performance during this period.

The capital investment results are consistent, with a negative insignificant effect on financial performance during the early and transition periods of COVID-19. This indicates that the relationship between capital expenditure and economic performance has no change in the impact of COVID-19 conditions. Local revenue sources have consistent results that significantly positively affect financial performance in the early and transition periods. Lastly, the equalization fund has inconsistent results, with significant positive results in the early period, while in the transition period, the results are positive and insignificant. Covid-19 has an impact on the financial performance of local governments. This can be seen from the results of the coefficient of financial performance and equalization funds. The effect of COVID-19 on regional revenues has decreased due to the economic downturn, and local governments must choose their regional spending priorities.

This research has several limitations: (1) the study uses the effectiveness ratio of local revenue, so it does not fully describe financial performance; (2) the determinants of this research only focus on capital investment, local revenue sources, and equalization funds,

and (3) at the time the research was carried out, COVID-19 had not completely ended. Thus, future research can elaborate other financial performance ratios such as regional dependency ratio, regional independence, degree of decentralization, and others that can describe the financial performance of local governments. Further, the research can use other determinations contained in the realization report, such as general allocation funds, employee spending, regional levies, and others, which are still related to the financial performance of local government. Future research is expected to compare the before and after periods of COVID-19 to find out the overall impact of COVID-19 on the financial performance of local governments.

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