

# Financial Performance Analysis of Local Governments in North Sumatra based-on Independence Ratio, Regional Original Income Effectiveness, and Efficiency

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**Abstract** — This study aims to analyze the financial performance of district/city governments in North Sumatra Province using the independence ratio approach, the effectiveness of Regional Original Revenue (PAD), and the efficiency of regional financial management. The study used a descriptive method with secondary data from the 2022–2023 fiscal year obtained from the official website of the North Sumatra Provincial Government. The analysis shows that the regional independence ratio is very low, averaging 5.51%, reflecting a pattern of instructive relationships and high dependence on central transfer funds. However, the PAD effectiveness ratio reached an average of 107.95%, which is considered very effective, while the PAD efficiency ratio averaged 9.2%, indicating highly efficient financial management. These findings confirm that despite the relatively good effectiveness and efficiency of PAD management, regional fiscal independence remains a major challenge in realizing strong regional autonomy. This study recommends optimizing PAD potential and strengthening regional fiscal capacity to reduce dependence on the central government.

**Keywords:** *Regional Financial Performance, PAD, General Allocation Fund (DAU), Special Allocation Fund (DAK), Independence Ratio, Effectiveness, Efficiency.*

## I. INTRODUCTION

Autonomous regions in Indonesia face significant challenges in optimizing the contribution of Regional Original Revenue (PAD), especially from regional taxes and levies, to total revenue. Data shows that the contribution of PAD still varies, ranging from less than 10% to 50% of total regional income (Hartiningih & Halim, 2015). This is a crucial issue considering the increasing need for regional spending for development financing. The limitations of PAD often lead to regions being highly dependent on the transfer of funds from the central government, such as the General Allocation Fund (DAU) and the Special Allocation Fund (DAK), which are supposed to function as instruments of equity and a driver of specific development, rather than as the main source of financing that replaces regional fiscal independence.

Regulatory efforts through Law Number 22 of 1999 and Law Number 25 of 1999 (which were later revised) have been carried out to strengthen regional decentralization and autonomy. However, the implementation is still not optimal. Since the decentralization policy was implemented in 2001, few regions have adequate resources to finance development projects independently. This is exacerbated by the tendency of greater regional expenditure allocation to indirect spending

than direct spending, even though the Minister of Home Affairs Regulation Number 25 of 2009 mandates the opposite. For example, data from the Central Statistics Agency of North Sumatra Province for the 2023 fiscal year shows that of the total realization of expenditure of IDR 39.86 trillion, IDR 34.05 trillion (64.97%) is indirect expenditure, and only IDR 9.32 trillion (17.79%) is for direct expenditure. This gap between regulation and implementation indicates a problem in the efficiency of the use of the regional budget.

Orderly, rule-abiding, efficient, effective, transparent, and responsible regional financial management is the key to overcoming this problem, as stipulated in Government Regulation Number 105 of 2000. The analysis of financial ratios in the APBD, such as the ratio of independence, effectiveness, and efficiency, is an important tool to measure the financial performance of local governments (Muhayanah, 2016; Halim, 2012). The independence ratio shows the capacity of the region to finance public activities and services independently (Halim, 2012; Florida, 2016), while the effectiveness ratio measures the ability of regions to achieve PAD targets (Halim, 2012), and efficiency ratios assess the costs incurred to generate regional income (Marsudi et al., 2019).

Various previous studies have indicated that the financial performance of local governments is influenced by factors such as PAD, *intergovernmental revenue* (including DAU and DAK), local government size, and *leverage* (Rochmah, 2015; Sumarjo, 2010). The ratio of independence, effectiveness, and efficiency has also been studied in relation to economic growth, although the results vary (Astuti, 2015; Sari et al., 2015; Siregar, 2016; Nurlita and Hamdani, 2018; Kumpangpune et al., 2019). This shows the complexity of the relationship between variables that needs to be further researched.

This phenomenon not only has an impact on the limitations of infrastructure development and community welfare programs, but also has the potential to create a high dependence on fund transfers from the central government. This dependence can hinder regional innovation and initiatives in developing their local potential independently, so that the goal of regional autonomy to accelerate development and improve public services is not achieved. Therefore, it is important to systematically assess the financial performance of local governments, especially in the context of their ability to produce and manage PAD optimally and utilize DAU and DAK efficiently and effectively.



Given the complexity of these challenges, in-depth research on the factors that affect the financial performance of local governments is particularly relevant. This study will focus on analyzing the ratio of independence, effectiveness, and efficiency, as well as examining the influence of Regional Original Revenue (PAD), General Allocation Fund (DAU), and Special Allocation Fund (DAK) on financial performance. The results of the study are expected to provide a comprehensive picture of the condition of the region's financial performance and identify critical areas that need improvement. Thus, the resulting recommendations can be the basis for the formulation of more effective policies to strengthen regional fiscal capacity and encourage sustainable development, especially in districts/cities throughout North Sumatra Province.

## II. THEORETICAL FOUNDATIONS

### A. *Agentic Theory*

Agency theory is used to analyze the relationship between the principal (owner) and the agent (manager). According to Scott, quoted by Tandiontong (2016:4) in Saepudin (2018), agency theory is a development of the concept that studies the structure of contracts in which agents act on behalf of the principal when their goals or interests are not aligned. When the principal does not fully trust the authorized agent, there will be agency costs. Saepudin (2018), also explained that agency fees are costs required to monitor the behavior or actions of agents so that it can be ensured that these actions are in accordance with the interests of the principal.

Saepudin (2018) stated that the main purpose of agency theory is to solve agency problems that arise because the parties who cooperate have different goals. The difference in interests causes a conflict of interest between the principal and the agent. The principal has an obligation to reward the services rendered by the agent to maximize his profits.

### B. *Regional Original Revenue*

According to Darise (2007: 43) argues that Regional Original Revenue is the income obtained by the region that is collected based on regional regulations in accordance with laws and regulations. Nurcholis (2007: 182), stated that "regional original income is income obtained from regional tax revenues, regional levy revenues, profits of regional companies, and others that are legitimate. Halim (2007: 96) stated that regional original revenue is the revenue obtained by the region from sources in its own territory which is collected based on regional regulations in accordance with applicable laws and regulations. (Pradana and Handayani, 2023).

According to Law No. 33 of 2004 article 1, PAD is income obtained by the regions that is collected based on local regulations in accordance with applicable laws and regulations. The purpose of the PAD is to give authority to local governments to fund the implementation of regional autonomy in accordance with regional potential as a manifestation of decentralization.

### C. *General Allocation Fund*

According to Ahmad (2009: 142) the General Allocation Fund (DAU) is a fund sourced from state budget revenues allocated with the aim of equalizing financial capabilities between regions to mark regional needs in the context of implementing decentralization. DAU is a "block grant" which means that its use is handed over to the regions in accordance with regional priorities and needs to improve services to the community in the context of the implementation of regional autonomy. In other words, the purpose of the DAU allocation is in the context of equitable distribution of public service delivery capabilities between local governments in Indonesia.

In Government Regulation No. 55 of 2005 concerning the Balance Fund, it is explained that the General Assessment Fund (DAU) is a fund derived from the State Expenditure Budget (APBN), which is allocated with the aim of equalizing financial capabilities between regions to fund regional needs in the context of implementing decentralization. The distribution of DAU to areas with relatively large capabilities will be smaller and conversely regional areas with relatively small financial capabilities will obtain relatively large DAU (Sidik, 2004:96). The DAU for a certain regency/city area is determined based on the multiplication of the number of DAU for all regency/city areas determined in the State Budget by the portion of the district/city area concerned.

#### 1) *Special Allocation Fund*

According to Darise (2009: 91) special allocation funds (DAK) are funds sourced from State Budget Revenues allocated to certain regions with the aim of helping to fund special activities that are regional affairs and in accordance with national priorities in accordance with the functions that have been determined in the State Budget. Special allocation funds (DAK) are funds derived from the state expenditure budget allocated to regions to finance certain needs.

### D. *Financial Performance*

Financial performance is the basis for an assessment related to the financial condition of a company in the form of an overview of financial conditions in a certain period that can be seen based on an analysis of financial statements (Sukmawati et al., 2022). Furthermore, financial performance is also referred to as one of the achievements achieved by companies in the financial sector in achieving performance goals (Faisal et al., 2017). On the other hand, financial performance also describes the number of assets owned by the company and how much the company is able to achieve profits.

In line with the previous explanation, Fahmi (2017) also explained that financial performance is an analysis that is carried out to see the extent to which a company has used the rules of financial implementation properly and correctly. Furthermore, financial performance is a delegation of the company's financial condition which is assessed using financial analysis tools to identify weaknesses and achievements that have been achieved by the company in the period when it is exclusive (Marsheline A.P et al., 2023).

### III. METHODS, DATA AND ANALYSIS

The research approach used in this study is a descriptive approach. Nazir (2017) explained that descriptive research aims to make a systematic, factual, and accurate description of the facts, natures, and relationships between the phenomena being investigated. Furthermore, the descriptive approach is a research that only collects, arranges, classifies and interprets data so that it can get a clear picture of the problem being studied.

According to Adiputra et al (2021), the type of descriptive research is tasked with describing, summarizing various conditions, situations, or social reality phenomena that exist in the society that is the object of research and seeks to draw that reality to the surface as a character, character, nature, model, sign, or description of the conditions of a certain situation or phenomenon. The purpose of descriptive research is to obtain data that describes the topic of interest (Sekaran, 2016:43).

This research was carried out in the Regional Government of Medan City. This research process will be carried out starting from January 2024 until it is completed.

According to Sugiyono (2017:61), research variables are an attribute or trait or value of people, objects, and activities, which have certain variations determined by the researcher to be studied and then drawn conclusions, which are as follows:

Table 1 Variable Operational Definitions

N O	Variable	Variable Definition	Indicators	Scale
1	Regional Original Revenue (PAD)	Revenue from sources within the area of a certain area, which is collected based on the applicable law.	Regional financial capability ratio	Ratio
2	General Allocation Fund (DAU)	A number of funds that must be allocated by the Central Government to each Autonomous Region in Indonesia every year as development funds.	Ratio of DAU's dependence on regional finances	Ratio
3	Special Allocation Fund (DAK)	Allocation from the State Revenue and Expenditure Budget to certain provinces/districts/cities with the aim of funding special activities.	Ratio of DAK's dependence on regional finances	Ratio
4	Dependent (Y) Financial Performance	The achievements achieved by the company are expressed in monetary value and are usually depicted in the company's financial statements.	Regional financial independence ratio	Ratio

In this study, the data used is secondary data. This secondary data is in the form of reports on Regional Original Revenue (PAD), General Allocation Funds (DAU) and Special Allocation Funds (DAK). The data sources are available on [the http://prp2sumut.sumutprov.go.id/](http://prp2sumut.sumutprov.go.id/) website. The secondary data used by the researcher is data in the period 2022 to 2023 which is processed through descriptive data processing methods.

#### A. Independence Ratio Analysis

The steps to analyze the independence ratio are carried out in a manner that is next:

- 1) Collect, identify, and tabulate data on the realization of PAD and total revenue from Regencies/Cities of North Sumatra Province for the 2022-2023 fiscal year.
- 2) Calculate the independence ratio based on each budget year which is formulated as follows (Halim, 2002:128)

$$\text{Rasio Kemandirian} = \frac{\text{Pendapatan Asli Daerah}}{\text{Total Pendapatan}}$$

- 3) Determine the pattern of relationships with regional capabilities (from a financial perspective) based on the independence ratio based on table 2.2 Relationship Patterns and Regional Capability Levels as follows:

Table 2 Regional Relationship Patterns and Ability Levels

Independence	Financial Ability	Relationship Patterns
0%-25%	Very Low	Instructive
25%-50%	Low	Constructive
50%-75%	Keep	Participatory
75%-100%	Tall	Delegative

- 4) Analyze the calculated independence ratio.

#### B. PAD Effectiveness Ratio Analysis

The steps to calculate the effectiveness ratio are carried out in the manner as next:

- 1) Collect, identify, and tabulated budget data and PAD realization from North Sumatra Provincial Regencies/Cities for the 2022-2023 fiscal year.
- 2) Calculate the PAD effectiveness ratio based on each budget year. The formula for the effectiveness ratio is:

$$\text{Rasio Efektivitas PAD} = \frac{\text{Realisasi Penerimaan PAD}}{\text{Target Penerimaan PAD}}$$

- 3) Determine the value of PAD effectiveness by referring to the following table 2

Table 3 Relationship Patterns and Financial Ability Levels

Financial Ability	Relationship Patterns
Highly Effective	> 100
Effective	100
Quite Effective	90-99
Less Effective	75-89
Ineffective	< 75

- 4) Analyze the calculated PAD effectiveness ratio.

### C. Efficiency Ratio Analysis

The steps to analyze the efficiency ratio are carried out in the following way:

- 1) Collect, identify, and tabulated data on the total acquisition of PAD and total realization of PAD from Regencies/Cities of North Sumatra Province for the 2022-2023 fiscal year.
- 2) Calculate the PAD efficiency ratio based on each budget year. According to Mahmudi (2010:143), the efficiency ratio is formulated as follows:

$$\text{Rasio Efisiensi PAD} = \frac{\text{Biaya Pemerolehan PAD}}{\text{Realisasi Penerimaan Daerah}}$$

- 3) Determine the value of PAD efficiency on the realization of the APBD by referring to the following table:

Table 4 Regional Capabilities in PAD Efficiency

Financial Ability	Efficiency Ratio
Highly Efficient	< 10
Efficient	10 - 20
Quite Efficient	21 - 30
Less Efficient	31 - 40
Inefficient	>40

- 4) Analyze the calculated PAD efficiency ratio.

## IV. RESULTS AND DISCUSSION

Medan is the capital of North Sumatra Province. The center of government of North Sumatra is located in the city of Medan. North Sumatra which is divided into 25 districts, 8 cities, 325 sub-districts, and 5,456 sub-districts/villages.

### A. Independence Ratio of Regencies/Cities in North Sumatra Province

#### a. Research Data

The ratio of regional independence is calculated by comparing the realization of PAD with the realization of total regional revenue. The PAD and total revenue of the Regency/City of North Sumatra Province for the 2022-2023 fiscal year can be seen in Table 3.1 as follows:

Table 5. PAD and total revenue of Prov. North Sumatra

Year	PAD	Total Revenue
2022	46.190.901.674.884	7.848.508.336.992
2023	49.333.776.888.128	9.570.226.151.361

Source : <http://prp2sumut.sumutprov.go.id/kabupaten-kota-2022>

#### b. Calculation of the Independence Ratio of Regencies/Cities of North Sumatra Province

Based on the above data, the value of the ratio of independence, financial ability, and the pattern of relations between the Regency/City of North Sumatra Province and the central government can be determined in table 3.2 as follows:

Table 6 Financial Ability and Pattern of District/City Relations of Prov. North Sumatra

Year	Independence Ratio	Financial Ability	Relationship Patterns
2022	5,88%	Very Low	Instructive
2023	5,15%	Very Low	Instructive
Average ratio		5,51%	

Source:<http://prp2sumut.sumutprov.go.id/kabupaten-kota-2022>

### B. Effectiveness Ratio of Regencies/Cities in North Sumatra Province

The effectiveness ratio describes the ability of local governments to realize the planned local revenue compared to the targets set based on the real potential of the region.

#### 1. Research Data

The Target and Realization of PAD for the Regency/City of North Sumatra Province for the 2022-2023 fiscal year is presented in the following Table 3.3 :

Table 7 Realization of PAD and PAD Targets of Provincial Regencies/Cities. North Sumatra

Year	Realization of PAD	Target PAD
2022	46.190.901.674.884	44.112.852.715.713
2023	49.333.776.888.128	44.368.554.832.331

Source : <http://prp2sumut.sumutprov.go.id/kabupaten-kota-2022>

#### 2. Calculation of the Effectiveness Ratio of Regencies/Cities of North Sumatra Province

Based on the target data and the realization of PAD presented earlier, it can be known the value of the PAD effectiveness ratio and the interpretation of the PAD effectiveness value of the Regency/City of North Sumatra Province in table 3.4 below:

Table 8 Financial Ability of Provincial Regencies/Cities. North Sumatra

Year	Effectiveness Ratio	Financial Ability
2022	104,71%	Highly Effective
2023	111,19%	Highly Effective
Average Ratio		107,95%

Source : <http://prp2sumut.sumutprov.go.id/kabupaten-kota-2022>

### C. Efficiency Ratio of Regencies/Cities of North Sumatra Province

The performance of local governments can be said to be efficient if it has achieved the set goals with minimal costs incurred.

#### 1. Research Data

The cost of obtaining PAD and the realization of PAD in North Sumatra Province for the 2022-2023 fiscal year is presented in table 3.5 as follows:

Table 9 Cost of PAD Acquisition and Realization of PAD in Provincial Regencies/Cities. North Sumatra

Year	PAD Acquisition Fee	Realization of PAD
2022	44.112.852.715.713	46.190.901.674.884
2023	44.368.554.832.331	49.333.776.888.128

Source : <http://prp2sumut.sumutprov.go.id/kabupaten-kota-2022>

## 2. Calculation of PAD Efficiency Ratio of Regency/City of North Sumatra Province

Based on the data on the cost of acquisition and realization of PAD presented earlier, the value of the PAD efficiency ratio and the interpretation of the efficiency value of the PAD of the Regency/City of North Sumatra Province in table 3.6 can be determined as follows:

Table 10 Cost of PAD Acquisition and Realization of PAD in Regency/City Prov. North Sumatra

Year	Efficiency Ratio	Financial Ability
2022	9,5%	Highly Efficient
2023	8,9%	Highly Efficient
Average Ratio	9,2%	

Source : <http://prp2sumut.sumutprov.go.id/kabupaten-kota-2022>

### D. The level of independence of the Regency/City of North Sumatra Province for the 2022-2023 fiscal year is as follows:

a. In 2022, the independence ratio of the Regency/City of North Sumatra Province is 5.88%, which shows that PAD's contribution to total revenue is only 5.88% or Rp. 46,190,901,674,884. In that year, the level of independence of the Regency/City of North Sumatra Province was very low by showing a pattern of instructive relationship with the central government. The contribution of funds from the central government through the Balance Fund is very dominant, which is Rp. 7,848,508,336,992 of the total regional revenue.

b. In 2023, the independence ratio of Regencies/Cities in North Sumatra Province decreased by 0.73% from the previous year to 5.15%. The decline was caused by PAD and total revenue increased to 49,333,776,888,128 and 9,570,226,151,361. However, the independence of Regencies/Cities of North Sumatra Province is still very low by showing a pattern of instructive relations with the central government.

### E. The level of effectiveness of the PAD of North Sumatra Province for the 2022-2023 fiscal year is described as follows:

a. In 2022, the effectiveness ratio of the Regency/City of North Sumatra Province is 104.71%. The financial performance of the Regency/City of North Sumatra Province based on the PAD effectiveness ratio is classified as very effective because it is in the range of more than 100%. This illustrates that the achievement of PAD in 2022 exceeds the set target of Rp. 44,112,852,715,713. The realization of PAD in 2022 is Rp. 46,190,901,674,884, while the target set is Rp. 44,112,852,715,713.

b. In 2023, the effectiveness ratio of Regencies/Cities in North Sumatra Province increased by 6.48% from 2022, which was 111.19%. The financial performance of North Sumatra Province's regencies/cities in 2023 based on the PAD effectiveness ratio is classified as very effective. The realization of PAD in North Sumatra Province has successfully exceeded the PAD target set based on regional regulations of Rp. 98,442,632,628 out of the total PAD

budget of Rp. 44,368,554,832,331. The realization of PAD in that year increased by 6.48% from 2022.

### F. The Efficiency Analysis of Regencies/Cities of North Sumatra Province in the 2022-2023 fiscal year is described in the following discussion:

a. In 2022, the efficiency ratio of PAD in North Sumatra Province is 9.5%. The financial performance of the Regency/City of North Sumatra Province based on the efficiency of PAD this year is classified as very efficient, because the efficiency ratio of PAD is in the range of >10%. This efficiency shows that the Regency/City of North Sumatra Province in obtaining PAD has succeeded in reducing the costs incurred. The cost of collecting PAD in 2022 is Rp. 44,112,852,715,713 or 9.5% of the total realized PAD, which is Rp. 46,190,901,674,884.

b. In 2023, the efficiency ratio of PAD in North Sumatra Province will be 8.9%, down 0.6% from 2022. So that in 2023, the financial performance of the Regency/City of North Sumatra Province based on the PAD efficiency ratio is classified as very efficient, because it is in the range below 10%. The cost of collecting PAD this year is Rp. 44,368,554,832.33.

## V. DISCUSSION

Based on the previous research method, the financial performance reviewed from the analysis of the effectiveness ratio, efficiency ratio, and independence ratio in the financial management of village fund allocation (2018-2021) showed that there was a similarity in this study, namely that the ratios analyzed had increased significantly. However, the increase cannot necessarily be categorized as an indication of good performance. These results are in line with previous research that found that despite improvements in effectiveness ratios, efficiency ratios, and self-sufficiency ratios, other factors such as operational efficiency and cost management also need to be considered to provide a more accurate picture of the village's financial performance.

Current research that analyzes the financial performance of Regional Original Revenue (PAD), General Allocation Fund (DAU), and Special Allocation Fund (DAK) based on the ratio of independence, effectiveness, and efficiency in districts/cities throughout North Sumatra Province also shows an increasing trend in these ratios. However, from the perspective of agency theory, this increase in the ratio does not automatically reflect good performance or the best interests of the main stakeholders, namely the community and local governments.

Linking these findings to agency theory, this study in North Sumatra is related to the analysis of financial performance of Regional Original Revenue (PAD), General Allocation Funds (DAU), and Special Allocation Funds (DAK) in districts/cities throughout North Sumatra Province showing that although there is an improvement in the ratio of independence, effectiveness, and efficiency, this does not necessarily mean that the financial performance of local governments is good overall. As in previous studies, the increase in these ratios needs to be further analyzed by considering other factors that can affect overall financial performance

Therefore, further analysis is needed to ensure that the increased ratios of effectiveness, efficiency, and independence truly reflect increased long-term value and benefits to society. This involves a more comprehensive assessment that considers operational and managerial aspects, as well as ensuring that the principal's long-term interests are not sacrificed for the agency's short-term gains. Thus, the results of the research can provide a more accurate and holistic picture of financial performance both at the village and district/city levels.

#### VI. SUGGESTION

The author realizes that this research is not free from errors and shortcomings due to the limitations experienced during this writing, therefore the suggestions that can be given for research related to the performance of the Regional Government are:

- a) Regional Governments should increase collection, supervision and control efforts as well as increase human resources (HR) of PAD managers.
- b) Regional Governments must continue to improve and optimize Regional Original Revenue (PAD), as well as pay attention to government performance so that a good level of effectiveness can be consistently maintained and can help in efforts to improve the efficiency of regional financial management.

#### VII. CONCLUSION

Based on the analysis and discussion that has been described, the author comes to the following conclusions:

- a) The Independence Ratio of Regencies/Cities in North Sumatra Province from 2022 to 2023 is classified as very low by showing an instructive relationship pattern.
- b) The average efficiency ratio of PAD in North Sumatra Province is 107.95%. This shows that the financial performance of the Regency/City of North Sumatra Province based on the PAD effectiveness ratio is classified as very effective.
- c) The financial performance of the Regency/City of North Sumatra Province for the 2022-2023 fiscal year based on the efficiency ratio of PAD is classified as very efficient with an average of 9.2% every year.

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