



The Role Of Central Transfer Funds In Increasing The Impact Of Capital Expenditure And The Size Of Local Government On Regional Financial Performance In Java Island

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ABSTRACT

This study aims to analyze the role of central transfer funds in increasing the influence of capital expenditure and local government size on regional financial performance in districts/cities across Java for the period 2019–2023. A quantitative approach was applied using secondary data obtained from the Directorate General of Fiscal Balance (DJPK) and audited Local Government Financial Reports (LKPD) issued by the Supreme Audit Agency (BPK). Regional financial performance was measured using the fiscal independence ratio, capital expenditure was assessed through its proportion to total regional expenditure, and local government size was proxied by total assets. Data analysis was performed using panel data regression with the Moderated Regression Analysis (MRA) method. The results show that capital expenditure has a negative and insignificant effect on regional financial performance, while local government size shows a negative and significant effect. Central transfer funds are also found to have a negative and significant impact on performance. Furthermore, central transfer funds strengthen the relationship between local government size and financial performance but do not moderate the effect of capital expenditure. These findings highlight the need for more efficient capital management and strategic utilization of central transfers to enhance fiscal independence in Java.

INTRODUCTION

Regional financial management plays a crucial role in strengthening public accountability and ensuring the sustainability of regional development. In the context of fiscal decentralization, the quality of financial management reflects the ability of local governments to mobilize local own-source revenue (PAD) and allocate expenditures effectively in order to support public services and development programs. A higher level of fiscal independence indicates that a region is less dependent on central government assistance and is more capable of managing its financial resources responsibly (Mahmudi, 2019).

Since the implementation of regional autonomy in Indonesia, local governments have been granted broader authority to manage their fiscal affairs. This authority was further reinforced through Law Number 1 of 2022 concerning Financial Relations between the Central Government and Regional Governments (HKPD), which emphasizes fiscal independence, optimization of PAD, and accountable management of intergovernmental transfer funds. Under this regulatory framework, local governments are expected to gradually reduce fiscal dependence on the central government through improved revenue capacity and more effective expenditure management.

Java Island represents a relevant empirical setting for examining regional financial performance, as it serves as the economic center of Indonesia and consistently contributes more than half of national gross domestic product. Compared to the national average, regions on Java generally show a relatively better level of fiscal independence. Most provinces on Java have reached a moderate level of fiscal independence, including West Java (70.10%), Central Java (67.06%), East Java (66.09%), DKI Jakarta (69.15%), and Banten (73.55%). However, Yogyakarta Special Region is still lagging behind with a ratio of only 40.56%, placing it in the low category. This disparity indicates that despite strong economic capacity, fiscal independence across regions on Java remains uneven and highly dependent on the effectiveness of regional revenue management and expenditure policies (BPS, 2023; Sanur, 2025).

One of the key components of regional expenditure expected to support long-term fiscal capacity is capital expenditure. Capital expenditure is intended to generate productive public assets and infrastructure that enhance service delivery and stimulate regional economic activity. However, empirical evidence indicates that the proportion of capital expenditure in regional budgets remains relatively limited, with a substantial share of spending still allocated to routine and operational expenditures (BPK RI, 2024). This condition raises concerns regarding the effectiveness of capital expenditure in improving regional financial performance.

In addition to expenditure structure, the size of local government also plays an important role in shaping fiscal outcomes. Local government size, commonly proxied by total assets, reflects the scale and complexity of public resource management. While larger asset ownership may indicate stronger fiscal capacity, it may also create financial pressure due to higher maintenance costs, administrative complexity, and operational expenditures. As a result, larger government size does not necessarily lead to better financial performance if asset utilization is not managed efficiently (Rahayu and Hendaris, 2022).

Central government transfer funds remain the largest source of most local governments in Indonesia. These transfers are designed to strengthen fiscal capacity and reduce interregional disparities. Nevertheless, extensive reliance on transfer funds may weaken incentives for local governments to optimize PAD, leading to fiscal dependency. Previous studies highlight the presence of the flypaper effect, where regional expenditure responds more strongly to transfer funds than to increases in own-source revenue, potentially limiting improvements in fiscal independence (Dick-sagoe and Tingum, 2021).

Although numerous studies have examined the direct effects of capital expenditure and local government size on regional financial performance, empirical evidence regarding the moderating role of central transfer funds remains limited, particularly for district and city

governments on Java Island during the 2019-2023 period. Therefore, this study aims to analyze the role of central transfer funds in strengthening or weakening the influence of capital expenditure and local government size on regional financial performances, as measured by the fiscal independence ratio. This research is expected to contribute to the public sector accounting literature and provide policy-relevant insights for improving regional fiscal sustainability in Indonesia.

LITERATURE REVIEW

Stewardship (Stewardship Theory)

Stewardship theory explains that public officials are intrinsically motivated to act in the collective interest and to prioritize organizational objectives over personal gain. Unlike agency theory, which emphasizes control mechanisms, stewardship theory highlights trust, professionalism, and ethical responsibility as key drivers of organizational performance (Keay, 2017).

Within local government financial management, stewardship theory implies that regional leaders and administrative officials are responsible for optimizing public expenditure and managing government assets to support sustainable development outcomes. Financial performance, therefore, reflects not only compliance with regulations but also the collective commitment of public officials to act in public interest (Lanita and Rachmawati, 2020). Empirical studies confirm that stewardship-oriented governance strengthens accountability and improves the quality of public financial management (Amalia *et al.*, 2024).

From this perspective, capital expenditure, local government size, and the utilization of central transfer funds represent key instruments through which stewardship responsibilities are exercised. Productive capital investment and effective asset management indicate a commitment to long-term fiscal sustainability, while the strategic use of transfer funds reflects the ability of local governments to balance autonomy and intergovernmental support. Accordingly, stewardship theory provides a relevant theoretical framework for examining the relationship between capital expenditure, government size, and regional financial performance, as well as the moderating role of central transfers funds.

Regional Financial Report Performance

Regional financial performance reflects the ability of local governments to finance public administration, development programs, and public services independently. One of the most widely used indicators to measure this capacity is the fiscal independence ratio, which compares local own-source revenue (PAD) to total regional revenue (Halim, 2007; Mahmudi, 2019). A higher ratio indicates stronger fiscal autonomy and reduced dependence on intergovernmental transfers.

Fiscal independence is a critical indicator of sound public financial management, as it demonstrates the sustainability of regional revenue capacity and the effectiveness of fiscal decentralization policies (Sanur, 2025). Regions with higher fiscal independence trend to have greater flexibility in determining development priorities and are less constrained by transfer allocation rules. Conversely, low fiscal independence indicates structural reliance on external funding and limited fiscal discretion (Aryani, 2021).

This study adopts the fiscal independence ratio as a proxy for regional financial performance because it directly captures the effectiveness of revenue mobilization and expenditure management. Previous studies have emphasized that the indicator is particularly relevant for evaluating whether fiscal policies strengthen regional capacity or perpetuate dependency on central government support (Remanta and Ramadhan, 2024).

Capital Expenditure

Government Regulation No. 12 of 2019 defines capital expenditure refers to government spending aimed at acquiring or improving long-term assets that provide benefits beyond a single fiscal period. In the context of regional development, effective capital expenditure is expected to support infrastructure provision and enhance public service delivery, thereby contributing to long-term fiscal sustainability (Aryani, 2021).

However, empirical evidence indicates that the proportion of capital expenditure in regional budgets remains relatively limited, with a substantial share of spending still allocated to routine and operational expenditures (BPK RI, 2024). As a result, the contribution of capital expenditure to improving fiscal independence is often constrained. Inefficient planning, delayed project implementation, and weak monitoring mechanisms may further reduce the effectiveness of capital expenditure in enhancing regional financial performance (Indriastuti and Satriawan, 2023).

Furthermore, Siraz (2023) emphasizes the importance of applying the Analysis of Standard Expenditure (ASB) to ensure that capital expenditure is planned and executed efficiently, economically, and effectively. Proper implementation of ASB can minimize budget inefficiencies and strengthen accountability in regional financial management. These findings suggest that increased capital expenditure does not automatically improve fiscal outcomes unless supported by strong expenditure planning and control mechanisms.

Size of Local Government

The size of local government reflects the scale and complexity of public resource management within a region. It is commonly proxied by total government assets, which represent the economic resources controlled by local governments to support public service provision and development activities (Putri and Amanah, 2020). Larger asset ownership may indicate greater fiscal capacity, but it also implies broader administrative responsibilities.

Previous studies indicate that larger government size is often associated with increased operational complexity and higher maintenance costs, which can place pressure on regional finances if not managed efficiently (Ernawati *et al.*, 2023). Without effective asset utilization, the financial burden of asset maintenance may outweigh potential fiscal benefits, thereby reducing financial performance.

Rahayu and Hendaris (2022) highlight that effective asset management is a critical determinant of regional financial performance. Their findings suggest that asset size alone does not guarantee improved fiscal outcomes unless supported by strong governance and efficient utilization strategies. Therefore, the relationship between local government size and regional financial performance depends largely on how assets are managed and integrated into development planning.

Central Transfer Funds

Central transfer funds represent a dominant component of local government revenue and play a strategic role in supporting fiscal decentralization and regional development. Rather than merely serving as revenue supplements, these funds are designed to reduce interregional fiscal disparities and enhance the capacity of local governments to deliver public services (DJPK, 2023). In Indonesia, central transfers primarily consist of Revenue Sharing Funds (DBH), General Allocation Funds (DAU), and Special Allocations Funds (DAK), each with distinct allocation mechanisms and policy objectives. While DAU functions as a block grant intended to equalize fiscal capacity, DAK is earmarked for specific priority sectors and development programs. Empirical studies indicate that these transfer instruments differ in their effectiveness, with DAK more likely to encourage productive expenditure, whereas DAU provides greater flexibility for financing routine government activities (Fitriani and Hendaris, 2023).

In the public finance literature, central transfers funds are frequently associated with the flypaper effect, whereby local government spending responds more strongly to transfers than to increases in own-source revenue (Dick-sagoe and Tingum, 2021). This phenomenon suggests that although transfer funds expand fiscal capacity, excessive reliance on them may weaken incentives to optimize local revenue generation. Nevertheless, transfers may also serve as fiscal stabilizers in the long term if they are managed effectively. Porto and Puig (2023) emphasize that the impact of transfer funds on fiscal performance largely depends on their allocation toward productive expenditure rather than routine spending. Therefore, the effectiveness of central transfer funds ultimately hinges on how local governments integrate these resources into strategic budgeting and fiscal management practices to support sustainable regional financial performance.

METHODS

This study uses quantitative methods. According to Sugiyono (2020, p 7) quantitative research methods are as follows:

"Quantitative research methods can be defined as research methods based on positivism philosophy, used to study a specific population or sample, with data collection using research instruments, quantitative/statistical data analysis, with the aim of testing predetermined hypotheses."

The data used in this study is secondary data, obtained from official publications of the Directorate General of Fiscal Balance (DJPK) of the Ministry of Finance of the Republic of Indonesia and the Supreme Audit Agency (BPK) for the period 2019–2023. Secondary data is data that has been collected, processed, and published by other parties, for example in the form of tables, financial reports, graphs, and statistical documents Sugiyono (2020, p 137). The location of this study covers regencies/cities on the island of Java, including the provinces of Banten, West Java, Central Java, East Java, DKI Jakarta, and DI Yogyakarta. The data used in this study includes capital expenditure and central transfer fund data obtained from official publications of the Directorate General of Fiscal Balance (DJPK) of the Ministry of Finance, data on the size of local governments proxied by total assets in the Local Government Financial Reports (LKPD) audited by the Supreme Audit Agency (BPK), and data on regional financial performance measured by the independence ratio, sourced from the DJPK and the Central Statistics Agency (BPS). This research was conducted from September 2025 until completion.

In quantitative research, variable operationalization is necessary so that each variable can be measured clearly and consistently. According to Paramita et al. (2021), variable operationalization is a technical explanation of how a variable will be measured in research, whether through indicators, dimensions, or instruments used.

Table 1. Operationalization of Research Variables

Variable	Concept	Indicator	Scale
Capital Expenditure (X1)	Regional government spending allocated for the acquisition of fixed assets that provide benefits for more than one accounting period (Government Regulation No. 12 of 2019).	Total realized capital expenditure in the Budget Realization Report (LRA), expressed in natural logarithm: Capital Expenditure = $\ln$ (Total Realized Capital Expenditure)	Ratio
Local Government Size (X2)	The size of fiscal capacity and the complexity of regional financial management, proxied by total regional assets (Agustina & Setyaningrum, 2022).	Total local government assets in the Regional Government Financial Statement (LKPD) Balance Sheet, expressed in natural logarithm: Local Government Assets = $\ln$ (Local Government Assets)	Ratio
Regional Financial Performance (Y)	The level of a region's ability to independently finance government administration, development, and public	Ratio of Local Own-Source Revenue (PAD) to Total Regional Revenue, calculated using the following formula: (PAD/Total Regional	Ratio

	services by utilizing Local Own-Source Revenue (PAD) (Mahmudi, 2019, p. 141).	Revenue) x 100%	
Central Government Transfer Funds (Z)	Funds sourced from the State Budget (APBN) and allocated to local governments to support the implementation of fiscal decentralization (DJPK, 2023).	Total realized central government transfer funds in the LKPD or Ministry of Finance data, expressed in natural logarithm: Central Government Transfers = $\ln$ (Central Government Transfers)	Ratio

Source: Data Processed (2025)

According to Paramita et al. (2021, p 73), data collection is the process of obtaining relevant data to answer research questions, either through surveys, experiments, or the use of secondary data. In this study, the data collection techniques used were documentation and literature review. The documentation technique was chosen because this study used secondary data sourced from official publications, namely:

1. Capital expenditure and central transfer fund data obtained from the Directorate General of Fiscal Balance (DJPK) of the Indonesian Ministry of Finance through the Local Government Budget Realization Report (LRA).
2. Data on the size of local governments, proxied by total assets, sourced from the Local Government Financial Reports (LKPD) audited by the Supreme Audit Agency (BPK RI).
3. Data on regional financial performance, measured by the independence ratio, sourced from DJPK and supplemented with supporting data from the Central Statistics Agency (BPS).

In addition, literature review techniques were used to obtain a theoretical basis and relevant previous research results. This study included searching for books, national and international journals, and regulatory documents such as Law Number 1 of 2022 concerning Financial Relations between the Central Government and Local Governments. The selection of these two techniques was based on the research requirements, which emphasized quantitative analysis based on official data and theoretical reinforcement. Thus, the data obtained is expected to be valid, accurate, and scientifically accountable.

With this method, researchers can identify patterns from a large amount of data, summarize the information obtained, and present it in a more systematic form so that it is easy to understand. In this study, descriptive statistics were used to describe the characteristics of the data from all research variables, namely capital expenditure (percentage of capital expenditure to total regional expenditure), the size of the regional government ($\ln$ total assets), central transfer funds (total transfer funds received by the region, including DAU, DAK, and DBH), and regional financial performance proxied by the fiscal independence ratio (PAD compared to total regional revenue). Classical Assumption Test

In this study, classical assumptions were tested, including normality, heteroscedasticity, and normality tests on the data.

Normality Test

The normality test was conducted to determine whether the residual data in the regression model was normally distributed. A good regression model requires normally distributed residuals in order for statistical tests to be valid. According to Ghazali (2021), the normality test aims to test whether the disturbance variables or residuals in the regression model are normally distributed. In this study, the normality test was performed using the Jarque-Bera (JB) test available in the EViews application. The decision criterion is that if the probability value (p-value) > 0.05, the residuals are normally distributed, whereas if the probability value ≤ 0.05, the residuals are not normally distributed.

Multicollinearity Test

According to Widarjono (2018, p 153), a multicollinearity test is a linear relationship between independent variables in a regression, which is used to determine whether there is a relationship between independent variables in a regression. The basis used in determining the presence or absence of multicollinearity is by looking at the value of the correlation test results.

The basis for deciding on multicollinearity testing is as follows:

- a. If the coefficient between independent variables is < 0.8 , it can be said that the model is free from multicollinearity.
- b. If the coefficient between independent variables is > 0.8 , it can be said that the model experiences multicollinearity.

In this study, the multicollinearity test is considered good if it is free from multicollinearity problems or, better yet, if there is no relationship between the independent variables.

1. Heteroscedasticity Test

The heteroscedasticity test is used to determine whether there is variance inequality of the residuals between observations in the regression model. A good regression model is one that meets the assumption of homoscedasticity, namely constant residual variance in all observations. Conversely, if the residual variance differs between one observation and another, this condition is called heteroscedasticity Ghazali (2021, p 134)

The basis for decision making is based on the probability value (p-value):

- a. If the p-value > 0.05 , then there is no heteroscedasticity.
- b. If the p-value ≤ 0.05 , then there is heteroscedasticity.

Model Goodness of Fit Test

According to (Ghozali, 2011), the goodness of fit test is conducted to measure the accuracy of the sample regression function in estimating actual values statistically.

1. Chow Test

The Chow test is used to determine the most appropriate panel data regression model between the Common Effect Model (CEM) and the Fixed Effect Model (FEM). According to Jauhari et al. (2020), the Chow test is conducted to test whether there is a significant difference between the two approaches. The basis for decision making is as follows:

- a. If the Chi-Square probability value (p-value) > 0.05 , then H_0 is accepted, so the model used is CEM.
- b. If the Chi-Square probability value (p-value) ≤ 0.05 , then H_0 is rejected, so the model used is FEM.

2. Hausman Test

The Hausman test was conducted to determine the more appropriate model between the Fixed Effect Model (FEM) and Random Effect Model (REM) after the Common Effect model was rejected through the Chow test. This test was used to see whether there was a correlation between individual effects and independent variables. According to Jauhari et al. (2020), the Hausman test uses Chi-Square statistics. The basis for decision making is as follows:

- a. If the probability value (p-value) $< 0.05 \rightarrow H_0$ is rejected, then the model selected is the Fixed Effect Model (FEM).
- b. If the probability value (p-value) $\geq 0.05 \rightarrow H_0$ is accepted, then the model used is the Random Effect Model (REM).

3. Lagrange Multiplier Test

According Jauhari et al. (2020), the Lagrange Multiplier Test (LM Test) is used to determine the most appropriate model between the Common Effect Model (CEM) and the Random Effect Model (REM). This test is used when the Common Effect model is still being considered and the results of previous tests have not directly rejected the existence of Random Effects.

RESULTS

In this study, the author aims to examine the role of central transfer funds in increasing the influence of capital expenditure and local government size on regional financial performance. This study was conducted on district/city governments on the island of Java during the period 2019-2023. The data used in this study is secondary data obtained from several sources. Data on capital expenditure, Local Own-Source Revenue (PAD), and central transfer funds were obtained through the official website of the Directorate General of Fiscal Balance (DJPK) of the Ministry of Finance of the Republic of Indonesia at www.djpk.kemenkeu.go.id. Meanwhile, data on total regional assets used to describe the size of regional governments was obtained from the Regional Government Financial Reports (LKPD) audited by the Supreme Audit Agency (BPK RI). All data is quantitative and measured in rupiah.

As explained in the research method, the variables of capital expenditure, local government size, and central transfer funds were converted into natural logarithms (Ln) for regression analysis purposes. Meanwhile, regional financial performance in the data description section is presented in percentages (%), but in the regression management process it is used in decimal form. Thus, the regression analysis uses Ln values for rupiah-based variables and decimal values for fiscal independence ratios, while the data development description continues to use the original figures for ease of understanding.

Based on the established sampling criteria, this study involved 113 district/city local governments on the island of Java with an observation period of 5 years, namely from 2019 to 2023. The data obtained amounted to 565 data points, which were further analyzed using a panel data analysis approach, followed by a moderation test, and finally concluded with partial and simultaneous conclusions.

Descriptive statistical analysis was conducted to provide an overview of the data for each variable used in this study. This analysis aims to determine the mean, minimum value, maximum value, and standard deviation of each variable, namely capital expenditure (X1), size of local government (X2), central transfer funds (Z), and regional financial performance (Y). Data processing in this study was performed using EViews software version 13. The results of the descriptive statistical analysis can be seen in the following table.

Table 2. Descriptive Statistics

Descriptive Statistic					
	N	Minimum	Maximum	Mean	Std. Deviation
Capital expenditure	565	24.77	29.39	26.528	0.6311
Local government size	565	26.33	33.21	29.205	0.7024
Central transfer fund	565	26.92	30.06	28.024	0.4438
Regional financial performance	565	0.06	0.91	0.215	0.1080

Source: EViews Output Results (Data Processed in 2025)

The results of descriptive statistical tests show that the independent variable of capital expenditure (X1) has a minimum value of 24.77 and a maximum value of 29.39, with an average of 26.528 and a standard deviation of approximately 0.6311. The relatively small standard deviation compared to the average indicates that the distribution of capital expenditure among districts/cities on the island of Java does not vary greatly. Thus, most regions have relatively similar levels of capital expenditure during the 2019-2023 period.

Furthermore, the independent variable of local government size (X2) has a minimum value of 26.33 and a maximum of 33.21, with an average of 29.205 and a standard deviation of 0.7024. This figure shows that the size of local governments on the island of Java varies, with some regions having considerable assets and others having smaller ones. This difference illustrates that the financial capacity and size of government organizations in each region are not the same.

Then, the central transfer fund variable (Z) as a moderating variable has a minimum value of 26.92 and a maximum value of 30.06, with an average of 28.024 and a standard deviation of 0.4438. The small standard deviation value indicates that the amount of central transfer funds received by regencies/cities is relatively even. This means that the distribution of funds from the central government does not show significant differences between regions. Meanwhile, the dependent variable of regional financial performance (Y) has a minimum value of 0.06 and a maximum value of 0.91, with an average of 0.215 and a standard.

Normality Test

A normality test is performed to determine whether the residual data in the regression model is normally distributed. The following are the results of the normality test.

Figure 1. Normality Test Results

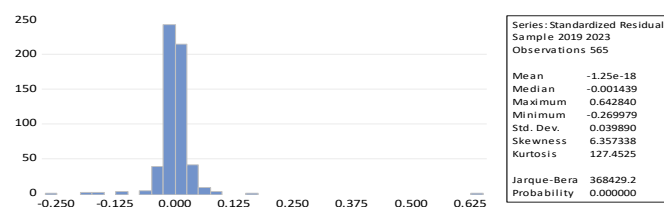


Image: Regional Financial Performance in Regencies/Cities across Java Island for the Period 2019-2023. Source: EViews Output Results (Data Processed in 2025)

It can be seen that the residual data distribution has not formed a symmetrical pattern. This can be seen from the Skewness value of 6.357338, which indicates that the data is skewed to the right, and the Kurtosis value of 127.4525, which indicates that the graph shape is very pointed, so that the graph is far from a normal distribution. The Jarque-Bera value of 368429.2 with a probability value (p-value) of 0.0000, which is less than 0.05, indicates that the residual data is not normally distributed. Thus, statistically, the regression model does not meet the normality assumption. However, in panel data regression with a relatively large number of observations, the normality assumption is not a strict requirement, as the parameter estimates remain consistent and unbiased under the Central Limit Theorem.

Multicollinearity Test

The multicollinearity test aims to determine whether there is a high relationship or correlation between independent variables in a regression model. The following are the results of the multicollinearity test.

Table 3. Multicollinearity Test Results

Variablei	X1	X2
X1	1.000000	0.703413
X2	0.703413	1.000000

Source: EViews Output Results (Data Processed in 2025)

Based on the multicollinearity test results, all correlation coefficients among the independent variables are below the threshold value of 0.8. This indicates that there is no serious multicollinearity problem in the regression model. Therefore, all independent variables can be included simultaneously in the regression analysis without causing biased or unstable coefficient estimates.

Heteroscedasticity Test

The heteroscedasticity test is used to determine whether there is variance inequality in the residuals between observations in the regression model. The following table shows the results of the heteroscedasticity test using the Glejser method.

Table 4. Heteroscedasticity Test Results

Variable	t-Statistic	Prob.
X1	-0.321653	0.7478
X2	-3.103550	0.0020

Source: EViews Output Results (Data Processed 2025)

Based on the results of the heteroscedasticity test conducted using the Glejser method in the table above, it was found that variable X1 had a probability value of 0.7478 (> 0.05), thus showing no indication of heteroscedasticity. Meanwhile, variable X2 has a probability value of 0.0020 (< 0.05), which indicates that this variable causes heteroscedasticity in the model. In other words, the regression model in this study still experiences heteroscedasticity.

Therefore, the researcher made improvements by using the heteroscedasticity-consistent standard errors (White) method in the main regression. This method serves to correct the standard error so that the t-test, F-test, and moderation analysis used are more accurate and not affected by heteroscedasticity. Therefore, all hypothesis testing in this study uses regression results that have been corrected using the White robust method.

The Chow test is used to determine the most appropriate panel data regression model between the Common Effect Model (CEM) and the Fixed Effect Model (FEM). The following are the results of the Chow test.

Table 5. Chow Test Results

Effect Test	Statistic	d.f.	Prob.
Cross-section F	9.585425	(112,449)	0.0000
Cross-section Chi-square	689.938743	112	0.0000

Source: EViews Output Results (Data Processed 2025)

The Hausman test is used to determine the most appropriate model between the Fixed Effect Model (FEM) and the Random Effect Model (REM). This test aims to determine whether differences between individuals in panel data have a fixed or random effect on the dependent variable. The following are the results of the Hausman test.

Table 6. Hausman Test Results

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	208.259886	3	0.0000

Source: EViews Output Results (Data Processed 2025)

The Lagrange Multiplier (LM) test is conducted to further examine whether the panel data model contains random effects and to compare the suitability of the Common Effect Model (CEM) and the Random Effect Model (REM). This test is applied as an additional robustness check within the model selection process. The following table presents the results of the Lagrange Multiplier test.

Table 7. Lagrange Multiplier Test Results

Null (no rand. effect) Alternative	Cross-section One-sided	Period One-sided	Both
Breusch-Pagan	154.4471 (0.0000)	56.45488 (0.0000)	210.9020 (0.0000)

Source: EViews Output Results (Data Processed 2025)

To determine the most appropriate panel data regression model, a sequence of model selection tests was conducted, including the Chow test, Hausman test, and Lagrange Multiplier test. The Chow test results indicate that the Fixed Effect Model (FEM) is more appropriate than the Common Effect Model (CEM), as the probability value (p-value) is below the 5% significance level. Furthermore, the Hausman test confirms that the FEM is preferred over the Random Effect Model (REM), indicating a significant correlation between individual effects and the explanatory variables. Although the Lagrange Multiplier test suggests that the Random Effect Model is statistically preferable to the Common Effect Model, this test is employed only as a robustness check. Based on the consistent results of the Chow and Hausman tests, the Fixed Effect Model (FEM) is selected as the final estimation model in this study.

Moderated Regression Analysis (MRA) was conducted to determine whether the Central Transfer Fund (Z) variable could strengthen or weaken the influence of Capital Expenditure (X_1) and Local Government Size (X_2) on Regional Financial Performance (Y). The following are the results of the Moderated Regression Analysis (MRA).

Table 8. Moderated Regression Analysis (MRA) Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	24.61298	4.903435	5.019537	0.0074
X1	-0.075987	0.158378	-0.479780	0.6564
X2	-0.756300	0.260305	-2.905439	0.0439
Z	-0.903771	0.174757	-5.171570	0.0066
X1Z	0.003452	0.005450	0.633447	0.5609
X2Z	0.027244	0.009003	3.025950	0.0389

Source: EViews Output Results (Data Processed 2025)

Based on the results of the Moderated Regression Analysis (MRA) in the table above, it shows that:

- Capital expenditure (X_1) has a regression coefficient value of -0.075987 with a probability value of 0.6564 (> 0.05), indicating that capital expenditure has a negative and insignificant effect on regional financial performance, even after the moderating variable is included in the model. This means that capital expenditure has not yet provided a measurable contribution to improving fiscal independence.
- The size of the local government (X_2) has a regression coefficient value of -0.756300 with a probability value of 0.0439 (< 0.05), which means that the local government size has a negative and significant effect on regional financial performance. This indicates that an

- increase in regional assets tends to reduce fiscal independence, likely because larger asset ownership requires higher maintenance and operational costs that burden regional finances.
- c. Central transfer funds (Z) have a regression coefficient of -0.903771 and a probability value of 0.0066 (< 0.05), indicating that central transfer funds have a negative and significant effect on regional financial performance. This shows that greater reliance on central transfers is associated with lower regional fiscal independence, reflecting the presence of the flypaper effect where regions depend more on external funds than on strengthening their own source revenues.
 - d. The interaction between capital expenditure and central transfer funds (X1Z) has a coefficient of 0.003452 with a probability value of 0.5609 (> 0.05), indicating that central transfer funds do not moderate the effect of capital expenditure on regional financial performance. In other words, the transfer funds received by the region do not make capital expenditure more effective in improving regional financial performance.
 - e. The interaction between local government size and central transfer funds (X2Z) has a coefficient of 0.027244 with a probability value of 0.0389 (< 0.05), which means that central transfer funds act as a significant moderating variable that strengthens the influence of the local government size on regional financial performance. This implies that regions with larger asset bases are better able to utilize central transfer funds to improve fiscal independence, provided that asset management is carried out effectively.

DISCUSSION

This study aims to analyze whether central transfer funds strengthen the effect of capital expenditure and local government size on regional financial performance. The study is important because fiscal independence remains a challenge in many regions. The main findings are discussed as follows.

The Effect of Capital Expenditure on Regional Financial Performance

Based on the t-test results, the capital expenditure variable (X_1) has a coefficient of -0.075987 with a probability value of 0.6564 (> 0.05). This result shows that capital expenditure has a negative and insignificant effect on regional financial performance. In other words, increases in capital spending have not yet produced a measurable contribution to improving fiscal independence among district and city governments in Java.

This finding suggests that capital expenditure allocation in many regions has not been optimally managed. As described in the theoretical review, capital expenditure should ideally create productive public assets that support service delivery and stimulate economic activity. However, previous studies highlight common challenges such as weak planning quality, implementation delays, and a dominance of infrastructure spending whose benefits are long term and not directly reflected in fiscal performance. These results are consistent with Indriastuti & Satriawan (2023) who state that capital expenditure may fail to significantly improve fiscal performance due to ineffective project execution and minimal supervision. This is also aligned with Fernandes & Putri (2022), who found that capital expenditure in various regions has not yet generated economically productive outcomes that enhance fiscal independence.

The Effect of Local Government Size on Regional Financial Performance

Based on the t-test results, the results show that local government size (X_2) has a coefficient value of -0.756300 with a probability of 0.0439 (< 0.05). This result indicates that local government size has a negative and significant effect on regional financial performance. This means that larger assets owned by local governments do not automatically increase fiscal independence; in fact, they may reduce it.

Practically, regions with large assets usually face greater bureaucratic complexity, high asset maintenance costs, and increased operational needs. These conditions can cause fiscal pressure that prevents financial performance from improving even though asset size increases. This finding is consistent with Nur and Murwaningsari (2020), who report that the size of local government assets does not significantly enhance financial performance due to ineffective asset management, and is further supported by Destiani *et al.* (2025), who argue that large asset holdings may become a fiscal burden when not accompanied by adequate governance practices.

The Moderating Effect of Central Transfer Funds on the Relationship Between Capital Expenditure and Financial Performance

Based on the results of the Moderated Regression Analysis (MRA) test, the interaction between capital expenditure and central transfer funds (X_1Z) has a coefficient of 0.003452 with a probability of 0.5609 (> 0.05). This means that central transfer funds do not act as a moderating variable in the relationship between capital expenditure and regional financial performance.

These results show that although central transfer funds increase regional fiscal capacity, this allocation has not strengthened the effectiveness of capital expenditure. This is because the structure of transfer fund usage is still dominated by mandatory expenditures such as personnel and basic services, thereby limiting its contribution to productive capital expenditure.

This finding is consistent with Fernandes and Putri (2022), who find that central government transfers do not have a significant effect due to their absorption being concentrated primarily on operational expenditures. Furthermore, the flypaper effect phenomenon, as documented by Lani *et al.* (2024), also supports this result, indicating that regional spending behavior is more strongly influenced by transfer funds than by the optimization of local own-source revenue (PAD). Consequently, capital expenditure does not function effectively as an instrument for enhancing fiscal independence.

The Moderating Effect of Central Transfer Funds on the Relationship Between Local Government Size and Financial Performance

Based on the results of the Moderated Regression Analysis (MRA), the interaction between local government size and central government transfer funds (X_2Z) has a coefficient of 0.027244 with a probability of 0.0389 (< 0.05). This indicates that central transfer funds act as a moderating variable that strengthens the relationship between the size of local government and regional financial performance.

The positive coefficient shows that the greater the transfer received, the stronger the influence of asset size on increasing regional fiscal capacity. With the support of central transfers, local governments can maintain, develop, and optimize their assets to support development, thereby having a positive impact on financial performance. The limitations encountered during this research process are as follows:

1. The data used in this study were obtained from secondary sources such as DJPK and BPK, therefore the accuracy and update frequency may vary across regions.
2. The research period only covers 2019-2023, which means that the results of the study cannot yet describe the long-term effect of central transfer funds on regional financial performance, especially after the post-pandemic recovery period.
3. This study focuses on three variables, namely capital expenditure, the size of the regional government, and central transfer funds, and does not include other factors that may influence regional financial performance.

CONCLUSION

The results of the study show that capital expenditure has a negative and insignificant effect on regional financial performance, while local government size has a negative and significant effect. Central transfer funds also have a negative and significant direct effect, indicating that higher transfers tend to increase fiscal dependence on the central government. Furthermore, the moderating analysis reveals that central transfer funds do not strengthen the influence of capital expenditure on regional financial performance, but they significantly enhance the relationship between local government size and regional financial performance. These findings suggest that regional financial performance is still strongly influenced by transfer dependency and has not been fully supported by the effectiveness of capital expenditure and asset management. Therefore, improving fiscal independence requires better expenditure planning, more effective asset utilization, stronger own source revenue capacity, and future research that incorporates additional variables and broader performance indicators to provide a more comprehensive analysis of regional financial performance.

LIMITATION

This study has several limitations. First, the research objects are limited to district and city governments on the island of Java, so the findings may not fully represent fiscal conditions in other Indonesian regions with different economic and administrative characteristics. Second, the observation period is relatively short, which may not adequately capture long-term trends in regional financial performance. Third, this study focuses only on capital expenditure, local government size, and central transfer funds, leaving out other potentially relevant determinants such as economic growth, poverty levels, governance quality, or the effectiveness of local revenue management. Fourth, regional financial performance is measured using a single ratio indicator, which may not capture the multidimensional nature of fiscal capacity and financial health. These limitations may influence the internal validity of the model, restrict the generalizability of the findings, and reduce the extent to which the results can capture broader fiscal dynamics. Therefore, the findings should be interpreted within this contextual and methodological scope.

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