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The Effect of Local Own-Source Revenue and Capital Expenditure on Local Government Financial Performance: The Moderating Role of Financial Reporting Quality

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Abstract

Indonesian local governments have expanded own-source revenue and capital budgets and mostly earn favorable audit opinions, yet their expenditure-to-revenue ratios remain near or above 100 percent. Prior studies report conflicting effects of revenue and capital spending and rarely test whether financial reporting quality conditions them. This study examines how own-source revenue and capital expenditure affect local government financial performance and whether reporting quality moderates these effects, drawing on fiscal decentralization, agency, and stewardship theories. We analyzed a balanced panel of 15 regencies and municipalities in Lampung Province from 2018 to 2024 (105 observations) using pooled regression with moderated regression analysis. Own-source revenue significantly raises the expenditure-to-revenue ratio (coefficient 15.07, p = 0.006), showing that revenue growth without discipline expands spending rather than efficiency. Capital expenditure and audit-based reporting quality have no significant direct effects at the 5 percent level. Reporting quality is a pure moderator: its negative interaction with revenue (coefficient −4.06, p = 0.007) reverses the marginal effect of revenue from +2.90 under qualified opinions to −1.15 under unqualified opinions. Audit compliance therefore disciplines spending only when revenue expands. It does not moderate capital expenditure, and the model explains only 8.2 percent of variance, so the results are conditional rather than general. The study contributes by modeling reporting quality as an institutional boundary condition in fiscal decentralization and by separating compliance from efficiency. Policymakers should pair revenue mobilization with expenditure controls and use audited statements for budget monitoring rather than as compliance targets.

Keywords: Fiscal Decentralization, Financial Reporting Quality, Local Own-Source Revenue, Agency Theory, Moderated Regression Analysis.

JEL Classification: H71, H72, H83, M42.

Introduction

Decentralized fiscal regimes rest on the economic premise that transferring revenue-raising authority and expenditure responsibilities to subnational governments improves allocative efficiency and public sector performance (Oates, 1972; Martinez-Vazquez & McNab, 2003). Across Organization for Economic Co-operation and Development (OECD) and emerging partner economies, subnational governments account for a substantial share of total public expenditure and public investment, yet empirical records indicate a persistent divergence between devolved fiscal authority and realized expenditure efficiency (OECD, 2024; Rodríguez-Pose & Vidal-Bover, 2024). In Indonesia, over two decades of fiscal decentralization and the enactment of Law Number 1 of 2022 on Financial Relations between the Central Government and Regional Governments (*Hubungan Keuangan antara Pemerintah Pusat dan Pemerintahan Daerah* [HKPD]) have expanded the statutory mechanisms for regional revenue mobilization and capital allocation. Nevertheless, official fiscal records from the Directorate General of Fiscal Balance (*Direktorat Jenderal Perimbangan Keuangan* [DJPK], 2024) and the World Bank (2022) reveal a structural anomaly: while central government transfers and local revenues have expanded in nominal terms, regional expenditure structures remain heavily skewed toward routine administrative outlays rather than productive capital formation. Concurrently, data from the Audit Board of Indonesia (*Badan Pemeriksa Keuangan* [BPK], 2024) indicate that although the vast majority of Indonesian local governments have attained Unqualified Audit Opinions (*Wajar Tanpa Pengecualian* [WTP]), regional financial efficiency ratios frequently hover near or exceed the 100% threshold, indicating that total expenditure regularly matches or outpaces realized revenue. This disconnect between administrative audit compliance, regional resource availability, and actual expenditure efficiency represents a central policy and governance problem in subnational public finance.

Within this institutional setting, Local Government Financial Performance serves as a primary metric of a regional administration's capacity to convert fiscal inputs into public outputs in accordance with value-for-money principles—economy, efficiency, and effectiveness (Mardiasmo, 2018; Turley et al., 2015). However, scholarly investigations into the fiscal determinants of subnational financial performance have produced fragmented and conflicting evidence across two primary analytical streams. The first stream examines the role of Local Own-Source Revenue (*Pendapatan Asli Daerah* [PAD]) as an indicator of regional fiscal capacity and autonomy. One group of scholars argues that higher locally generated

revenue expands budgetary discretion, reduces fiscal dependency on central intergovernmental transfers, and strengthens local government financial performance (Safitri et al., 2023; Ekaningtias et al., 2023; Wahyuni & Ali, 2024; Cifuentes-Faura et al., 2024). Conversely, a competing body of empirical work demonstrates that increases in Local Own-Source Revenue exhibit statistically insignificant or even adverse effects on financial efficiency (Andjarwati et al., 2021; Saputra & Kurniawati, 2025; Dharmayasa & Darmayanti, 2021; Maulina et al., 2021). These latter studies suggest that when incremental local revenue is absorbed by expanded bureaucratic overhead and unmonitored operational spending rather than disciplined budgetary execution, revenue growth fails to lower the expenditure-to-revenue ratio.

A second, closely related debate concerns the efficacy of Capital Expenditure as a strategic instrument for regional economic development, public service expansion, and long-term asset accumulation. Proponents of public investment-led growth contend that higher capital outlays build productive infrastructure that expands the regional tax base and improves subnational financial performance (Mubarok et al., 2022; Pramesti & Hendaris, 2025; Chaerani & Firmansyah, 2024). In contrast, several recent empirical evaluations find no statistically significant relationship—or report negative short-term associations—between capital expenditure and local government financial performance (Angelina et al., 2020; Jesika & Purnawati, 2025; Wulandari, & Nindiasari, 2026; Yudiastuti et al., 2025). Comparative international evidence similarly indicates that local governments frequently face trade-offs between short-term fiscal expenditure competition and long-term capital investment efficiency, particularly when project planning, procurement governance, and asset utilization mechanisms are weak (Wenjuan & Zhao, 2023; Mohammed et al., 2024; Zarychta et al., 2024). Moreover, because infrastructure investments entail multi-year gestation periods, contemporaneous annual efficiency ratios often capture the immediate cash outflow of capital spending without reflecting its delayed economic returns.

A critical synthesis of these two literature streams exposes three interrelated blind spots regarding theory, measurement, and context. First, prior empirical models predominantly estimate the direct, unconditional effects of Local Own-Source Revenue and Capital Expenditure on financial performance, implicitly assuming that fiscal inputs operate uniformly across varying institutional environments (Padang & Padang, 2023; Maulina et al., 2021). Second, while public sector accounting scholars increasingly recognize Financial Reporting Quality—proxied by independent audit opinions from Supreme Audit Institutions—as a core governance mechanism (Cordery & Hay, 2022; Ferry et al., 2023; Firmansyah et al., 2022),

existing studies rarely test whether reporting quality acts as a boundary condition that moderates the conversion of local revenue and capital spending into financial efficiency (Purwati & Firmansyah, 2024; Rahmadhanty & Firmansyah, 2025; Raditya et al., 2022; Rahayu & Badrudin, 2017; Sukma & Hendaris, 2026). Third, from a contextual perspective, subnational empirical inquiries in Indonesia have heavily concentrated on Java and Bali, leaving provinces with heterogeneous fiscal capacities—such as Lampung Province—underexplored during periods of macroeconomic shock. Comprising 13 regencies and two municipalities with pronounced disparities between urban commercial centers (Bandar Lampung and Metro) and agrarian jurisdictions (Statistics Indonesia, Lampung Province, 2024), Lampung Province over the 2018–2024 period provides an instructive empirical laboratory encompassing pre-pandemic baseline operations, COVID-19 fiscal reallocations, and post-pandemic regulatory adjustments.

To address these gaps, this study integrates Fiscal Decentralization Theory, Agency Theory, and Stewardship Theory to construct an analytical framework linking fiscal capacity, capital allocation, and financial reporting governance. Under Fiscal Decentralization Theory (Oates, 1972; Martinez-Vazquez & McNab, 2003), local governments possessing higher own-source revenue exercise greater fiscal autonomy in aligning budgets with local preferences; however, in the context of expenditure-to-revenue efficiency ratios, rising revenue availability can also induce proportional or excessive expenditure expansion unless constrained by budgetary discipline. We therefore hypothesize that Local Own-Source Revenue significantly affects Local Government Financial Performance (H_1). Drawing on Stewardship Theory (Donaldson & Davis, 1991; Davis et al., 1997), public executives act as collective stewards who allocate capital expenditure toward long-term public assets to enhance service delivery and organizational efficiency (Halim & Kusufi, 2018; Mahmudi, 2019). Accordingly, we hypothesize that Capital Expenditure significantly affects Local Government Financial Performance (H_2). Furthermore, Agency Theory (Jensen & Meckling, 1976; Eisenhardt, 1989) posits that public administration is characterized by information asymmetry between citizens (principals) and local government officials (agents), which enables opportunistic budget slack and allocative inefficiency (Riswan & Affandi, 2014). High-quality financial reporting, verified through rigorous independent auditing, reduces this information asymmetry by providing reliable, comparable, and verifiable financial disclosures for legislative oversight and budget evaluation (Cordery & Hay, 2022; Ferry et al., 2023; Purwati & Firmansyah, 2024). Thus, we hypothesize that Financial Reporting Quality directly affects Local Government

Financial Performance (H_3). Extending this agency-stewardship logic to an interaction framework, transparent financial reporting subjects locally generated revenue and capital project budgets to stricter external scrutiny, thereby curbing tendencies toward inefficient spending as fiscal resources expand (Rahmadhanty & Firmansyah, 2025; Zarychta et al., 2024). Consequently, we hypothesize that Financial Reporting Quality significantly moderates the effect of Local Own-Source Revenue on Local Government Financial Performance (H_4) and significantly moderates the effect of Capital Expenditure on Local Government Financial Performance (H_5).

This study makes three contributions to the literature on public financial management and strategic economic governance. First, it advances theoretical debates on fiscal decentralization by moving beyond direct linear specifications to model Financial Reporting Quality as an institutional moderating variable that conditions how subnational revenues and capital outlays relate to expenditure efficiency. Second, it clarifies the analytical distinction between compliance-based reporting accountability (attaining favorable audit opinions) and operational expenditure efficiency, demonstrating how audit quality interacts differently with recurrent revenue streams versus multi-year capital investments. Third, it provides balanced panel evidence across all 15 regencies and municipalities in Lampung Province over a seven-year horizon (2018–2024, $N = 105$), capturing longitudinal fiscal dynamics across diverse regional economies. The central argument defended in this article is that while local revenue capacity is a primary determinant of subnational budget dynamics, expanding fiscal resources without the disciplinary interaction of high-quality financial reporting tends to inflate expenditure ratios rather than improve financial efficiency. Empirical estimations using panel regression and Moderated Regression Analysis (MRA) indicate that Local Own-Source Revenue and its interaction with Financial Reporting Quality significantly explain variations in regional financial performance, whereas Capital Expenditure, the direct effect of Financial Reporting Quality, and their interaction term are statistically insignificant. The remainder of this article outlines the panel research methodology and variable operationalization, presents the empirical estimation and diagnostic results, discusses the theoretical and policy implications of the findings, and concludes with limitations and directions for future research.

Research Method

This study executed a quantitative explanatory panel data design to estimate the direct effects of Local Own-Source Revenue and Capital Expenditure on Local Government Financial Performance and to test the moderating effect of Financial Reporting Quality. The unit of

analysis comprised all autonomous subnational governments at the regency (*kabupaten*) and municipal (*kota*) levels within Lampung Province, Indonesia, observed annually from 2018 to 2024. Combining cross-sectional variation across 15 jurisdictions with a seven-year longitudinal dimension allowed the identification strategy to control for regional fiscal heterogeneity while tracking intertemporal budget adjustments across pre-pandemic baseline years, COVID-19 fiscal reallocations, and post-pandemic regulatory transitions under Law Number 1 of 2022 (Baltagi, 2021; Ritonga & Buanaputra, 2023; Bisogno et al., 2024). Panel data regression was paired with Moderated Regression Analysis (MRA) in EViews 13 to evaluate whether institutional reporting quality conditioned the marginal effects of local revenue and capital outlays on regional expenditure efficiency.

Secondary archival data were extracted from three official Indonesian institutional repositories: the Directorate General of Fiscal Balance (*Direktorat Jenderal Perimbangan Keuangan* [DJPK]) of the Ministry of Finance for realized regional revenue and expenditure records from audited Budget Realization Reports (*Laporan Realisasi Anggaran* [LRA]); the Audit Board of Indonesia (*Badan Pemeriksa Keuangan* [BPK]) for annual audit opinions on Local Government Financial Statements (*Laporan Keuangan Pemerintah Daerah* [LKPD]); and Statistics Indonesia (*Badan Pusat Statistik* [BPS]) of Lampung Province for administrative and jurisdictional classifications (Badan Pemeriksa Keuangan Republik Indonesia, 2024; Badan Pusat Statistik Provinsi Lampung, 2024; Direktorat Jenderal Perimbangan Keuangan, 2024). A census saturation technique was applied across the entire population of 15 local governments in Lampung Province, consisting of 13 regencies and two municipalities. Mandatory inclusion criteria required each jurisdiction to maintain continuous statutory operations throughout the 2018–2024 fiscal window and possess complete, audited LRA and LKPD disclosures across all seven consecutive years. Because no jurisdiction exhibited missing values, administrative splits, or unreported fiscal items during the observation window, zero observations were excluded, yielding a balanced panel dataset of $N = 105$ local government-year observations (15 jurisdictions $\times$ 7 fiscal years). The cross-sectional units included in the panel census are detailed in Table 1.

Table 1. Research Population in Lampung Province

No.	Regency/Municipality	Administrative Center	Status
1	West Lampung	Liwa	Regency
2	Tanggamus	Kota Agung	Regency
3	South Lampung	Kalianda	Regency
4	East Lampung	Sukadana	Regency

5	Central Lampung	Gunung Sugih	Regency
6	North Lampung	Kotabumi	Regency
7	Way Kanan	Blambangan Umpu	Regency
8	Tulang Bawang	Menggala	Regency
9	Pesawaran	Gedong Tataan	Regency
10	Pringsewu	Pringsewu	Regency
11	Mesuji	Mesuji	Regency
12	West Tulang Bawang	Panaragan Jaya	Regency
13	West Pesisir	Krui	Regency
14	Bandar Lampung	—	Municipality
15	Metro	—	Municipality

Source: Badan Pusat Statistik Provinsi Lampung (2024), covering 13 regencies and 2 municipalities observed over 2018–2024 ($N = 105$ balanced panel observations).

Four core variables were operationalized for econometric estimation, as summarized in Table 2. The dependent variable, Local Government Financial Performance (Y_KKPD_{it}), was measured using the Regional Financial Efficiency Ratio, which compares total realized regional expenditure against total realized regional revenue for jurisdiction i in fiscal year t (Halim & Kusufi, 2018; Mahmudi, 2019; Turley et al., 2015; Zein et al., 2024):

$$\text{Y_KKPD}_{it} = \frac{\text{Realized Regional Expenditure}_{it}}{\text{Realized Regional Revenue}_{it}} \times 100\%$$

Under this cost-to-revenue specification, a lower percentage ratio indicates higher expenditure efficiency because budget execution consumes a smaller fraction of realized revenue, whereas a higher percentage ratio indicates lower financial efficiency (Halim & Kusufi, 2018; Mahmudi, 2019). The first independent variable, Local Own-Source Revenue (LN_PAD_{it}), captured realized annual collections from local taxes, regional levies, returns on separated regional wealth, and other legitimate local revenues recorded in the LRA. The second independent variable, Capital Expenditure (LN_BM_{it}), captured realized annual spending allocated to acquire or construct fixed public assets, including roads, irrigation networks, government buildings, and public equipment. Because raw monetary figures in Indonesian Rupiah (IDR) differed substantially in scale between urban municipalities and agrarian regencies, both explanatory variables were transformed into natural logarithms to compress distributional skewness, mitigate outlier sensitivity, and align their measurement scale with the percentage and ordinal variables (Wooldridge, 2013; Chaerani & Firmansyah, 2024):

$$\text{LN_PAD}_{it} = \ln(\text{Realized PAD}_{it})$$

$$\text{LN_BM}_{it} = \ln\left(\text{Realized Capital Expenditure}_{it}\right)$$

Table 2. Operationalization of Research Variables

Variable	Role	Measurement Indicator	Scale
Local Government Financial Performance (Y_KKPD)	Dependent	Regional Financial Efficiency Ratio	Ratio (%)
Local Own-Source Revenue (LN_PAD)	Independent	Natural log of realized PAD (IDR)	Ratio (ln)
Capital Expenditure (LN_BM)	Independent	Natural log of realized capital expenditure (IDR)	Ratio (ln)
Financial Reporting Quality (Z_KLK)	Moderating	BPK annual audit opinion score on LKPD	Ordinal (1–4)

Source: Processed by the authors (2026) based on Halim and Kusufi (2018), Mahmudi (2019), and Badan Pemeriksa Keuangan Republik Indonesia (2024).

The moderating variable, Financial Reporting Quality (Z_KLK_{it}), was operationalized through the statutory audit opinion issued by BPK on each local government's annual financial statements (Cordery & Hay, 2022; Ferry et al., 2023; Firmansyah et al., 2022; Purwati & Firmansyah, 2024). Following established public sector accounting conventions in Indonesia (Rahmadhanty & Firmansyah, 2025; Sukma & Hendaris, 2026), audit opinions were coded on a four-level ordinal scale ranging from 1 to 4, where higher values denote stronger compliance with governmental accounting standards, lower material misstatement, and higher financial disclosure reliability, as presented in Table 3.

Table 3. Financial Reporting Quality Classification

BPK Audit Opinion	Indonesian Statutory Classification	Score
Unqualified Opinion	*Wajar Tanpa Pengecualian* (WTP)	4
Qualified Opinion	*Wajar Dengan Pengecualian* (WDP)	3
Adverse Opinion	*Tidak Wajar* (TW)	2
Disclaimer of Opinion	*Tidak Menyatakan Pendapat* (TMP)	1

Source: Processed by the authors (2026) based on Badan Pemeriksa Keuangan Republik Indonesia (2024) audit opinion classifications.

Econometric estimation proceeded in four sequential stages using EViews 13. First, descriptive statistics (mean, median, minimum, maximum, and standard deviation) were computed to inspect distributional properties across the 105 panel observations. Second, panel model specification tests were performed at the 5% significance threshold ($\alpha = 0.05$) to select the optimal estimator among the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM) (Baltagi, 2021; Wooldridge, 2013). As summarized in Table

4, the Chow test evaluated cross-sectional fixed effects between CEM and FEM, the Hausman test compared FEM against REM, and the Breusch–Pagan Lagrange Multiplier (LM) test assessed random effects between CEM and REM.

Table 4. Panel Regression Model Selection Procedures

Statistical Test	Model Comparison	Null Hypothesis (H0)	Decision Criterion (α=0.05)
Chow Test	CEM vs. FEM	Pooled intercept (CEM)	$p < 0.05$: Select FEM
Hausman Test	FEM vs. REM	Uncorrelated effects (REM)	$p < 0.05$: Select FEM
Lagrange Multiplier Test	CEM vs. REM	Zero individual variance (CEM)	$p < 0.05$: Select REM

Source: Processed by the authors (2026) following Baltagi (2021) and Wooldridge (2013).

Third, classical assumption diagnostic tests were executed to verify Gauss–Markov estimator properties. Residual normality was evaluated using the Jarque–Bera statistic ($p > 0.05$), multicollinearity was checked via pairwise correlation coefficients among LN_PAD, LN_BM, and Z_KLK (adopting a < 0.80 cutoff), heteroskedasticity was tested using the Glejser procedure by regressing absolute residuals ($|\hat{\varepsilon}_{it}|$) on the regressors ($p > 0.05$), and first-order autocorrelation was examined using the Durbin–Watson (DW) statistic within the $1.50–2.50$ non-autocorrelation band (Wooldridge, 2013). Fourth, Moderated Regression Analysis (MRA) was estimated by introducing multiplicative interaction terms between the moderating variable and each fiscal regressor ($\text{X1Z}_{it} = \text{LN_PAD}_{it} \times \text{Z_KLK}_{it}$ and $\text{X2Z}_{it} = \text{LN_BM}_{it} \times \text{Z_KLK}_{it}$) (Raditya et al., 2022; Rahmadhanty & Firmansyah, 2025):

$$\text{Y_KKPD}_{it} = \alpha + \beta_1 \text{LN_PAD}_{it} + \beta_2 \text{LN_BM}_{it} + \beta_3 \text{Z_KLK}_{it} + \beta_4 \text{X1Z}_{it} + \beta_5 \text{X2Z}_{it} + \varepsilon_{it}$$

where α denotes the constant intercept, β_1 through β_5 represent the slope parameters to be estimated, and ε_{it} is the idiosyncratic error term. Individual hypotheses (H_1 through H_5) were evaluated using partial two-tailed t-tests at $\alpha = 0.05$, while overall model fit was assessed through the joint F-statistic, the coefficient of determination (R^2), and the Adjusted R^2.

Result

Empirical analysis begins by inspecting the distributional properties of the balanced panel dataset across the 15 regencies and municipalities in Lampung Province from 2018 to 2024 ($N = 105$). As reported in Table 5, the natural logarithm of Local Own-Source Revenue

(LN_PAD) recorded a sample mean of 25.3593 (approximately IDR 103.14 billion at the geometric mean) and a median of 25.2012, with a standard deviation of 0.8235. The spread between the minimum value of 23.5421 and the maximum value of 27.2978 reflects structural divergence in revenue-raising capacity between agrarian regencies and commercial urban municipalities (Badan Pusat Statistik Provinsi Lampung, 2024; Direktorat Jenderal Perimbangan Keuangan, 2024). The natural logarithm of Capital Expenditure (LN_BM) exhibited a higher mean of 26.0053 (median = 25.9881) but a narrower dispersion (SD = 0.4171, ranging from 25.3359 to 26.7748), indicating that annual capital allocations remained comparatively uniform across jurisdictions relative to locally generated revenues.

Table 5. Descriptive Statistics

Statistic	LN_PAD	LN_BM	Y_KKPD	Z_KLK
Mean	25.3593	26.0053	100.0071	3.6667
Median	25.2012	25.9881	99.7095	4.0000
Maximum	27.2978	26.7748	111.5000	4.0000
Minimum	23.5421	25.3359	88.5000	3.0000
Std. Dev.	0.8235	0.4171	5.2605	0.4737
Observations	105	105	105	105

Source: EViews 13 output (2026).

Local Government Financial Performance (Y_KKPD), operationalized through the regional financial efficiency ratio, averaged 100.0071% with a median of 99.7095% and a standard deviation of 5.2605%. Under public sector accounting benchmarks (Halim & Kusufi, 2018; Mahmudi, 2019), a mean efficiency ratio exceeding the 100% threshold indicates that, on average, realized regional expenditure across Lampung Province matched or slightly exceeded realized regional revenue during the 2018–2024 period, with jurisdictional performance ranging from an efficient minimum of 88.5000% to a deficit-prone maximum of 111.5000%. Meanwhile, Financial Reporting Quality (Z_KLK) recorded a mean score of 3.6667, a median of 4.0000, and a standard deviation of 0.4737, bounded strictly between 3.0000 (*Qualified Opinion* [WDP]) and 4.0000 (*Unqualified Opinion* [WTP]). This restricted range demonstrates institutional convergence toward favorable audit opinions across the province, with zero jurisdictions receiving Adverse or Disclaimer opinions during the seven-year window (Badan Pemeriksa Keuangan Republik Indonesia, 2024; Cordery & Hay, 2022).

Prior to parameter estimation, panel specification tests were executed to determine whether unobserved cross-sectional heterogeneity required fixed or random effects modeling (Baltagi, 2021; Wooldridge, 2013). As summarized in Table 6, the Chow test yielded a Cross-

section F-statistic of 0.6983 ($p = 0.7701$) and a Cross-section Chi-square statistic of 11.4311 ($p = 0.6519$). Because both probability values exceeded the $\alpha = 0.05$ threshold, the null hypothesis of a pooled common intercept could not be rejected, favoring the Common Effect Model (CEM) over the Fixed Effect Model (FEM). Consistent with this result, the Hausman test produced a random cross-section Chi-square statistic of 2.0192 ($p = 0.8465$), failing to reject the null hypothesis of zero correlation between individual effects and the regressors and thus favoring the Random Effect Model (REM) over FEM. To adjudicate between CEM and REM, the Breusch–Pagan Lagrange Multiplier (LM) test was conducted, yielding a cross-section statistic of 0.9183 ($p = 0.3379 > 0.05$). The non-significant LM statistic confirmed that the variance of cross-sectional individual effects was statistically indistinguishable from zero, establishing the pooled Common Effect Model (CEM) as the appropriate estimator for the dataset.

Table 6. Panel Regression Model Selection Results

Statistical Test	Test Statistic	Probability	Selected Model
Chow Test (Cross-section F)	0.6983	0.7701	CEM
Chow Test (Cross-section Chi-square)	11.4311	0.6519	CEM
Hausman Test (Cross-section Random)	2.0192	0.8465	REM
Lagrange Multiplier (Breusch–Pagan)	0.9183	0.3379	CEM

Source: EViews 13 output (2026).

Diagnostic evaluations were subsequently performed on the selected CEM specification to verify adherence to classical linear regression assumptions (Wooldridge, 2013). The Jarque–Bera test for residual normality produced a test statistic of 0.550221 ($p = 0.759488 > 0.05$), confirming that the regression disturbances followed an asymptotic normal distribution. Pairwise Pearson correlation coefficients among the baseline explanatory variables (LN_PAD, LN_BM, and Z_KLK) were inspected to detect potential multicollinearity, as reported in Table 7. The highest absolute correlation occurred between LN_PAD and LN_BM ($r = 0.3692$), whereas Z_KLK exhibited low negative correlations with both LN_PAD ($r = -0.2647$) and LN_BM ($r = -0.2184$). Because all pairwise coefficients remained well below the conventional 0.80 threshold, orthogonal variation among the baseline regressors was preserved.

Table 7. Multicollinearity Correlation Matrix

Variable	LN_PAD	LN_BM	Z_KLK
LN_PAD	1.0000	0.3692	-0.2647
LN_BM	0.3692	1.0000	-0.2184
Z_KLK	-0.2647	-0.2184	1.0000

Source: EViews 13 output (2026).

Error variance homoskedasticity was assessed via the Glejser procedure by regressing the absolute residuals against the explanatory variables and their multiplicative interaction terms ($\text{X1Z} = \text{LN_PAD} \times \text{Z_KLK}$ and $\text{X2Z} = \text{LN_BM} \times \text{Z_KLK}$). As shown in Table 8, individual t-test probability values ranged from 0.2358 (Z_KLK) to 0.9982 (LN_PAD), and the joint F-test probability reached 0.4400. Since all probability metrics exceeded 0.05, the null hypothesis of homoskedastic error variance was maintained. Furthermore, the Durbin–Watson (DW) statistic of 1.9720 fell near the theoretical center of 2.00 within the 1.50–2.50 acceptance interval, indicating the absence of first-order serial correlation in the panel residuals.

Table 8. Glejser Heteroskedasticity Test Results

Variable	Coefficient	t-Statistic	Probability
C	163.2280	1.1536	0.2514
LN_PAD	-0.0074	-0.0023	0.9982
LN_BM	-6.2718	-1.0137	0.3132
Z_KLK	-48.0828	-1.1927	0.2358
X1Z	0.1444	0.1660	0.8685
X2Z	1.7514	1.0352	0.3031

Source: EViews 13 output (2026); Joint F-test probability $= 0.4400$.

Table 9 presents the parameter estimates, standard errors, t-statistics, and model fit diagnostics from the Moderated Regression Analysis (MRA) estimated via CEM. Based on the estimated coefficients, the empirical panel regression equation is specified as follows:

$$\text{Y_KKPD}_{it} = 237.0522 + 15.0689\,\text{LN_PAD}_{it} - 20.0065\,\text{LN_BM}_{it} - 25.8094\,\text{Z_KLK}_{it} - 4.0557\,\text{X1Z}_{it} + 4.9568\,\text{X2Z}_{it} + \varepsilon_{it}$$

Table 9. Moderated Regression Analysis and Model Fit Statistics

Variable / Diagnostic Indicator	Coefficient / Value	Std. Error	t-Statistic	Probability
Constant (C)	237.0522	238.8021	0.9926	0.3232
LN_PAD	15.0689	5.3847	2.7984	0.0061
LN_BM	-20.0065	10.4418	-1.9159	0.0582

Z_KLK	-25.8094	68.0355	-0.3793	0.7052
X1Z (LN_PAD × Z_KLK)	-4.0557	1.4682	-2.7622	0.0068
X2Z (LN_BM × Z_KLK)	4.9568	2.8551	1.7360	0.0856
R-squared (R^2)	0.0817	—	—	—
Adjusted R-squared	0.0353	—	—	—
F-statistic	1.7611	—	—	0.1278
Standard Error of Regression	5.1668	—	—	—
Durbin–Watson Statistic	1.9720	—	—	—
Total Panel Observations (N)	105	—	—	—

Source: EViews 13 output (2026).

Evaluating the partial regression parameters at the 5% significance threshold ($\alpha = 0.05$) reveals distinct empirical patterns across the direct and moderated pathways, as synthesized in Table 10. First, the direct baseline coefficient for Local Own-Source Revenue (LN_PAD) was positive and statistically significant ($\beta_1 = 15.0689, t = 2.7984, p = 0.0061 < 0.05$), supporting H_1. In this linear-log specification, a positive coefficient indicates that, in the absence of moderating reporting controls, higher locally generated revenue is associated with an upward shift in the expenditure-to-revenue ratio (Y_KKPD), reflecting proportional or greater-than-proportional expenditure expansion (Safitri et al., 2023; Cifuentes-Faura et al., 2024). Second, Capital Expenditure (LN_BM) recorded a negative coefficient ($\beta_2 = -20.0065, t = -1.9159, p = 0.0582$). Because the two-tailed probability slightly exceeded the strict $\alpha = 0.05$ cutoff (showing only marginal significance at the 10% level), H_2 was not supported at the conventional 5% threshold. Third, the direct parameter for Financial Reporting Quality (Z_KLK) was negative but statistically indistinguishable from zero ($\beta_3 = -25.8094, t = -0.3793, p = 0.7052 > 0.05$), leading to the rejection of H_3 and indicating that audit opinion scores alone do not independently alter regional financial efficiency ratios (Felix et al., 2024; Purwati & Firmansyah, 2024).

Table 10. Summary of Hypothesis Testing Decisions

Hypothesis	Structural Path	Estimate (β)	t-Statistic	Probability	Decision (α=0.05)
H_1	LN_PAD → Y_KKPD	15.0689	2.7984	0.0061	Supported
H_2	LN_BM → Y_KKPD	-20.0065	-1.9159	0.0582	Not supported
H_3	Z_KLK → Y_KKPD	-25.8094	-0.3793	0.7052	Not supported
H_4	LN_PAD × Z_KLK → Y_KKPD	-4.0557	-2.7622	0.0068	Supported

H_5	LN_BM × Z_KLK → Y_KKPD	4.9568	1.7360	0.0856	Not supported

Source: Processed by the authors (2026) based on EViews 13 output.

Regarding the interaction hypotheses, the multiplicative term between Local Own-Source Revenue and Financial Reporting Quality (X1Z) yielded a negative and statistically significant coefficient ($\beta_4 = -4.0557, t = -2.7622, p = 0.0068 < 0.05$), providing empirical support for H_4.Following econometric conventions for multiplicative interaction models (Brambor et al., 2006; Hainmueller et al., 2019; Kingsley et al., 2017), differentiating the estimated regression equation with respect to LN_PAD yields the conditional marginal effect of local revenue on the financial efficiency ratio: ∂Y_KKPD/∂LN_PAD $= 15.0689 - 4.0557$ Z_KLK. When a local government holds a Qualified Audit Opinion (Z_KLK $= 3$), the net marginal slope of LN_PAD on the expenditure-to-revenue ratio is $+2.9018$; however, when reporting quality improves to an Unqualified Audit Opinion (Z_KLK $= 4$), the net marginal slope declines to -1.1539. This sign reversal demonstrates that high-quality financial reporting dampens the tendency of rising own-source revenue to inflate regional expenditure ratios (Rahmadhanty & Firmansyah, 2025). Conversely, the interaction term between Capital Expenditure and Financial Reporting Quality (X2Z) was positive ($\beta_5 = 4.9568, t = 1.7360$) but failed to reach statistical significance at the 5% level ($p = 0.0856 > 0.05$), leaving H_5 unsupported.

Finally, the model fit statistics reported in Table 9 indicate that the MRA specification yielded a coefficient of determination (R^2) of 0.0817 and an Adjusted R^2 of 0.0353, with a standard error of regression of 5.1668. Accordingly, Local Own-Source Revenue, Capital Expenditure, Financial Reporting Quality, and their interaction terms collectively accounted for 8.17% (3.53% after degrees-of-freedom adjustment) of the total variance in Local Government Financial Performance across Lampung Province, while the remaining 91.83% was attributable to unobserved structural and fiscal factors outside the specification. Consequently, the joint F-statistic of 1.7611 recorded an overall probability of 0.1278 ($p > 0.05$), indicating that while the partial parameters for LN_PAD and X1Z were individually significant at the 1% level ($p < 0.01$), the five-regressor model as a whole exhibited modest explanatory power when combined with the non-significant capital expenditure and baseline audit score terms (Boex et al., 2024; Wooldridge, 2013).

Discussion

The empirical findings demonstrate that Local Own-Source Revenue (LN_PAD) exerts a statistically significant positive baseline effect on Local Government Financial Performance (Y_KKPD) across the 15 regencies and municipalities in Lampung Province ($\beta_1 = 15.0689, p = 0.0061$). Evaluating this parameter requires careful attention to the operationalization of the dependent variable as the Regional Financial Efficiency Ratio, which measures realized regional expenditure as a percentage of realized regional revenue (Halim & Kusufi, 2018; Mahmudi, 2019; Turley et al., 2015). Under this cost-to-revenue metric, a positive baseline regression coefficient indicates that when local revenue increases without the moderating restraint of high-quality financial reporting, regional expenditure expands proportionally or more than proportionally relative to total revenue, driving the efficiency ratio upward. While Fiscal Decentralization Theory posits that locally generated revenue strengthens regional fiscal autonomy and allocative discretion (Oates, 1972; Martinez-Vazquez & McNab, 2003; Boex et al., 2021), empirical anomalies in subnational public finance indicate that expanding revenue availability frequently relaxes perceived budget constraints and stimulates operational spending (Hines & Thaler, 1995; Rodríguez-Pose & Vidal-Bover, 2024). This result aligns with prior studies confirming a significant relationship between Local Own-Source Revenue and regional financial performance (Safitri et al., 2023; Ekaningtias et al., 2023; Wahyuni & Ali, 2024; Cifuentes-Faura et al., 2024), while simultaneously explaining why several empirical evaluations observe that rising local revenue fails to automatically lower expenditure ratios when incremental funds are absorbed by administrative overhead (Andjarwati et al., 2021; Dharmayasa & Darmayanti, 2021; Maulina et al., 2021; Saputra & Kurniawati, 2025). Furthermore, structural economic disparities across Lampung Province—where commercial urban municipalities such as Bandar Lampung and Metro possess diversified tax and levy bases compared to agrarian regencies (Badan Pusat Statistik Provinsi Lampung, 2024)—indicate that revenue mobilization must be paired with expenditure prioritization to prevent revenue growth from inducing fiscal inefficiency.

In contrast to local revenue, Capital Expenditure (LN_BM) exhibits no statistically significant effect on Local Government Financial Performance at the 5% significance threshold ($\beta_2 = -20.0065, p = 0.0582$), leaving H_2 unsupported. Although the negative sign of the parameter is directionally consistent with cost reduction, the absence of statistical significance at $\alpha = 0.05$ indicates that annual capital outlays on roads, irrigation networks, public buildings, and equipment do not yield immediate, systematic improvements in contemporaneous regional

financial efficiency ratios. Three economic and institutional mechanisms account for this finding. First, public infrastructure investments are characterized by multi-year gestation periods; while capital disbursement inflates the numerator of the expenditure-to-revenue ratio in the current fiscal year, the resulting economic returns and cost-saving efficiencies materialize over subsequent budget cycles (Wenjuan & Zhao, 2023; Zein et al., 2024). Second, the conversion of capital budgets into measurable performance depends on project feasibility planning, procurement competitiveness, contract execution, and post-completion asset utilization (Mohammed et al., 2024). This finding corroborates empirical evidence reported by Angelina et al. (2020), Jesika and Purnawati (2025), Wulandari and Nindiasari (2026), and Yudiastuti et al. (2025), who found that capital expenditure does not consistently improve subnational financial performance, though it diverges from studies identifying direct positive effects (Mubarok et al., 2022; Pramesti & Hendaris, 2025; Chaerani & Firmansyah, 2024). Third, from the perspective of Stewardship Theory (Donaldson & Davis, 1991; Davis et al., 1997), while local executives are expected to deploy capital resources to advance collective welfare, the 2018–2024 observation window encompassed severe fiscal disruptions during the COVID-19 pandemic. Mandatory budget reallocations (*refocusing*) toward healthcare containment and social safety nets altered capital project schedules across Indonesian local governments (Ahrens & Ferry, 2020; Ritonga & Buanaputra, 2023), attenuating the empirical link between capital outlays and annual efficiency metrics.

Similarly, the direct effect of Financial Reporting Quality (Z_KLK) on Local Government Financial Performance is statistically indistinguishable from zero ($\beta_3 = -25.8094, p = 0.7052$), rejecting H_3. This finding underscores a fundamental analytical distinction between compliance-oriented reporting accountability and operational expenditure efficiency in public sector administration (Grossi et al., 2020; Mardiasmo, 2018). In this study, Financial Reporting Quality was proxied by statutory audit opinions issued by the Audit Board of Indonesia (Badan Pemeriksa Keuangan Republik Indonesia, 2024). An Unqualified Audit Opinion (*Wajar Tanpa Pengecualian* [WTP]) certifies that a local government's financial statements are presented fairly in accordance with governmental accounting standards, free from material misstatement. Viewed through Agency Theory (Jensen & Meckling, 1976; Eisenhardt, 1989; Riswan & Affandi, 2014), reliable financial disclosures reduce information asymmetry between local executives and external principals. However, formal accounting compliance does not automatically compel budget-holders to minimize operational costs or optimize expenditure-to-revenue ratios unless audit disclosures are actively leveraged for

legislative oversight and performance evaluation (Cordery & Hay, 2022; Ferry et al., 2023; Felix et al., 2024; Purwati & Firmansyah, 2024). Moreover, from an econometric standpoint, the direct explanatory power of Z_KLK is constrained by institutional score convergence across Lampung Province, where all 105 panel observations clustered strictly between Qualified (score $= 3$) and Unqualified (score $= 4$) opinions with a mean of 3.6667 (Firmansyah et al., 2022). Consequently, cross-sectional variation in audit opinions alone is insufficient to independently drive differences in regional financial efficiency.

A central finding of this study emerges from the significant negative interaction between Local Own-Source Revenue and Financial Reporting Quality (X1Z: $\beta_4 = -4.0557, p = 0.0068$), which supports H_4. Within the econometric taxonomy of moderating variables (Sharma et al., 1981; Brambor et al., 2006; Hainmueller et al., 2019; Kingsley et al., 2017), because Financial Reporting Quality exhibits no significant direct main effect ($p = 0.7052$) but interacts significantly with Local Own-Source Revenue ($p = 0.0068$), it functions as a *pure moderator*. Because the dependent variable represents the ratio of realized expenditure to revenue, the negative interaction parameter indicates that higher Financial Reporting Quality significantly dampens the positive association between expanding local revenue and rising expenditure ratios. Specifically, the conditional marginal effect (∂Y_KKPD/∂LN_PAD $= 15.0689 - 4.0557$ Z_KLK) reveals that when a jurisdiction holds a Qualified Opinion (Z_KLK $= 3$), incremental local revenue is associated with a net upward shift in the expenditure ratio ($+2.9018$), whereas attaining an Unqualified Opinion (Z_KLK $= 4$) reverses the marginal slope to -1.1539, compressing expenditure relative to revenue. Under Agency Theory, transparent, standardized, and verifiable financial reporting strengthens external monitoring by regional legislatures (*DPRD*) and supreme audit authorities, thereby curbing opportunistic budget slack and unmonitored administrative spending when own-source revenues grow (Zarychta et al., 2024). This result is consistent with Rahmadhanty and Firmansyah (2025) and Sukma and Hendaris (2026), confirming that institutional reporting quality conditions how subnational governments translate fiscal autonomy into disciplined budget execution.

Conversely, the interaction between Capital Expenditure and Financial Reporting Quality (X2Z) is statistically insignificant at the 5% level ($\beta_5 = 4.9568, p = 0.0856$), failing to support H_5. This result indicates that variations in BPK audit opinions do not significantly alter the contemporaneous relationship between capital spending and regional financial efficiency. Conceptually, while reliable financial reporting enhances transparency regarding

capital budget realization and fixed asset recording, financial statement audits are conducted *ex-post* at the end of the fiscal year and focus primarily on statutory accounting recognition rather than *ex-ante* investment appraisal. Capital expenditure performance is governed by operational stages that lie largely outside financial statement preparation, including technical feasibility design, procurement execution, construction supervision, and long-term asset maintenance (Padang & Padang, 2023). Weaknesses across these operational stages diminish the efficiency of public investment regardless of whether the resulting year-end accounting records receive an unqualified audit opinion. This finding aligns with Raditya et al. (2022) and Rahayu and Badrudin (2017), illustrating that audit opinion indicators do not uniformly moderate every fiscal expenditure pathway. From the perspective of Stewardship Theory, responsible financial reporting must be complemented by multi-year capital budgeting governance and physical asset management to generate measurable efficiency gains.

These empirical findings yield three theoretical contributions and actionable policy implications for subnational financial management. First, the results refine Fiscal Decentralization Theory by demonstrating that regional revenue mobilization (LN_PAD) and expenditure efficiency (Y_KKPD) do not move in automatic harmony; without strong governance controls, higher own-source revenue can inflate expenditure-to-revenue ratios rather than enhance cost efficiency. Second, the study extends Agency Theory in public sector accounting by establishing that Financial Reporting Quality operates as a pure moderating mechanism—restraining expenditure expansion when local revenues increase—even when its direct main effect on efficiency is statistically null. Third, the non-significant direct and moderated findings for Capital Expenditure qualify Stewardship Theory by highlighting the measurement limits of evaluating multi-year public investments solely through contemporaneous annual cash-flow efficiency ratios (Bisogno et al., 2024). For regional policymakers and municipal administrators in Lampung Province operating under Law Number 1 of 2022 (Government of Indonesia, 2022), these findings imply that local tax and levy intensification must be integrated with stringent internal expenditure controls and performance-informed budgeting. Local governments should transition from treating BPK audit opinions as mere administrative compliance targets toward utilizing audited financial disclosures as operational tools for budget monitoring and cost containment. Finally, given the modest overall explanatory power of the regression specification ($R^2 = 0.0817$, Adjusted $R^2 = 0.0353, F = 1.7611, p = 0.1278$), these findings should be interpreted with appropriate statistical caution (Boex et al., 2021; Wooldridge, 2013). Because subnational financial

efficiency is shaped by broader structural determinants beyond own-source revenue, capital outlays, and audit opinions, subsequent empirical models should incorporate intergovernmental transfer dependency, mandatory spending rigidities, internal control system weaknesses, and lagged capital investment structures.

Conclusion

This study addressed the disconnect between subnational fiscal autonomy and expenditure efficiency by examining the effects of Local Own-Source Revenue and Capital Expenditure on Local Government Financial Performance across 15 regencies and municipalities in Lampung Province, while testing Financial Reporting Quality as an institutional moderating condition. The empirical estimations indicate that Local Own-Source Revenue significantly affects the regional financial efficiency ratio by expanding expenditure relative to revenue in the baseline specification, whereas Capital Expenditure and Financial Reporting Quality exhibit no statistically significant direct effects. In the interaction specification, Financial Reporting Quality acts as a pure moderator that significantly dampens the positive association between Local Own-Source Revenue and the expenditure-to-revenue ratio, but it does not moderate the relationship between Capital Expenditure and financial performance. Ultimately, converting decentralized fiscal capacity into disciplined financial performance requires integrating local revenue mobilization with the oversight mechanisms of reliable financial reporting rather than relying on revenue growth or capital allocations alone.

Required Statements

CRediT authorship contribution statement. A.N.: Conceptualization, Methodology, Software, Formal analysis, Investigation, Data curation, Writing – original draft. **A.F.:** Conceptualization, Methodology, Validation, Supervision, Writing – review and editing. **U.M.:** Methodology, Validation, Supervision, Project administration, Writing – review and editing.

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Data availability. The secondary fiscal, audit, and regional administrative data that support the findings of this study are publicly available from the official repositories of the Directorate General of Fiscal Balance (DJPK) of the Ministry of Finance of the Republic of Indonesia (https://djpk.kemenkeu.go.id), the Audit Board of Indonesia (BPK) (https://www.bpk.go.id), and Statistics Indonesia (BPS) of Lampung Province (https://lampung.bps.go.id). The structured panel dataset and EViews 13 estimation outputs are available from the corresponding author (ahmadnjib04@gmail.com) upon reasonable request.

Ethics statement. This study used only publicly available, aggregated secondary data obtained from official government financial statements and statistical publications. Therefore, ethical approval and informed consent were not required.

Declaration of generative AI and AI-assisted technologies in the writing process. During the preparation of this work, the authors used Google Gemini to improve the academic English language, grammar, and readability of the manuscript. After using this tool, the authors reviewed and edited the content as needed and take full responsibility for the content of the published article.

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