

## **Analysis of Factors Affecting Local Government Financial Performance**

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Abstract: The financial performance of local governments (LG) in implementing regional autonomy has a central role. However, the phenomenon is that only some local governments have this financial capability. Therefore, this study examines what factors can affect financial performance. This study empirically analyzed the effect of capital expenditure, local government size, legislative size, local revenue, and audit opinion on the financial performance of local governments in districts and cities in West Java. The method used uses quantitative methods. The research data used financial reports of Regency and City Regional Governments in West Java for the period 2015 - 2022 using Purposive Sampling. A total of 216 data were analyzed using Multiple Linear Regression. The steps in this study begin with a review of literature and regulations, data collection, data tabulation, data analysis, and then reporting and publication of research results. The results showed that the size of local government, local revenue, and audit opinion had a positive effect on financial performance, while capital expenditure and legislative size did not affect financial performance. Based on the results of this study, the implication is that district and city governments in West Java must increase the size of local governments, local revenue, and audit opinion to improve their regions' financial performance.

**Keywords:** Performance, Capital Expenditure, Local Government Size, PAD, Legislative Size, Audit Opinion.

#### **INTRODUCTION**

Local government financial performance in developing countries is an essential issue in the public finance literature (Kapidani, 2018). Governments in various countries are engaged in public sector reforms to encourage privatization of the public sector through increased financial autonomy. (Thoa & Nhi, 2022). Economic performance has played a vital role in successfully implementing regional autonomy in Indonesia, which has entered its second decade. Financial performance is critical in implementing regional autonomy in Indonesia, which has entered its second decade. Until now, the economic capacity of local governments in Indonesia still depends on transfer revenues and revenue sharing from the central government. (Zamzami & Rakhman, 2023). The following is data on the financial independence of districts and cities in West Java Province, calculated using the decentralization ratio, namely, the total local revenue divided by the total local revenue. (Zamzami & Rakhman, 2023), Accompanied by its interpretation for the year 2023.

8	2		
% Regional Financial Capability	Interpretation	Number of LGs	%
0 - 25%	Very Low	6	22%
> 25% - 50%	Low	11	41%
>50% - 75%	Medium	4	15%
> 75%	High	6	22%
Number of LGs		27	

 Table 1. Regional Financial Capability Ratio Districts and Cities in West Java in 2023

Source: Directorate General of Regional Fiscal Balance (2023) processed

Based on the data in Table 1, it can be explained that the phenomenon of this research gap is that districts and cities (local governments) in West Java province, on average, do not have high regional finances but are still low. City districts with high regional capabilities are only 22%, while the rest have financial capabilities that are still very low, 22%, low 41%, and moderate as much as 15%. Thus, most of the regional financial capacity of districts and cities in West Java Province still needs to be classified as low or very low, which means that regional finances are still very dependent on transfers from the central government, so they have low financial performance.

Ideally, when regional autonomy is implemented in a local government, the local government has the financial capacity to finance government affairs and development for the welfare of its people. (Zamzami & Rakhman, 2023).. In the name of regional autonomy, local governments can manage resources in the regions to be handled by themselves, not submitted to the central government. However, based on the data in Table 1, local governments in West Java Province still need a higher financial capability. They are still dependent on transfers from the central government. Therefore, it is necessary to investigate why this happens. What factors can affect the financial performance of local governments? Based on the results of previous research, the influencing factor is the amount of capital expenditure (Zamzami & Rakhman, 2023), (Setiawan & Winarna, 2022), (Wijaya & Solikhi, 2022), (Putri & Aswar, 2022), (Oktaviani & Yudhia Wijaya, 2020)However, the research results (Hariani & Febriyastuti, 2020), (Sutopo & Siddi, 2018) prove that capital expenditure hurts government performance. Furthermore, the factor that affects government financial performance is the size of the local government. (Zamzami & Rakhman, 2023), (Shadrina Hashifa et al., 2023), (Setiawan & Winarna, 2022), but the research results (Oktaviani & Yudhia Wijaya, 2020) prove that local government size does not affect local government financial performance. Another factor affecting local governments' financial performance is the legislature's size, which has a positive impact. (Aprianto, 2021), (Aswar, 2019), (Setyaningrum & Duval Pratama, 2017). However, the results of the study (Shadrina Hashifa et al., 2023), (Banunaek et al., 2022), (Nurhayati et al., 2021), (Ilmiyah et al., 2017) concluded that legislative size does not affect local government financial performance. The next factor that influences the financial performance of local governments is the local revenue (Rizki et al., 2022), (Banunaek et al., 2022), (Aprianto, 2021), (Oktaviani & Yudhia Wijaya, 2020), (Aswar, 2019)However, the research results (Mulyani & Wibowo, 2017) prove that local revenue hurts the financial performance of local governments. Another factor that affects the financial performance of local governments is audit opinion. (Zamzami & Rakhman, 2023), (Shadrina Hashifa et al., 2023) (Wijayanti & Suryandari, 2020), (Sutopo et al., 2017). However, the study's results (Jannah et al., 2020) concluded that audit opinion does not affect the financial performance of local governments.

The results of previous research show that they have yet to be consistent, so they still need to be studied again.

The grand theory used in this study uses the Stewardship theory perspective as a novelty because previous research studies used the agent theory perspective. The use of stewardship theory is based on leaders in local government who must work to benefit the organization, namely to improve services to stakeholders. The concept of Stewardship explains that circumstances and situations make management focus more on organizational than individual interests. (Dallas & Lubrano, 2023). According to the Stewardship theory, government officials as stewards will work optimally to achieve organizational goals, namely for the welfare of the people as principals. Therefore, they will always try how to make their performance good, including financial performance. The main elements of stewardship theory consist of (1) Intrinsic Motivation, where leaders act based on intrinsic motivation, such as achievement, recognition, and commitment to organizational values, not just financial incentives. The implication is that leaders tend to make decisions that benefit the organization and shareholders. (2) Shared Interests, i.e., leaders have common interests and goals. The success of the organization means success for all parties involved. The implication is that it reduces potential conflicts of interest because all parties work towards the same goal. (3) Trust and autonomy, i.e., leaders are given trust and autonomy to carry out their duties without close supervision. This trust is based on the belief that leaders will act in the organization's best interest. This implies a more positive and productive work environment and more effective and innovative decisions. (4) Improving the quality of relationships, which focuses on building strong and trusting relationships between leaders. Open and collaborative communication is critical. This implies harmonious and constructive working relationships, which support achieving organizational goals. (Dallas & Lubrano, 2023).

This study empirically tested the effect of capital expenditure, local government size, legislative size, local revenue, and audit opinion on local government performance. The results of this study contribute to the development of public sector accounting science, especially those related to factors that affect the financial performance of local governments. The results of this study will obtain a model related to factors that affect the financial performance in district and city governments in West Java.

## METHOD

To answer the formulation of problems and research objectives, quantitative research is used. This study used a sample of all local governments in West Java Province, totaling 27 districts and cities. The data used are financial reports including balance sheets, budget realization reports of district and city governments in West Java Province, audit data by the Supreme Audit Agency, and data from the Central Bureau of Statistics from 2015 to 2022 (8 years of observation) so that a sample of 216 was obtained. Purposive sampling is used to collect data by determining the complete data provided by the local government. The definitions of the variables used in this study are as follows. Capital expenditure is budget expenditure for the acquisition of fixed assets and other assets that provide benefits for more than one accounting period. (Government Regulation No. 71 Year 2010, n.d.).. Capital expenditure is calculated based on the realization of expenditure for capital expenditure each year from 2015 to 2022. . The data source comes from the Budget Realization Report. The size of local government is proxied by the total assets controlled and utilized by the government. (Zamzami & Rakhman, 2023). The source of total asset data is obtained from the Balance Sheet Report from 2015 to 2022. Legislative size is proxied by the number of members of the Regional People's Representative Council (DPRD) or legislative members tasked with overseeing local governments so that local governments can allocate existing budgets to be

utilized properly (Shadrina Hashifa, 2023). (Shadrina Hashifa et al., 2023). The data source for the number of members of the regional people's representative council comes from the Central Statistics Agency of each region published from 2015 to 2022. Local revenue is revenue consisting of local taxes, local levies, the results of the management of separated regional assets and other legitimate revenues. (Oktaviani & Yudhia Wijaya, 2020). The data source comes from the Budget Realization Report from 2015 to 2022. Audit opinion is an audit opinion on local government financial statements issued by the Supreme Audit Agency (BPK). (Sutopo et al., 2017). The data source comes from the results of the examination of local government financial statements by the Supreme Audit Agency from 2015 to 2022.

The data was analyzed using the Multiple Linear Regression method using the SPSS Version 27 application. The regression equation is as follows.

$Y = \alpha + \beta 1 X 1 + \beta 2 X$	$2 + \beta 3X3 + \beta 4X4 + \beta 5X5$ (1)
Description:	
Y	= Financial Performance
β1, β2, β3, β4, β5	= Dependent Variable Coefficients
X1	= Capital Expenditure
X2	= Size of Local Government
X3	= Legislative Size
X4	= Regional Original Revenue
X5	= Audit Opinion

## **RESULTS AND DISCUSSION**

**Descriptive Statistics** 

Table 2. Descriptive Statistical Value of Research Variables								
Descriptive Statistics								
	Ν	Minimum	Maximum	Mean	Std. Deviation			
Financial performance	216	0.06308	0.45258	0.22142	0.11185			
Capital Expenditure	216	10.75908	12.23077	11.6668	0.27108			
Size of Local Government	216	12.04289	13.66299	12.6906	0.3342			
Legslative size	216	1.39794	1.74036	1.66973	0.06392			
Local Revenue	216	10.8096	12.57541	11.7379	0.36374			
Opinion	216	0	1		0.467			
Valid N (listwise)	216							

Source: Data processing, 2024

Based on the data in Table 2, the financial performance variable has a mean value of 0.22142, a minimum value of 0.06308, and a maximum value of 0.45258; the data range is 0.45258 - 0.06308 = 0.38950, and a standard deviation of 0.11185. A standard deviation value of 0.11185 shows that financial performance varies, but most data tends to be in a relatively close range with an average of 0.22142.

The capital expenditure variable has a mean value of 11.66677, a minimum value of 10.75908, a maximum value of 12.23077, and a standard deviation value of 0.27108. The standard deviation value of 0.27108 indicates that most capital expenditures are close to the average of 11.66677.

The local government size variable has a mean value of 12.69060, a minimum value of 12.04289, a maximum value of 13.66299, and a standard deviation value of 0.33420. A standard deviation value of 0.33420 indicates a variation in the size of the LG variable.

The legislative size variable has a mean value of 1.66973, a minimum value of 1.39794, a maximum value of 1.74036, and a standard deviation value of 0.06392. A standard deviation value of 0.06392 indicates that the legislative size is not diverse, and most values are close to the average of 1.66973. This slight standard deviation indicates that the Legislative Size variable tends to be consistent in the analyzed dataset.

The PAD variable has a mean value of 11.73785, a minimum value of 10.80960, a maximum value of 12.57541, and a standard deviation value of 0.36374. With a standard deviation value of 0.36374, there is a significant variation in local revenue among the regions studied. The relatively large standard deviation value indicates substantial differences between regions regarding own-source revenues, so not all areas have revenues close to the average.

The audit opinion variable has a mean value of 0.68, a minimum value of 0 an m, a maximum value of 1, and a standard deviation value of 0.467. A standard deviation value of 0.467 indicates considerable variation in audit opinion among the entities studied. A standard deviation value that is almost half of the range (0 to 1) suggests that many entities have very different audit opinions, with some getting very favorable opinions and others not.

### **Regression Classical Assumption Testing** Normality Test

Table 3. Normality Test Results						
One-Sample Kolmogorov-Smirnov Test						
			Unstandardized			
			Residual			
Ν			216			
Normal Danamatanah		Mean	0			
Normai Paran	lieters,"	Std. Deviation	0.05405			
Maat	E	Absolute	0.079			
Differences	Extreme	Positive	0.079			
Differences		Negative	-0.04			
Kolmogorov-	Smirnov Z		1.164			
Asymp. Sig. (2-tailed)			0.133			
a. Test distribution is Normal.						
b. User-Specit	fied					

Source: data processing, 2024

Based on the data in Table 3, the results of the calculation of the normality test of the regression model based on the table above show the Kolmogorov (Kolmogorov-Smirnov Z) value obtained is 1.164 with a p-value (sig value) of 0.133. Normality test results for residual value data have a significance (p) greater than 0.05. So, the residual value of the regression model follows a customarily distributed data distribution. Normality testing shows that the regression model fulfills the assumption of normality.

## **Autocorrelation Test**

Table 4. Durbin-Watson Value Table								
Model Summary								
Model	р	D Caucaro	Adjusted R	Std. Error of	Durbin-			
Widdel	ĸ	K Square	Square	the Estimate	Watson			
1	.875ª	0.766	0.76	1 0.054693	1.712			
a. Predictors:	(Constant), C	pinion, Local	Government	Size, Legislative	Size, Capital			
Expenditure, PAD								
b. Dependent Variable: Financial Performance								

Source: data processing, 2024

Based on Table 4, the calculation results of Durbin-Watson (D-W) statistics are obtained at 1.712.

 Table 5.Durbin-Watson Test Results

D-W	$d_L$	$d_{\mathrm{U}}$	Description			
1,712	1,623	1,725	None			
Source: Data processing, 2024						

The D-W value obtained from the model is compared against the Durbin-Watson table value. For the number of observations of 216 and X variables in the regression model of 5, obtained from the Durbin-Watson (D-W) table, the lower limit value of DL is 1.623, and the upper limit value of DU is 1.725. The DW-stat value is 1.696, which is in the dL - dU range, namely the Doubtful area or no autocorrelation test decision. To obtain a test decision, further tests are carried out using the Run test to determine the randomness of the residual value.

Table 0. Series	i est Results					
Test Ru	Test Runs					
	Unstandardized					
	Residual					
Test Value	0					
Cases < Test Value	113					
Cases >= Test Value	103					
Total Cases	216					
Number of Runs	80					
Ζ	-1.133					
Asymp. Sig. (2-tailed)	0.084					
a. Mean						

Source: Data Processing, 2024

Based on Table 6, the test results show the test significance value - p-value (Asymp. Sig. (2-tailed)) of 0.084. Because the p-value>  $\alpha = 0.05$ , it can be concluded that the residual value of the regression model is random, and there is no autocorrelation problem.

## **Heteroscedasticity Test**



## Figure 1: scatter plot

Based on the scatter plot image above, it can be seen that the dots do not form a specific pattern and are mainly spread out. This means that the regression model does not have a heteroscedasticity problem.

## **Multiple Regression Analysis**

		1 au	ne 7. Multip	ie Lineal Ke	gi ession Res	buits		
Coefficient	s							
Model		Unstandardized Coefficients		Standardi zed Coefficie nts	t	Sig.	Collinearity Statistics	
		В	Std. Error	Beta			Tolerance	VIF
	(Constant )	-2.07	0.172		-12.066	0		
- 1	Capital Expenditu re	-0.054	0.024	-0.132	-2.22	0.027	0.316	3.162
	Size of Local Governm ent	0.062	0.024	0.185	2.591	0.01	0.218	4.588
	Legslativ e size	-0.708	0.079	-0.404	-9.012	0	0.552	1.81
	PAD	0.282	0.022	0.916	12.853	0	0.219	4.572
	Opinion	0.019	0.009	0.079	2.102	0.037	0.788	1.268
a Depender	nt Variable <sup>.</sup> F	Financial Perf	ormance					

Table 7 Multiple Linear Degregation Degulta

Source: Data processing, 2024

Based on the calculation results in Table 7, the multiple linear regression equation can be made as follows:

Y= -2.070 - 0.054 X1 + 0.062 X2 - 0.708 X3 + 0.282 X4 + 0.019 X5

Capital expenditure (X1) has an inverse (negative) relationship with the financial performance of district/city governments in West Java (Y), indicated by a negative regression coefficient value (-0.054). So, a one-unit increase in capital expenditure decreases financial performance by 0.054.

Local government size (X2) has a unidirectional (positive) relationship with the financial performance of district/city governments in West Java (Y), indicated by a positive regression coefficient value (0.062). So, an increase of one unit of local government size (local government with a larger/increased asset size) improves financial performance by 0.06.

Legislative Size has an inversely proportional (negative) relationship with the financial performance of district/city governments in West Java (Y), indicated by a negative regression coefficient value (-0.708). So, increasing one unit of Legislative Size reduces financial performance by 0.708.

Regional Original Revenue (X4) has a unidirectional (positive) relationship with the financial performance of district/city governments in West Java (Y), indicated by a positive regression coefficient value (0.282). So, an increase of one unit of PAD increases financial performance by 0.282.

Audit Opinion has a unidirectional (positive) relationship with the financial performance of district/city governments in West Java (Y) indicated by a positive regression coefficient value (0.019). So, local governments with increased audit opinion have increased financial performance by 0.019.

The constant value ( $\alpha$ ) of -2.070 shows the average Financial Performance (Y) of -4.070 if the conditions of Capital Expenditure, Local Government Size, Legislative Size, Local Revenue, and Audit Opinion do not change (constant) or zero (0).

# Multiple Correlation (R) and Coefficient of Determination (R-squares) Table 8. Multiple Correlation Coefficient and Determination Model Summary

Model	R	R Square	Adjusted Square	R	Std. Error of the Estimate		
1	.875 <sup>a</sup>	0.766	0.761		0.054693		
a. Predicto	rs: (Constant),	Opinion, Local Go	vernment Siz	e, Le	egislative Size,		
Capital Expenditure, PAD							
b. Dependent Variable: Financial Performance							
Samuel Data ana seria 2024							

Source: Data processing, 2024

Based on Table 8, the results of the calculation of the multiple correlation coefficient of capital expenditure, local government size, legislative size, local revenue, and audit opinion with financial performance are obtained at 0.875. The value obtained is in the strong category. Economic performance is closely related to capital expenditure, local government size, legislative size, local revenue, and audit opinion. The magnitude of the influence of capital expenditure, local government size, legislative size, local revenue, and audit opinion on financial performance can be seen from the coefficient of determination (R Square). From the calculation results, the coefficient of determination (R2) value is 0.766. This means that capital expenditure, local government size, legislative size, local revenue, and audit opinion contribute to 76.6% of financial performance, while other variables outside the research model explain the remaining 23.4%.

Table 9. F Test Results									
ANOVA <sup>a</sup>									
Model		Sum Squares	of	df		Mean Square	F	Sig.	
	Regression	2.062		5		0.412	137.8	36 .000	) <sup>b</sup>
1	Residuals	0.628		210		0.003			
	Total	2.69		215					
a. Depende	ent Variable: Fin	ancial Perf	orma	ince					
b. Predicto	ors: (Constant),	Opinion,	Size	e of	Local	Government,	Size of	Legislature,	Capital
Expenditur	e, PAD								
		D C		D					

## **Regression Model Test (F Test Statistics)**

Source: Data processing, 2024

Based on the results of SPSS calculations in Table 9 ANOVA, the value of Fcount = 137.836 with a significant value of 0.000. From the F table for free degrees df1 = k = 5 and df2 =n-k-1 = 216 -5-1 = 210 obtained Ftable value = 2.257. The value of Fcount = 137.836 is greater than Ftable = 2.257. The obtained probability F value or seen significance value of 0.000 is smaller than the alpha value ( $\alpha = 0.05$ ). The result of the statistical hypothesis test decision is to reject the null hypothesis (H0) and accept the alternative hypothesis (H1). The results obtained mean the model is Fit. The model feasibility test shows that the model has the accuracy of the sample function in statistically estimating the actual value or that there is a significant effect of capital expenditure, local government size, legislative size, local revenue, and audit opinion on financial performance.

Table 10 Hypothesis Tasting Table (t-test)								
VariablesCoef.tP (sig)DecisionDescription								
Capital Expenditure	-0.054	-2.22	0.027	H <sub>0</sub> accepted	Not Significant			
Size of Local Government	0.062	2.591	0.01	H <sub>0</sub> is rejected	Significant			

## Hypothesis Test (t Statistical Test)

Legislative size	-0.708	-9.012	0	H <sub>0</sub> accepted	Not Significant
Local Revenue	0.282	12.853	0	H <sub>0</sub> is rejected	Significant
Audit Opinion	0.019	2.102	0.037	H <sub>0</sub> is rejected	Significant
	n		•	1, 2024	

Source: Data processing results, 2024

Hypothesis 1: Capital expenditure positively affects local government financial performance; the test results are as follows.

The results of testing the first hypothesis obtained the t-test value = -2.220 with p (0.027) <0.05. The conclusion is that the test is not meaningful because the regression coefficient value is negative. So, capital expenditure does not positively affect local government financial performance. The results of this study do not support the results of the research of Zamzani & Rakhman, 2023; Setiawan & Winarna, 2022. However, it supports the research results by Hariani and Rahkman, 2020. The implication of the results of this study is that it shows that existing capital expenditure could be used more efficiently and effectively. Local governments must re-evaluate how they plan and manage capital expenditure to ensure that the investment provides the expected benefits.

Hypothesis 2: Local government size positively affects local government financial performance; the test results are as follows.

The results of testing the second hypothesis obtained a t-test value = 2.591 with p (0.010) < 0.05. The conclusion is that the test is meaningful. So, local government size positively affects local government's financial performance. The study's results support the research results of Shadrina Hashifa et al. 2023; Setiawan & Winarna, and Nurhayatiet al, 2021. The implication of this study's results is that larger local governments have more resources that can be used for various programs and public services that can improve local government financial performance.

Hypothesis 3: Legislative size positively affects local government financial performance; the test results are as follows.

The results of testing the third hypothesis obtained the t-test value = -9.012 with p (0.000) <0.05. The conclusion is that the test is not meaningful because the regression coefficient value is negative. So, legislative size has no positive effect on local government financial performance. The study's results support the research (Aprianto, 2021). The results of this study imply that a large number of legislative members does not guarantee an increase in financial performance.

Hypothesis 4: Local revenue positively affects local government financial performance; the test results are as follows.

The results of testing the fourth hypothesis obtained a t-test value = 12.853 with p (0.000) <0.05. The conclusion is that the test is meaningful. So, local revenue positively affects the regional government's financial performance. The results of this study support the research of Aprianto, 2021; Aswar, 2019. The results of this study imply that higher PAD can improve the financial performance of local governments. PAD reflects regional financial independence, reducing dependence on transfers from the central government.

Hypothesis 5: Audit Opinion positively affects local government financial performance; the test results are as follows.

The results of testing the fifth hypothesis obtained a t-test value = 2.102 with p (0.037) <0.05. The conclusion is that the test is meaningful. So, the audit opinion positively affects the local government's financial performance. The results of this study support the research of Shadrina Hashifa et al. 2023; Aswar, 2019; Sutopo et al., 2017. The results of this study imply that a favorable audit opinion indicates that local government financial reports are well prepared and comply with applicable accounting standards, thereby increasing public and stakeholder confidence. Local governments can gain more significant support from the public

and stakeholders, which in turn can increase participation and cooperation in development programs.

## **CONCLUSION**

Based on the results of the research and discussion that has been explained, the conclusions of the research results are as follows.

- 1. Capital expenditure does not significantly affect financial performance, indicating the need for better evaluation and management in allocating capital expenditure. Local governments need to review projects funded through capital expenditure to ensure that the investment has a positive impact.
- 2. The significant effect of local government size on financial performance indicates the importance of optimizing the size and structure of government to achieve operational efficiency.
- 3. Legislative size is insignificant and has a negative coefficient, indicating that a more significant number of legislators does not necessarily contribute positively to financial performance. Local governments may need to evaluate the legislative structure and look for ways to improve effectiveness without necessarily increasing the legislature's size.
- 4. The significant effect of local revenue on financial performance emphasizes the importance of increasing local revenue. Local governments can focus on diversifying revenue sources and improving the efficiency of tax and levy collection.
- 5. Audit opinion significantly affects financial performance, indicating the importance of a transparent and accountable audit process. Local governments must ensure that the audit process is conducted independently and the results are used to improve financial performance.

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