

ANALYZING THE ROLE OF GOVERNMENT SIZE IN THE RELATIONSHIP BETWEEN CAPITAL EXPENDITURE EFFECTIVENESS, AUDIT OPINIONS, AND FISCAL PERFORMANCE



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Abstract

Improving the effectiveness and accountability of local financial management is a major concern in Indonesia's fiscal decentralization policy. Local government financial performance serves as a critical benchmark in evaluating fiscal management under regional autonomy. In practice, many local governments remain highly dependent on central transfers and fail to optimize capital spending due to weak budget planning, supervision, and institutional capacity. This study investigates the effects of capital expenditure and audit opinion on local government financial performance, with government size as a moderating variable. The study focuses on eight regencies and cities in Banten Province from 2015 to 2023, using a quantitative approach with secondary data analyzed through multiple linear regression and interaction analysis. The results show that capital expenditure has a negative and significant effect on financial performance, indicating inefficiency in managing long-term investments. Audit opinion has no significant influence, either directly or when moderated. However, government size strengthens the negative effect of capital expenditure on performance. This study addresses a gap in empirical literature by incorporating government size as a moderating variable to explain prior inconsistencies and to offer a deeper understanding of fiscal capacity in decentralized governance. The findings highlight the importance of improving fiscal and institutional quality to ensure that capital spending effectively contributes to sustainable local financial independence.

Keywords: Capital Expenditure, Audit Opinion, Financial Performance

INTRODUCTION

Enhancing the effectiveness and accountability of regional financial management remains a central concern in the era of fiscal decentralization. Various aspects such as public expenditure, the quality of financial reporting, and governance have been the focus of numerous contemporary studies (Nurfadilah & Mahadianto, 2025). Fiscal decentralization constitutes one of the primary pillars of governance reform in post-reform Indonesia, emphasizing the distribution of authority and accountability between the central government and newly formed regional governments. This principle is explicitly regulated in the legal framework governing the relationship between the central and regional governments, as stipulated in Law No. 23 of 2014 on Regional Government, and the fiscal intergovernmental transfer arrangements outlined in Law No. 33 of 2004 on the Fiscal Balance between the Central and Regional Governments. Through decentralization, regional governments are granted autonomy to manage governmental affairs and development within their respective jurisdictions, including the management of public finances. In this context, the success of decentralization is not solely determined by the size of the allocated budget, but also by the extent to which regional administrations can manage financial resources efficiently, effectively, and accountably.

The level of effectiveness in regional financial management serves as a key indicator in assessing a region's fiscal capacity to carry out governmental functions optimally. However, empirical conditions across various regions indicate that a number of regencies and municipalities have yet to achieve the desired financial performance. One such indicator is the persistently high dependence on fiscal transfers from the central government. For instance, fiscal dependency ratios in regencies/municipalities across Banten Province in 2023 reveal that most regions remain at a very high dependency level, with transfers exceeding 70% of total regional revenues. This condition reflects the suboptimal capacity of regional governments to finance their needs independently through locally generated revenue (Pendapatan Asli Daerah, PAD).

Moreover, the Regional Financial Management Index (Indeks Pengelolaan Keuangan Daerah, IPKD) scores for regencies and municipalities in Banten Province during the period 2021–2023 remain within the medium category, with average scores ranging between 55 and 73. These results highlight fundamental challenges, including weaknesses in budget planning, suboptimal implementation of the regional budget (APBD), inadequate financial reporting and administration systems, and ineffective oversight mechanisms. Such circumstances raise fundamental questions regarding the effectiveness of regional government spending, particularly capital expenditure, in fulfilling its role as an efficient fiscal instrument, as well as the extent to which financial accountability is reflected in audit opinions issued by the Audit Board of Indonesia (Badan Pemeriksa Keuangan, BPK). This aligns with the findings of Rahayu & Hendaris (2022), who emphasize the importance of good governance principles and internal oversight in enhancing regional performance, while also noting that transparency has not yet become a strong driver of oversight effectiveness.

Capital expenditure holds a critical position as it is directed toward financing infrastructure development and procuring fixed assets with long-term benefits for the region. In accordance with Government Regulation No. 12 of 2019, capital expenditure is defined as a type of spending used for the acquisition of land, construction of buildings, procurement of equipment, development of roads, irrigation systems, networks, and other fixed assets of lasting value. Theoretically, an increase in capital expenditure should correlate with

improved public service quality and operational efficiency in government, ultimately strengthening regional fiscal performance. In practice, however, the magnitude of capital expenditure allocation does not always translate into significant improvements in fiscal outcomes, suggesting that the effectiveness of capital expenditure utilization remains an issue requiring further investigation.

On the other hand, audit opinions issued by the BPK on regional government financial statements serve as an indicator of the quality of financial governance, reflecting the degree of compliance with principles of transparency and public accountability. An unqualified opinion (*Wajar Tanpa Pengecualian*, WTP) represents the highest level of assessment, indicating that financial statements are prepared in accordance with governmental accounting standards and free from material misstatements. Although most regencies and municipalities in Banten Province have obtained unqualified opinions from 2015 to 2023, these achievements do not necessarily signify substantive improvements in financial performance. Persistent fiscal dependency on central transfers and the suboptimal use of regional expenditures indicate that audit opinions do not always align with enhanced fiscal capacity. Consistent with the findings of Putri & Hendaris (2025), audit opinions from the BPK were found to have no significant impact on regional financial performance, suggesting that such opinions are not a definitive measure of fiscal management success.

In light of these issues and prior empirical evidence, this study seeks to provide objective evidence on the influence of regional government capital expenditure and audit opinions on regional financial performance, incorporating government size as a moderating variable in the relationship. The focus of this research is on regency and municipal governments in Banten Province over the period 2015–2023. A quantitative approach is employed, utilizing secondary data from budget realization reports and audit reports issued by the BPK.

It is expected that the findings of this study will not only expand the academic discourse in the field of public sector accounting but also offer practical insights for policymakers at the regional government level across Indonesia. The results are anticipated to serve as a basis for recommendations in formulating more efficient, transparent, and accountable strategies for sustainable regional financial management. Furthermore, the study's outcomes may provide valuable input for the BPK and legislative bodies in developing more targeted financial performance evaluation systems. More broadly, this research aims to contribute as a reference for future studies focusing on strengthening fiscal governance in the era of decentralization.

REVIEW OF LITERATURE

Expenditure Agency Theory

Agency theory (Jensen & Meckling, 1976) explains the relationship between society as the principal and local government as the agent mandated to manage public resources for the common welfare. In practice, this relationship is prone to agency problems such as information asymmetry, moral hazard, and potential abuse of power, thereby necessitating external monitoring mechanisms. One important monitoring instrument is the audit opinion issued by the Audit Board of the Republic of Indonesia (BPK), based on criteria from the Government Accounting Standards (SAP), adequacy of disclosure, compliance with laws and regulations, and the effectiveness of internal control systems. This opinion serves not only as an indicator of regulatory compliance but also as a tool to assess the quality of local

financial governance. Several studies have shown a positive influence of audit opinion on local government financial performance (Parwanto & Harto, 2017; Harahap, 2023), while other studies have found no significant effect (Putri & Hendaris, 2025; Halimah, 2017). These divergent findings underscore that within the agency theory framework, the effectiveness of audit opinions in improving financial performance greatly depends on the implementation capacity, follow-up of audit recommendations, and managerial readiness of local governments.

Capital Expenditure

Capital expenditure, as stipulated in Government Regulation No. 12 of 2019, refers to spending for the acquisition of fixed assets or other assets that provide benefits for more than one fiscal year, including expenditures for land, equipment, buildings, roads, irrigation, and other assets. This expenditure is considered a strategic investment contributing to the improvement of public service quality, infrastructure development, and regional economic growth. From the perspective of agency theory, capital expenditure that is managed transparently and accountably can strengthen public trust in local government, while mismanaged spending can trigger distrust and hinder financial performance. Research by Digdowiseiso et al. (2022) and Kirana & Sulardi (2020) has demonstrated a positive influence of capital expenditure on local government financial performance, whereas Fernandes & Putri (2022) reported an insignificant effect. These differences may be attributed to variations in fiscal capacity, development priorities, and oversight effectiveness across regions. A research gap emerges due to the limited studies examining the effect of capital expenditure in non-financial local government work units (OPD), which, although not managing large local revenue (PAD), still make asset investments to support operations. Based on the literature, the research hypothesis is:

H1: Capital expenditure has a positive effect on local government financial performance.

Audit Opinion

The BPK audit opinion is a professional statement regarding the fairness of financial statement presentation based on SAP criteria, adequacy of disclosure, legal compliance, and the effectiveness of internal control (BPK RI, 2017). An Unqualified Opinion (Wajar Tanpa Pengecualian/WTP) is often regarded as an indicator of good financial governance, whereas other types of opinions may indicate weaknesses in local financial management. Studies by Parwanto & Harto (2017), Harahap (2023), and Satria & Sari (2018) found a positive effect of audit opinion on financial performance, while research by Pratama (2022), Putri & Hendaris (2025), and Halimah (2017) found no significant effect. These differing results suggest that although audit opinions have the potential to improve financial performance, their impact largely depends on the region's ability to follow up on audit recommendations and improve financial management systems. A research gap is evident in the lack of studies focusing on audit opinion analysis in non-financial OPDs, which typically have limited resources to implement audit-based improvements. Based on the above discussion, the proposed hypothesis is:

H2: Audit opinion has a positive effect on local government financial performance.

Local Government Size

Local government size reflects a region's fiscal and administrative capacity and can be measured through total assets, number of employees, land area, or regional revenue (Robbins & Coulter, 2016). Larger regions generally possess more adequate resources to

plan, implement, and supervise development programs, but they also face challenges such as greater bureaucratic complexity (Bovens, 2007). Research by Aulia & Rahmawaty (2020) and Sukma et al. (2021) found a positive effect of government size on local government financial performance, while Mulyani & Wibowo (2017) found a negative effect, and Pratama (2022) reported no significant effect. These differences indicate that local government size is not merely a control variable but can also serve as a moderating variable influencing the relationship between capital expenditure and audit opinion on financial performance.

Local Government Size as a Moderating Variable

Local government size has the potential to moderate the effect of capital expenditure on financial performance by influencing budget planning, implementation, and monitoring capacity. Larger local governments tend to have better resources and oversight systems to ensure that capital expenditures are well-targeted and efficient, thereby strengthening their impact on financial performance. Conversely, smaller regions with limited resources may face challenges in managing capital expenditure effectively. Similarly, government size can moderate the relationship between audit opinion and financial performance, as larger regions may have greater capacity to follow up on audit findings, while smaller regions may encounter constraints in implementing audit recommendations. The scarcity of empirical studies examining the moderating function of local government size in this relationship, particularly in non-financial OPDs, presents an important research gap. Based on the theoretical foundation and previous studies, the proposed hypotheses are:

H3: Local government size moderates the effect of capital expenditure on local government financial performance.

H4: Local government size moderates the effect of audit opinion on local government financial performance.

RESEARCH METHOD

The analytical study conducted in this research applies a quantitative approach utilizing secondary data, which is subsequently analyzed statistically. This study employs a quantitative approach to analyze the effect of capital expenditure and audit opinion on local government financial performance, with government size considered as a moderating variable. The research objects comprise eight district and municipal governments within a single province over the period 2015 to 2023. Due to the limited research population, a saturated sampling method was employed, in which the entire population was taken as the sample. Data were obtained from publicly available financial reports and audit results, collected through documentation studies. The variables examined include capital expenditure (X1) and audit opinion (X2) as independent variables, financial performance (Y) as the dependent variable, and government size (Z) as the moderating variable. Capital expenditure and government size are measured using ratio scales, audit opinion is classified as a dummy variable, and financial performance is measured using the fiscal independence ratio.

The operationalization of the variables in this study is as follows: Capital Expenditure (X1) is measured by the percentage of realized capital expenditure to total regional expenditure. Audit Opinion (X2) is assigned a value of 1 for an Unqualified Opinion (Wajar Tanpa Pengecualian – WTP) and 0 for opinions other than WTP. Financial Performance (Y) is measured using the fiscal independence ratio, namely the comparison between locally generated revenue (Pendapatan Asli Daerah – PAD) and total regional revenue. Government

Size (Z) is measured based on the natural logarithm of the total assets of each local government.

Data processing is carried out in a gradual and systematic manner. The analysis begins with the presentation of descriptive statistics to illustrate the basic characteristics of the data, such as averages, extreme values, and distribution. This is followed by a series of data feasibility tests to ensure that the data meet the requirements for analysis, including tests for normality, multicollinearity, heteroskedasticity, and autocorrelation. Once all assumptions are met, hypothesis testing is conducted to assess the effect of each variable on financial performance by examining the level of statistical significance. Additionally, the strength of the relationships among variables and the contribution of independent variables to the dependent variable are also analyzed. All stages are structured to ensure the validity of the results and scientific accountability.

To evaluate the role of government size as a moderating variable in the relationship between capital expenditure and audit opinion on local government financial performance, this study applies an interaction analysis approach using Moderated Regression Analysis (MRA). This method is employed to determine the extent to which the moderating variable influences the direction and intensity of the relationship between the independent and dependent variables. This approach is considered relevant to describe the complexity of fiscal relationships within the local government environment. Based on this framework, the research model is structured in the form of multiple regression by incorporating the interaction between the independent variables and the moderating variable. The model used is formulated as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 Z + \beta_4 (X_1 \times Z) + \beta_5 (X_2 \times Z) + \varepsilon$$

Keterangan:

- Y : Local Government Financial Performance
X₁ : Capital Expenditure
X₂ : Audit Opinion
Z : Government Size
X₁ × Z : Government Size
X₂ × Z : Interaction between Capital Expenditure and Government Size
β₀ – β₅ : Interaction between Audit Opinion and Government Size
ε : Error Term

RESULTS AND DISCUSSION

Before conducting the regression analysis, this study first presents descriptive statistics to provide an initial overview of the characteristics of each variable, namely capital expenditure, audit opinion, local government financial performance, and government size. Based on the processed data, it is observed that the average capital expenditure of local governments during the observation period reached IDR 9,378,631,815,176.39, with a minimum value of IDR 178,523,626,330 and a maximum value of IDR 52,727,104,251,439. The standard deviation of IDR 9,959,788,239,834.25 reflects a high disparity in capital expenditure allocations across regions.

For the audit opinion variable, which was coded as a dummy (1 for an unqualified opinion/WTP and 0 for others), the mean value of 0.9583 with a standard deviation of 0.20123 indicates that the majority of regions obtained an unqualified opinion from the Audit

Board of the Republic of Indonesia (BPK). The local government financial performance variable, measured through the fiscal independence ratio, recorded an average value of IDR 73,304,555.62, with a minimum of IDR 9,044,131 and a maximum of IDR 201,516,165, along with a standard deviation of IDR 56,635,441.01, suggesting variation in performance levels among regions.

Meanwhile, the government size variable, measured by total assets, recorded an average of IDR 8,965,313,693,459.78, with a minimum of IDR 708,213,277,676 and a maximum of IDR 50,724,709,103,854, and a standard deviation of IDR 9,527,151,603,627.04, indicating a considerable disparity in fiscal capacity across local governments.

Table 1.
Regression Analysis

Variable	Coefficient	T	Significance
Capital Expenditure	-0,412	-2,746	0,007
Audit Opinion	-0,014	-0,223	0,824
Government Size	0,044	0,300	0,765
Capital Expenditure × Government Size	0,599	3,151	0,002
Audit Opinion × Government Size	-0,101	-0,739	0,461

Source: Data processed (2025)

This study aims to analyze the effect of capital expenditure and audit opinion on the financial performance of local governments, as well as to evaluate the role of government size as a moderating variable in the relationship. The research was conducted on eight regencies and cities in Banten Province during the period 2015 to 2023. A quantitative approach was employed using interaction analysis to examine both the direct effects among variables and the moderating effect of government size in strengthening or weakening the relationships under study.

Tests of the fundamental assumptions including normality of distribution, relationships among independent variables, variance stability, and sequential data correlation showed that the data met the criteria for analysis using multiple regression. The findings indicate that some variables in the model significantly affect the financial performance of local governments, while others do not show statistically significant relationships. Furthermore, the analysis results presented in Table 1 reveal that capital expenditure has a significant relationship with local government financial performance. This is evidenced by a negative coefficient of -0.412, with a high level of statistical significance. The test result shows a t-value of -2.746, and the probability value is 0.007, which exceeds the 95% confidence level threshold. Thus, it can be concluded that an increase in capital expenditure during the observation period tends to be correlated with a decrease in the level of fiscal independence of local governments. The negative sign of the coefficient indicates that higher capital spending is followed by a lower ratio of financial management performance in a local

government in Indonesia. This finding suggests that capital expenditure allocation during the observation period has not been able to optimally drive fiscal independence, possibly due to planning and implementation that have yet to effectively create long-term economic impact.

On the other hand, audit opinion shows no meaningful effect on the financial performance of local governments. This is reflected in the very small coefficient value of -0.014 and a high significance level of 0.824, indicating that the relationship between the two variables is not statistically significant. In other words, although most regencies and cities obtained an unqualified opinion (WTP), such recognition has not been directly associated with tangible improvements in fiscal independence. This suggests that the assessment of compliance of financial statements with accounting standards cannot yet be used as a benchmark for the overall effectiveness of financial management at the local level.

Government size, used as a moderating variable, shows mixed results. Directly, government size measured by total assets does not exhibit a meaningful relationship with financial performance, as indicated by a small coefficient and a high probability value. This suggests that the size of the government does not necessarily have a direct impact on improving fiscal performance. However, when government size is combined with capital expenditure in the interaction model, the results show a significant relationship. In other words, in regions with greater fiscal capacity and assets, the effect of capital expenditure on financial performance becomes stronger. This finding indicates that adequate institutional and fiscal capacity can enhance the effectiveness of capital expenditure in promoting greater local fiscal independence.

Conversely, the analysis of the combined effect of audit opinion and government size shows that the relationship is not significant. The low coefficient value and high probability level indicate that government size cannot strengthen or weaken the effect of audit opinion on local financial performance. Thus, this finding reinforces that audit opinion, either independently or in interaction with the size of the government institution, has not provided tangible improvements in fiscal governance at the local level. This shows that even achieving the highest audit opinion does not necessarily align with improved effectiveness in comprehensive budget management.

Based on the results presented in the table, it can be concluded that of all the independent variables analyzed, only capital expenditure has a significant direct effect on financial performance, albeit with a negative relationship. In terms of moderation effects, only the interaction between capital expenditure and government size is proven to be significant. This finding underscores that fiscal and institutional capacity plays a key role in determining the extent to which local government spending can drive improvements in the financial management performance of local governments.

Discussion

The findings of this study indicate that capital expenditure has a significant effect on the financial management performance of local governments, although the direction of the relationship shows a negative correlation. This result is noteworthy because, in theory, capital expenditure should serve as one of the main drivers in improving the effectiveness of local financial management through long-term investments, such as infrastructure and other fixed assets. However, the negative coefficient suggests potential inefficiencies in both the allocation and realization of capital spending. In other words, even though local governments

allocate substantial funds for capital expenditure, the impact has not been positively reflected in financial performance ratios, such as the degree of fiscal decentralization.

These findings are consistent with Fernandes & Putri (2022), who argue that capital expenditure does not always yield a positive impact on financial management performance, especially when allocation is not strategically planned or when its management is not carried out optimally and efficiently. This also reinforces the notion that high capital spending does not necessarily reflect budget effectiveness, particularly if it is not supported by proper planning and adequate oversight. Conversely, this result contrasts with the findings of Digdowiseiso et al. (2022) and Kirana & Sulardi (2020), which show that capital expenditure can have a positive and beneficial effect on the fiscal performance of local governments.

Audit opinions issued by the state audit institution in Indonesia were found to have no significant effect on local government financial performance. Although the majority of districts and cities in Banten Province obtained an unqualified opinion (WTP) during the study period, this achievement has not been accompanied by tangible improvements in fiscal independence. This suggests that while audit opinions are often regarded as a symbol of accountability in financial reporting, they do not necessarily reflect the overall effectiveness of budget management. This finding aligns with Pratama (2022) and Halimah (2017), who also report that audit opinions have no significant effect on regional fiscal performance. One possible explanation is that the scope of audit opinions focuses more on compliance with accounting standards and laws rather than directly measuring the extent to which budget allocations translate into the achievement of regional development objectives.

Government size, as a moderating variable, produced two key findings. First, it does not have a direct effect on the financial management performance of local governments. Second, government size was found to play a significant role in strengthening the relationship between capital expenditure and financial management performance. This suggests that regions with larger economic capacity measured through total assets or the volume of resources managed tend to have a better ability to optimize capital spending. Consequently, such spending is more likely to yield positive effects on improving financial performance. This finding supports the work of Sukma et al. (2021), who indicate that the size of a government can strengthen the effect of other variables on its financial management performance.

However, in the interaction between audit opinions and government size, no significant effect was found. This means that the size of a government entity does not strengthen or weaken the relationship between audit opinions and financial performance. This implies that audit opinions are relatively homogeneous and are not influenced by organizational complexity or fiscal capacity. This result is consistent with Tama & Adi (2018) and Mulyani & Wibowo (2017), who found that government size does not necessarily play a significant role in explaining variations in financial performance when associated with audit opinions.

Overall, the results of this study clarify that improvements in local financial performance do not solely depend on the amount of capital expenditure or the audit opinions obtained, but also on institutional capacity and efficiency in implementation. Local governments need to strengthen budget planning and oversight systems so that capital spending truly supports fiscal independence. Furthermore, audit opinions should be utilized

as a tool to improve management systems, rather than being regarded merely as an administrative achievement.

CONCLUSION

This study provides empirical evidence regarding the relationship between capital expenditure in government institutions, the audit process opinion, and the financial management performance of local governments, while also evaluating the role of government size as a moderating variable in that relationship. Based on the analysis of eight regional areas in Banten Province during the 2015–2023 period, the findings indicate that capital expenditure has a significant yet negative correlation with financial management performance. Thus, an increase in capital expenditure is associated with a decline in the level of fiscal independence, which may indicate inefficiencies in the planning and implementation of such budget allocations. On the other hand, the audit process opinion does not show a meaningful effect on financial management performance, either directly or through its interaction with government size. This finding suggests that although most regions have obtained an Unqualified Opinion (Wajar Tanpa Pengecualian – WTP), such an achievement has not necessarily reflected substantial improvements in fiscal management capacity or the quality of local financial governance.

The size of a local government does not have a direct effect on financial management performance. Nevertheless, this variable is proven to play a significant role in strengthening the relationship between capital expenditure and financial management performance. These findings show that local governments with greater fiscal capacity tend to have better ability to manage and optimize capital expenditure, thereby being more capable of driving improvements in financial performance. Conversely, in regions with limited fiscal capacity, the influence of capital expenditure on financial performance tends to be less evident. Meanwhile, government size does not exhibit a moderating role in the relationship between the audit process opinion and financial management performance, whether in strengthening or weakening the effect. These results also address the differences in findings from previous studies and fill the gap in research on the role of government size as a moderating variable in the context of local financial management in Indonesia. Based on these findings, it is recommended that local governments place greater emphasis on efficiency in the use of capital expenditure and enhance institutional capacity so that the results can be more optimally reflected in fiscal performance. For future research, it is suggested to expand the scope of variables, extend the observation period, and increase the sample size to obtain results that are more representative of national conditions and have a higher level of generalizability.

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