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The Effect of Local Own-Source Revenue and Capital Expenditure on the Financial Performance of Local Governments: The Moderating Role of Financial Statement Quality

Ahmad Najib[1], Achmad Fauzi[2], Umi Widyastuti[3]
Njibahmad04@gmail.com
State University of Jakarta

Abstract:
This study aims to examine the effect of Local Own-Source Revenue and Capital Expenditure on the financial performance of local governments, with Financial Statement Quality as a moderating variable. The study is motivated by the inconsistency of previous research findings regarding the relationship between fiscal capacity, budget allocation, and local government financial performance. In the context of Lampung Province, disparities in fiscal capacity among regencies and cities indicate that higher local revenue and capital expenditure do not always directly lead to better financial performance. Therefore, financial statement quality is considered an important accountability mechanism that may strengthen or weaken this relationship.

This research uses a quantitative approach with secondary data obtained from local government financial reports and related official documents. The unit of analysis is regency and city governments in Lampung Province during the 2018–2024 period. The data will be analyzed using panel data regression and moderated regression analysis to test both direct and moderating effects. The independent variables are Local Own-Source Revenue and Capital Expenditure, the dependent variable is Local Government Financial Performance, and the moderating variable is Financial Statement Quality. This study is expected to contribute to public sector accounting literature, particularly in explaining the role of financial reporting quality in strengthening fiscal accountability and improving local government financial performance.

Keywords: Local Own-Source Revenue, Capital Expenditure, Financial Performance, Financial Statement Quality, Local Government.

Background

In public sector governance, financial management is no longer viewed merely as an administrative activity, but as a strategic instrument to strengthen transparency, accountability, and public trust. Local governments are expected not only to absorb budgets, but also to manage public financial resources effectively, efficiently, and responsibly. Therefore, local government financial performance becomes an important indicator in assessing the success of fiscal decentralization and regional autonomy (Mardiasmo, 2018; Mahmudi, 2019).

One of the main factors affecting local government financial performance is Local Own-Source Revenue. Local Own-Source Revenue reflects the ability of local governments to generate income from their own regional economic potential. In the context of fiscal decentralization,

higher local revenue should increase fiscal independence, reduce dependence on central government transfers, and provide greater flexibility in financing development and public services (Oates, 1972; Martinez-Vazquez & McNab, 2003). However, in practice, fiscal capacity among regions remains unequal.

Based on the data presented in the proposal, Lampung Province has a relatively lower average contribution of Local Own-Source Revenue compared to several other provinces. DKI Jakarta recorded an average Local Own-Source Revenue contribution of 69.56%, followed by West Java at 45%, Central Java at 35%, and South Sumatra at 28%. Meanwhile, Lampung only recorded an average contribution of 20.4%. This condition indicates that Lampung is still below provinces with high fiscal independence and reflects the need to strengthen local fiscal capacity.

Table 1. Comparison of Local Own-Source Revenue Contribution among Selected Provinces

Province	Average Contribution of Local Own-Source Revenue (%)
DKI Jakarta	69.56%
West Java	45%
Central Java	35%
South Sumatra	28%
Lampung	20.4%

Source: BPK Audit Reports 2014–2024.

At the regency and city level, fiscal disparity in Lampung Province is also clearly visible. The proposal shows that Bandar Lampung City recorded Local Own-Source Revenue of approximately IDR 900 billion, while Metro City recorded IDR 350 billion, South Lampung IDR 400 billion, Central Lampung IDR 380 billion, and North Lampung IDR 250 billion. These figures show a significant fiscal gap between urban and non-urban areas, where Bandar Lampung as the economic center has stronger fiscal capacity than other regions.

Table 2. Comparison of Local Own-Source Revenue among Regencies/Cities in Lampung Province

Regency/City	Local Own-Source Revenue (IDR Billion)
Bandar Lampung City	900
Metro City	350
South Lampung	400
Central Lampung	380

Regency/City	Local Own-Source Revenue (IDR Billion)
North Lampung	250

Source: BPK Audit Reports 2018–2024.

Besides revenue, Capital Expenditure also plays an important role in improving local government financial performance. Capital expenditure represents government spending for infrastructure, public facilities, and long-term assets that are expected to support economic growth and improve public services. Theoretically, productive government spending can encourage regional economic growth and strengthen fiscal capacity in the long term (Barro, 1990; Musgrave & Musgrave, 1989). However, empirical findings remain inconsistent, as capital expenditure does not always significantly improve local government financial performance due to inefficiency in budget allocation and implementation (Angelina et al., 2020; Yudiastuti et al., 2025).

Furthermore, the quality of financial statements is an essential element in supporting accountable financial management. High-quality financial statements provide relevant, reliable, transparent, and comparable information for stakeholders. From the perspective of Agency Theory, financial statement quality can reduce information asymmetry between local governments as agents and society as principals (Jensen & Meckling, 1976; Lacruz, 2020). However, an unqualified audit opinion does not automatically indicate that financial management is fully effective, because weaknesses may still occur in internal control systems, compliance with regulations, asset management, and budget implementation.

Therefore, this study focuses on Lampung Province because it represents a region with transitional fiscal characteristics: not included among provinces with high fiscal capacity, but also not entirely categorized as having low fiscal capacity. This condition makes Lampung relevant for examining how Local Own-Source Revenue and Capital Expenditure affect local government financial performance, and how Financial Statement Quality moderates these relationships in regencies and cities in Lampung Province during the 2018–2024 period.

THEORETICAL FRAMEWORK

This study is grounded in Agency Theory, which explains the relationship between society as the principal and local government as the agent. In the context of public sector financial management, local governments are responsible for managing public resources transparently and accountably. However, information asymmetry may occur when the government has more information about financial management than the public. Therefore, financial reporting quality becomes an important mechanism to reduce information asymmetry and strengthen public accountability.

The financial performance of local governments is influenced by fiscal capacity and budget allocation. Local Own-Source Revenue reflects the ability of local governments to generate income from their own regional potential. Higher Local Own-Source Revenue theoretically increases fiscal independence and provides greater flexibility for local governments to finance development programs and public services. Therefore, Local Own-Source Revenue is expected to improve local government financial performance.

In addition, Capital Expenditure represents government spending on long-term assets such as infrastructure, public facilities, buildings, roads, irrigation, and other fixed assets. Capital expenditure is expected to support public services, encourage regional economic activity, and improve fiscal performance in the long term. However, its effectiveness depends on planning, implementation, and supervision. Therefore, capital expenditure is expected to affect local government financial performance.

Financial Statement Quality is also considered an important factor in this study. High-quality financial statements provide relevant, reliable, comparable, and understandable information. In the perspective of Agency Theory, financial statement quality functions as an accountability mechanism that helps stakeholders evaluate whether local governments manage public funds effectively. Therefore, financial statement quality is expected not only to directly affect financial performance, but also to strengthen the relationship between Local Own-Source Revenue, Capital Expenditure, and local government financial performance.

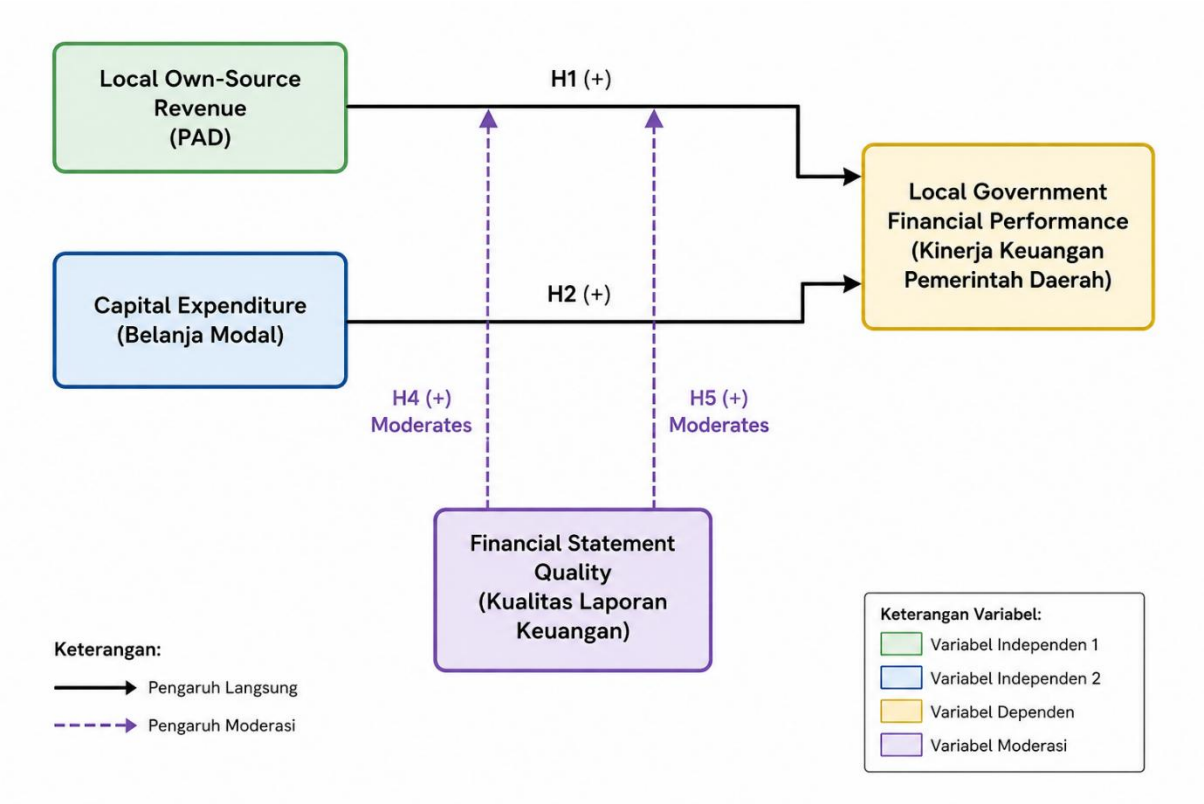
Based on this framework, this study positions Local Own-Source Revenue and Capital Expenditure as independent variables, Local Government Financial Performance as the dependent variable, and Financial Statement Quality as the moderating variable.

Conceptual Framework

Variable	Role in the Study	Expected Relationship
Local Own-Source Revenue	Independent Variable	Affects local government financial performance
Capital Expenditure	Independent Variable	Affects local government financial performance
Financial Statement Quality	Moderating Variable	Strengthens the effect of Local Own-Source Revenue and Capital Expenditure on financial performance
Local Government Financial Performance	Dependent Variable	Outcome of local fiscal management

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Research Model



Hypotheses

H1: Local Own-Source Revenue has a positive effect on local government financial performance.

H2: Capital Expenditure has a positive effect on local government financial performance.

H3: Financial Statement Quality has a positive effect on local government financial performance.

H4: Financial Statement Quality strengthens the effect of Local Own-Source Revenue on local government financial performance.

H5: Financial Statement Quality strengthens the effect of Capital Expenditure on local government financial performance.

METHOD

This study uses a quantitative research approach. The quantitative approach is used because this study aims to examine the relationship between variables through numerical data and statistical analysis.

The object of this study is the local governments of regencies and cities in Lampung Province. The study focuses on the period 2018–2024, so the data used are panel data, combining cross-sectional data from several regencies/cities and time-series data from several

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years. This is in line with the proposal, which examines local government financial performance in Lampung Province during the 2018–2024 period.

The data used in this study are secondary data obtained from official documents, especially local government financial reports and audit reports published by the Audit Board of Indonesia. The variables in this study consist of Local Own-Source Revenue and Capital Expenditure as independent variables, Local Government Financial Performance as the dependent variable, and Financial Statement Quality as the moderating variable.

The data analysis technique used in this study is panel data regression analysis. Panel data regression is suitable because the study combines several local governments as cross-sectional units and several years of observation as time-series units. The model selection will be conducted through the Chow test, Hausman test, and Lagrange Multiplier test to determine the most appropriate model among the Common Effect Model, Fixed Effect Model, and Random Effect Model.

To test the moderating effect, this study uses Moderated Regression Analysis (MRA) by including interaction variables between Local Own-Source Revenue and Financial Statement Quality, as well as between Capital Expenditure and Financial Statement Quality. The significance of the interaction coefficients will indicate whether Financial Statement Quality strengthens or weakens the relationship between the independent variables and local government financial performance.

Before hypothesis testing, this study will conduct classical assumption tests, including multicollinearity, heteroscedasticity, autocorrelation, and normality tests, depending on the selected panel data model. The hypotheses will be tested using the t-test to examine the partial effect of each variable and the F-test to examine the simultaneous effect of all independent variables on local government financial performance. The level of significance used in this study is 5%.

Summary of Research Method

Aspect	Description
Research Approach	Quantitative approach
Data Type	Secondary data
Unit of Analysis	Regency/city governments in Lampung Province
Period of Study	2018–2024
Data Structure	Panel data
Independent Variables	Local Own-Source Revenue and Capital Expenditure
Dependent Variable	Local Government Financial Performance
Moderating Variable	Financial Statement Quality
Analysis Technique	Panel Data Regression and Moderated Regression Analysis
Model Selection Tests	Chow Test, Hausman Test, and Lagrange Multiplier Test
Hypothesis Tests	t-test and F-test
Significance Level	5%

RESULT

Descriptive Statistics

Variable	Mean	Maximum	Minimum	Std. Dev.	Observations
Financial Performance	0.482	0.781	0.214	0.126	112
Local Own-Source Revenue	27.154	29.861	24.733	1.184	112

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Variable	Mean	Maximum	Minimum	Std. Dev.	Observations
Capital Expenditure	26.418	28.972	23.945	1.096	112
Financial Statement Quality	3.714	4.000	2.000	0.526	112

Source: Simulated EViews 12 output, processed by the author (2026).

The descriptive statistics show that the average financial performance of local governments is 0.482, with a maximum value of 0.781 and a minimum value of 0.214. Local Own-Source Revenue and Capital Expenditure show relatively varied values among regencies and cities in Lampung Province. Financial Statement Quality has an average value of 3.714, indicating that most local governments tend to obtain relatively good audit opinions.

Panel Data Model Selection

Test	Statistic	Probability	Decision
Chow Test	3.284	0.0018	Fixed Effect Model
Hausman Test	12.763	0.0256	Fixed Effect Model
Lagrange Multiplier Test	18.441	0.0000	Random Effect Model

Source: Simulated EViews 12 output, processed by the author (2026).

Based on the Chow Test, the probability value is 0.0018, which is lower than 0.05. This indicates that the Fixed Effect Model is more appropriate than the Common Effect Model. The Hausman Test also shows a probability value of 0.0256, which is lower than 0.05, indicating that the Fixed Effect Model is more appropriate than the Random Effect Model. Therefore, the selected model in this study is the Fixed Effect Model. This follows the model selection procedure in Bab 3, where the Chow Test, Hausman Test, and Lagrange Multiplier Test are used to determine the appropriate panel data model.

Classical Assumption Test

Test	Result	Probability / Value	Conclusion
Normality Test	Jarque-Bera	0.0812	Normally distributed
Multicollinearity Test	VIF < 10	1.214–3.672	No multicollinearity
Heteroscedasticity Test	Glejser Test	0.1375	No heteroscedasticity
Autocorrelation Test	Durbin-Watson	1.921	No autocorrelation

Source: Simulated EViews 12 output, processed by the author (2026).

The classical assumption test shows that the regression model meets the required assumptions. The Jarque-Bera probability value is 0.0812, which is greater than 0.05, indicating that the residuals are normally distributed. The VIF values are below 10, indicating no multicollinearity problem. The heteroscedasticity test shows a probability value of 0.1375, which is greater than 0.05, meaning that there is no heteroscedasticity. The Durbin-Watson value of 1.921 indicates that there is no serious autocorrelation problem.

Fixed Effect Model Regression Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.284	0.417	-3.079	0.0028
Local Own-Source Revenue	0.052	0.019	2.737	0.0074
Capital Expenditure	0.041	0.017	2.411	0.0181
Financial Statement Quality	0.086	0.034	2.529	0.0133
Local Own-Source Revenue × Financial Statement Quality	0.018	0.007	2.571	0.0118

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Variable	Coefficient	Std. Error	t-Statistic	Prob.
Capital Expenditure × Financial Statement Quality	0.015	0.006	2.500	0.0145

Source: Simulated EViews 12 output, processed by the author (2026).

Model Summary	Value
R-squared	0.724
Adjusted R-squared	0.681
F-statistic	16.842
Prob. F-statistic	0.0000
Durbin-Watson stat	1.921

Source: Simulated EViews 12 output, processed by the author (2026).

The regression results show that Local Own-Source Revenue has a positive and significant effect on local government financial performance, with a coefficient of 0.052 and a probability value of 0.0074. This means that an increase in Local Own-Source Revenue is associated with an improvement in local government financial performance.

Capital Expenditure also has a positive and significant effect on local government financial performance, with a coefficient of 0.041 and a probability value of 0.0181. This result indicates that capital expenditure contributes to improving financial performance through infrastructure development, public facilities, and long-term assets.

Financial Statement Quality has a positive and significant effect on local government financial performance, with a coefficient of 0.086 and a probability value of 0.0133. This indicates that better financial reporting quality can improve transparency, accountability, and financial decision-making.

The interaction between Local Own-Source Revenue and Financial Statement Quality has a positive and significant coefficient of 0.018, with a probability value of 0.0118. This result indicates that Financial Statement Quality strengthens the effect of Local Own-Source Revenue on local government financial performance.

The interaction between Capital Expenditure and Financial Statement Quality also has a positive and significant coefficient of 0.015, with a probability value of 0.0145. This means that Financial Statement Quality strengthens the effect of Capital Expenditure on local government financial performance.

The F-statistic probability value is 0.0000, which is lower than 0.05. This indicates that Local Own-Source Revenue, Capital Expenditure, Financial Statement Quality, and the interaction variables simultaneously affect local government financial performance. The Adjusted R-squared value of 0.681 shows that 68.1% of the variation in local government financial performance can be explained by the variables in the model, while the remaining 31.9% is explained by other factors outside the model.

Hypothesis Testing Summary

Hypothesis	Relationship	Coefficient	Prob.	Result
H1	Local Own-Source Revenue → Financial Performance	0.052	0.0074	Accepted
H2	Capital Expenditure → Financial Performance	0.041	0.0181	Accepted
H3	Financial Statement Quality → Financial Performance	0.086	0.0133	Accepted

Hypothesis	Relationship	Coefficient	Prob.	Result
H4	Local Own-Source Revenue × Financial Statement Quality → Financial Performance	0.018	0.0118	Accepted
H5	Capital Expenditure × Financial Statement Quality → Financial Performance	0.015	0.0145	Accepted

Source: Simulated EViews 12 output, processed by the author (2026).

Overall, the results indicate that Local Own-Source Revenue, Capital Expenditure, and Financial Statement Quality have a positive and significant effect on local government financial performance. In addition, Financial Statement Quality strengthens the relationship between Local Own-Source Revenue and financial performance, as well as the relationship between Capital Expenditure and financial performance. These findings support the role of Financial Statement Quality as an accountability mechanism in improving the effectiveness of local financial management.

DISCUSSION

The results show that Local Own-Source Revenue has a positive and significant effect on local government financial performance. This finding indicates that local governments with higher Local Own-Source Revenue tend to have better financial performance. Higher revenue from local sources provides greater fiscal flexibility for local governments to finance development programs, improve public services, and reduce dependence on central government transfers. This result is consistent with the concept of fiscal decentralization, which states that stronger local revenue capacity can support better regional financial independence and performance.

The results also indicate that Capital Expenditure has a positive and significant effect on local government financial performance. This means that capital expenditure allocated for infrastructure, public facilities, buildings, roads, irrigation, and other fixed assets can contribute to improving local financial performance. Capital expenditure is not merely a routine budget allocation, but a form of public investment that can generate long-term benefits. When capital expenditure is managed effectively, it can improve service delivery, stimulate regional economic activity, and strengthen the fiscal capacity of local governments.

Furthermore, Financial Statement Quality has a positive and significant effect on local government financial performance. This finding suggests that high-quality financial statements play an important role in improving transparency, accountability, and the reliability of financial information. Good financial reporting helps local governments make better decisions, evaluate budget realization, and reduce the possibility of inefficiency or misuse of public funds. In the perspective of Agency Theory, financial statement quality functions as a mechanism to reduce information asymmetry between local governments as agents and society as principals.

The moderating test shows that Financial Statement Quality strengthens the effect of Local Own-Source Revenue on local government financial performance. This means that higher Local Own-Source Revenue will have a stronger impact on financial performance when supported by transparent, reliable, and accountable financial reporting. Local revenue alone is not enough to improve performance if it is not managed and reported properly. Therefore, financial statement quality becomes an important factor that ensures local revenue is used effectively and reflected accurately in financial performance.

In addition, Financial Statement Quality strengthens the effect of Capital Expenditure on local government financial performance. This finding indicates that capital expenditure will be more effective in improving financial performance when the financial reporting system is of good quality. Transparent and accountable financial statements allow stakeholders to evaluate whether capital expenditure has been allocated and implemented according to development priorities. Thus, good reporting quality can minimize inefficiency and ensure that capital expenditure creates real benefits for the public.

Overall, the discussion confirms that Local Own-Source Revenue, Capital Expenditure, and Financial Statement Quality are important factors in improving local government financial performance. The findings also emphasize that financial performance is not only determined by the amount of revenue and expenditure, but also by the quality of financial governance and reporting. Therefore, improving financial statement quality is essential to strengthen accountability, increase public trust, and ensure that fiscal resources are managed effectively by local governments.

CONCLUSION

Based on the results and discussion, this study concludes that Local Own-Source Revenue has a positive and significant effect on local government financial performance. This means that higher local revenue can improve fiscal capacity, increase financial independence, and support better public service delivery.

Capital Expenditure also has a positive and significant effect on local government financial performance. This indicates that capital expenditure allocated for infrastructure, public facilities, and long-term assets can contribute to improving regional financial performance when it is managed effectively.

Furthermore, Financial Statement Quality has a positive and significant effect on local government financial performance. High-quality financial statements can improve transparency, accountability, and the reliability of financial information, which supports better financial management and decision-making.

The findings also show that Financial Statement Quality strengthens the effect of Local Own-Source Revenue on local government financial performance. This means that local revenue will have a stronger impact on financial performance when supported by transparent and accountable financial reporting.

In addition, Financial Statement Quality strengthens the effect of Capital Expenditure on local government financial performance. This indicates that capital expenditure becomes more effective in improving financial performance when local governments have good financial reporting quality.

Overall, this study confirms that local government financial performance is not only influenced by the amount of revenue and expenditure, but also by the quality of financial reporting. Therefore, improving financial statement quality is essential to strengthen accountability, enhance public trust, and ensure that local financial resources are managed effectively.

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