# Financial and non-financial determinants of local government financial performance: evidence from West Java, Indonesia

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## Abstract

This study investigates the financial and non-financial determinants of local government financial performance by analyzing panel data from 27 regencies and cities in West Java Province, Indonesia, over the 2019–2023 fiscal period. Recent decentralization reforms in Indonesia have intensified the need for stronger fiscal independence and accountability at the regional level. However, empirical evidence indicates persistent dependence on central transfers and varied performance across regions. This research contributes to the literature by integrating intergovernmental fiscal transfers, regional expenditure, surplus of budget financing (SILPA), audit opinions, government size, and legislative size into a unified analytical framework grounded in stewardship theory and signaling theory. Using a panel-data regression approach, the study reveals that fiscal transfers, regional expenditure, and SILPA negatively and significantly affect financial performance, while audit opinion and government size exert a positive and significant influence. Legislative size shows a positive but statistically insignificant effect. The findings highlight that both financial management quality and institutional governance characteristics jointly shape the fiscal capacity of local governments. This study extends current understanding by providing updated empirical evidence on the post-pandemic fiscal period and offers practical insights for policymakers aiming to strengthen fiscal autonomy and regional accountability.

Keywords: fiscal decentralization, intergovernmental transfers, audit quality, regional governance, financial performance.

## INTRODUCTION

Fiscal decentralization has become a central pillar of public-sector governance reforms in many developing economies, including Indonesia. Under Law No. 23/2014 and Law No. 1/2022, local governments are granted authority to manage public services, regulate regional development, and administer financial resources independently (Republic of Indonesia, 2014; 2022). In theory, decentralization is expected to enhance public-sector efficiency, improve service delivery, and strengthen local accountability (Nirwana et al., 2023; Ritonga & Buanaputra, 2022). However, empirical realities often demonstrate uneven fiscal capacity and persistent dependence on central government transfers (Kiziltan & Yereli, 2023; Yu et al., 2023).

West Java Province, one of Indonesia's most economically dynamic regions, presents an illustrative case. Despite its large population and substantial economic activity, many of its regencies and cities continue to exhibit low fiscal independence, as reflected in the average fiscal autonomy ratio of only 23% between 2019 and 2023. This indicates continued reliance on intergovernmental fiscal transfers, particularly the General Allocation Fund (DAU), which remains a dominant revenue source for most regions (Siswidiyanto & Sahputri, 2023).

Financial performance serves as a crucial indicator of a local government's ability to manage revenues and expenditures efficiently, meet public service obligations, and achieve development targets. Prior studies have identified a range of determinants influencing local government financial performance, including fiscal transfers, regional spending patterns, audit quality, institutional size,

political oversight, and budget management effectiveness (Hummel & Kusumasari, 2025; Setiawan et al., 2022; Zein et al., 2024).

This study extends the literature by examining financial and non-financial drivers of financial performance through an integrated framework based on stewardship theory and signaling theory. Stewardship theory emphasizes that public managers act in the best interest of citizens by safeguarding public resources, while signaling theory explains how governments convey credibility and accountability through financial disclosures and audit outcomes (Aliahmadi, 2024; Connelly et al., 2025; Dzagah et al., 2025; Jasir et al., 2023; Salomonsen et al., 2024; Shahid et al., 2024).

Focusing on West Java's 27 regencies and cities during the 2019-2023 period, including the COVID-19 fiscal shock, this research contributes new empirical evidence on how budget behavior, fiscal transfer dependence, internal governance capacity, and institutional size affect financial sustainability. Given ongoing national efforts to enhance fiscal autonomy and governance quality, the findings offer relevant insights for policymakers, auditors, and regional leaders aiming to strengthen public financial management.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### Fiscal Decentralization and Local Government Financial Performance

Fiscal decentralization constitutes the transfer of authority, responsibility, and resources from central to local governments to enhance autonomy and public-service efficiency. Decentralization improves performance when local governments possess adequate fiscal capacity and governance quality (Adana et al., 2024; de Mello & Jalles, 2024). In Indonesia, the decentralization reforms under Law No. 1/2022 emphasize local responsibility for generating revenue and managing expenditures. Empirical studies show mixed outcomes: while decentralization increases accountability, it may also widen gaps in fiscal capability across regions (Eifeky et al., 2023). Financial performance reflects a region's ability to manage public finances efficiently through independence, effectiveness, and fiscal sustainability (Neuhuber et al., 2025; Xia & Zhang, 2025).

### Intergovernmental Transfers and Financial Performance

Intergovernmental fiscal transfers, particularly the General Allocation Fund (DAU) and the Specific Allocation Fund (DAK), play a dominant role in local budgeting (Wati et al., 2022). Excessive dependence on transfers may reduce fiscal discipline and weaken incentives for revenue generation (Hidayat et al., 2024). Previous studies report that high transfer reliance often correlates negatively with financial performance because regions become less motivated to optimize their own-source revenue (Haslam McKenzie & Eyles, 2024). Thus, transfer dependence may hinder autonomy and weaken fiscal capacity.

H1: Intergovernmental fiscal transfers negatively affect local government financial performance.

### Regional Expenditure and Financial Performance

Regional expenditure reflects the government's obligation to deliver public services. However, inefficient or excessive spending may impair financial capacity and reduce performance. Prior research notes that expenditure growth without proportional revenue increases tends to reduce financial sustainability (Neuhuber et al., 2025). Conversely, effective expenditure allocation can strengthen service delivery and promote financial accountability (Guan et al., 2023). Given spending pressures during and after the COVID-19 pandemic, expenditure management becomes critical.

H2: Regional expenditure negatively affects local government financial performance.

### Budget Surplus (SILPA) and Financial Performance

SILPA represents the remaining budget resulting from inefficiencies in planning or execution. Though high SILPA may appear positive, it often signals poor budget absorption and weak financial planning (Andonoska & Alda, 2025). Studies in Indonesian local governments frequently interpret

high SILPA as an indicator of low fiscal performance due to delays in procurement, inadequate project management, or overly conservative budgeting. Hence, SILPA is posited to have a negative association with performance.

H3: Budget surplus (SILPA) negatively affects local government financial performance.

**Audit Opinion and Financial Performance**

Audit opinion, particularly from the Audit Board of Indonesia (BPK), serves as a credibility signal reflecting the quality of financial reporting and internal control. Signaling theory suggests that high-quality audit outcomes strengthen stakeholder trust and signal responsible fiscal management (Chen & Hu, 2025; Zhen Li et al., 2023). Empirical studies show that regions receiving an unqualified opinion tend to exhibit better fiscal performance due to stronger internal control systems and compliance (Chen & Hu, 2025; Zhang et al., 2022). Thus, audit quality is expected to improve financial performance.

H4: Audit opinion positively affects local government financial performance.

**Government Size and Financial Performance**

Government size, typically measured by asset value or budget magnitude, may strengthen fiscal capacity by enabling economies of scale and improved administrative capability. Larger governments often possess stronger financial resources, skilled personnel, and more advanced infrastructures (Han & Kou, 2022; Luo, 2024). Therefore, government size is expected to facilitate better performance.

H5: Government size positively affects local government financial performance.

**Legislative Size and Financial Performance**

Legislative councils (DPRD) are responsible for budgeting, oversight, and political accountability. Larger legislative bodies may increase representation but can also introduce coordination challenges, political fragmentation, and potential agency problems. Prior research notes inconsistent findings, with some studies suggesting positive oversight effects and others indicating inefficiencies arising from excessive political bargaining (Zafra-Gómez et al., 2023). Thus, legislative size may influence performance but with uncertain direction.

H6: Legislative size positively affects local government financial performance.

**METHODS**
**Research Design**

This study employed a quantitative explanatory research design using a panel data approach to examine the financial and non-financial determinants of local government financial performance. The explanatory design is appropriate because the objective of the study is to test the causal influence of intergovernmental transfers, regional expenditure, budget surplus (SILPA), audit opinion, government size, and legislative size on financial performance across multiple local government entities. Panel-data analysis also enhances statistical efficiency by combining cross-sectional and time-series variations, thereby enabling stronger inference regarding temporal patterns and heterogeneity among regions (Rüttenauer & Ludwig, 2023).

**Population and Sample**

The population consisted of all 27 regencies and cities in West Java Province, Indonesia. A census sampling technique was applied, meaning all local governments within the province were included in the analysis. The study period covered the 2019-2023 fiscal years, representing both pre-pandemic, pandemic, and post-pandemic phases. The complete inclusion of all regions ensures representativeness and reduces sampling bias while capturing variations in governance capacity and fiscal behavior across jurisdictions.

**Table 1.** Sample

| No. | Regencies / Cities | The Area (Km$^2$) | District | Urban Vilage | Village |
|---|---|---|---|---|---|
| 1 | Regency of Bandung | 2.710,62 | 31 | 10 | 270 |
| 2 | Regency of Bandung Barat | 1.305,77 | 16 | - | 165 |
| 3 | Regency of Bekasi | 1.224,88 | 23 | 7 | 180 |
| 4 | Regency of Bogor | 2.710,62 | 40 | 19 | 416 |
| 5 | Regency of Ciamis | 1.414,71 | 27 | 7 | 258 |
| 6 | Regency of Cianjur | 3.840,16 | 32 | 6 | 354 |
| 7 | Regency of Cirebon | 984,52 | 40 | 12 | 421 |
| 8 | Regency of Garut | 3.074,07 | 42 | 21 | 421 |
| 9 | Regency of Indramayu | 2.040,11 | 31 | 8 | 309 |
| 10 | Regency of Karawang | 1.652,20 | 30 | 12 | 297 |
| 11 | Regency of Kuningan | 1.110,56 | 32 | 15 | 361 |
| 12 | Regency of Majalengka | 1.204,24 | 26 | 13 | 330 |
| 13 | Regency of Pangandaran | 1.010,00 | 10 | - | 93 |
| 14 | Regency of Purwakarta | 825,74 | 17 | 9 | 183 |
| 15 | Regency of Subang | 1.893,95 | 30 | 8 | 309 |
| 16 | Regency of Sukabumi | 4.145,70 | 47 | 5 | 381 |
| 17 | Regency of Sumedang | 1.518,33 | 32 | 15 | 361 |
| 18 | Regency of Tasikmalaya | 2.551,19 | 39 | - | 351 |
| 19 | City of Bandung | 167,67 | 30 | 151 | - |
| 20 | City of Banjar | 113,49 | 4 | 9 | 16 |
| 21 | City of Bekasi | 206,61 | 12 | 56 | - |
| 22 | City of Bogor | 118,50 | 6 | 68 | - |
| 23 | City of Cimahi | 39,27 | 3 | 15 | - |
| 24 | City of Cirebon | 37,36 | 5 | 22 | - |
| 25 | City of Depok | 200,29 | 11 | 63 | - |
| 26 | City of Sukabumi | 48,25 | 7 | 33 | - |
| 27 | City of Tasikmalaya | 171,61 | 10 | 69 | - |

**Data Types and Sources**

This study relied entirely on secondary data obtained from publicly accessible governmental databases, including:

1. Local Government Financial Statements (LKPD) issued by the Audit Board of Indonesia (Badan Pemeriksa Keuangan – BPK);
2. APBD Realization Reports published by each regency/city;
3. Ministry of Finance (DJPK) fiscal transfer database;
4. Regional autonomy and governance indicators issued by the Ministry of Home Affairs;
5. BPK annual audit report summaries for determining audit opinion.

These sources were selected due to their institutional credibility, standardized reporting mechanisms, and consistent availability during the 2019–2023 timeframe.

**Variable Measurement and Operationalization**

The study included one dependent variable and six independent variables. Financial performance was operationalized using the fiscal independence ratio, while predictors captured financial, managerial, and institutional characteristics of local governments.

**Table 2.** Variable Measurement and Operationalization

| Variable | Type | Operational Definition | Indicator Measurement | Scale |
|---|---|---|---|---|
| Financial Performance (Y) | Dependent | The ability of local governments to generate own-source revenue relative to total revenue, indicating fiscal independence | Fiscal Independence Ratio = PAD / Total Revenue | Ratio |
| Intergovernmental Transfers ($X_1$) | Independent | Fiscal dependence on central government funds | Natural Log of Total Transfer | Nominal |
| Regional Expenditure ($X_2$) | Independent | Level of government spending relative to fiscal capacity | Realized of Total Expenditure | Nominal |
| Budget Surplus – SILPA ($X_3$) | Independent | Remaining unspent budget at end of fiscal year | SILPA (Rp) reported in LKPD | Nominal |
| Audit Opinion ($X_4$) | Independent | Quality of financial statements as evaluated by BPK | WTP (1) Non-WTP (0) | Nominal |
| Government Size ($X_5$) | Independent | Magnitude of regional assets and administrative capacity | Natural Log of Total Assets | Nominal |
| Legislative Size ($X_6$) | Independent | Number of DPRD members responsible for supervision and budgeting | Total Number of DPRD Members | Nominal |

**Data Analysis Procedures**
**1. Descriptive Statistics**
Descriptive analyses were conducted to identify data characteristics, including minimum, maximum, mean, and standard deviation for each variable.
**2. Panel Regression Model Estimation**
Three potential model specifications were examined:
a. Common Effect Model (CEM)
b. Fixed Effect Model (FEM)
c. Random Effect Model (REM)
The final model was selected based on statistical significance and theoretical consistency.
**3. Classical Assumption Tests**
To ensure estimator reliability:
a. Multicollinearity was tested using VIF.
b. Heteroskedasticity was assessed using the Modified Wald Test.
c. Autocorrelation was evaluated using the Wooldridge Test.
d. Cross-sectional dependence was examined when required.
e. Robust standard errors were applied to correct any detected violations.
**4. Software**
All statistical tests were performed using *Eviews* 9.0, which provides comprehensive tools for panel-data econometric analysis.
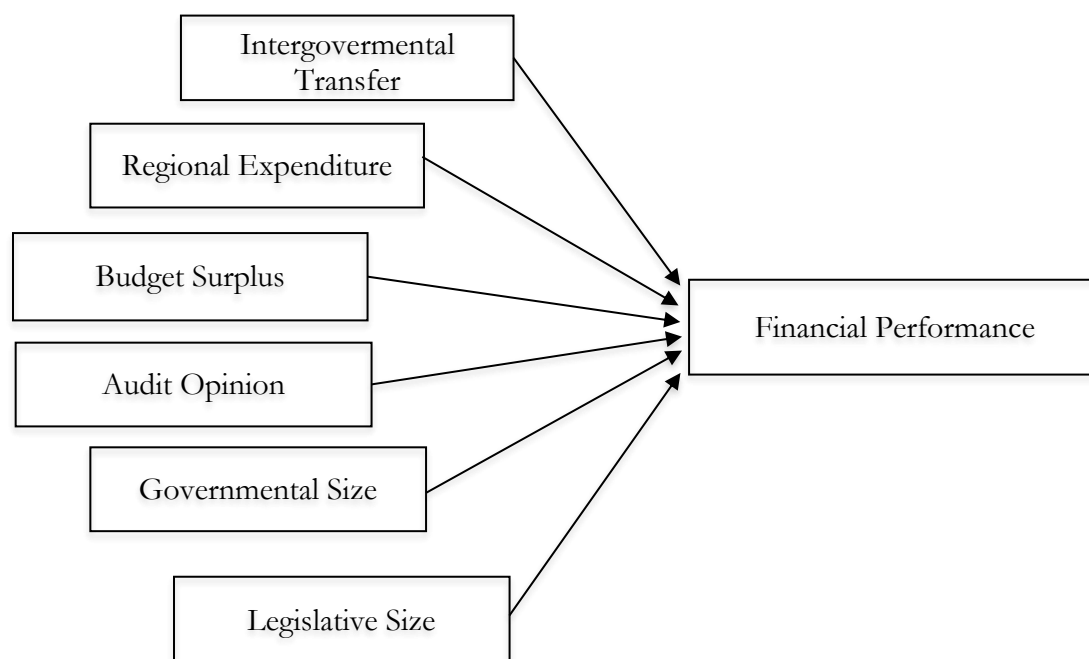
**Figure 1.** Research Model

## RESULT AND DISCUSSION
### Descriptive Statistics

Descriptive statistics were first employed to understand the key characteristics of the dataset from 27 local governments observed over five fiscal years (2019–2023). The financial performance variable, measured using the fiscal independence ratio, shows generally low levels of regional autonomy, with most regions relying heavily on central transfers. During the post-COVID period (2021–2023), several regions experienced a decline in PAD growth, reflecting the economic disruptions that weakened local tax sources.

Intergovernmental transfers display relatively low variation, illustrating the structural dependence of regions on DAU and DAK allocations. Regional expenditure demonstrates higher dispersion, reflecting heterogeneous development priorities and different levels of spending efficiency. SILPA values vary widely, indicating inconsistent budget absorption performance across local governments, a phenomenon commonly found in Indonesian public finance (Andonoska & Alda, 2025).

Audit opinions show that the majority of regions obtained an unqualified opinion (WTP), aligning with recent national trends in which BPK reports indicate improvements in compliance and financial reporting quality. Government size indicators also exhibit substantial variation, consistent with differences in asset ownership and administrative scale. Legislative size varies moderately across regions, reflecting differences in population and representation mandates.

Overall, descriptive statistics highlight structural inequalities across West Java's local governments, reinforcing the importance of examining the combined influence of financial and institutional determinants.

### Model Diagnostic and Goodness-of-Fit Tests

Prior to estimating the panel regression, several diagnostic tests were conducted to ensure that the model satisfies the classical assumptions. The White heteroskedasticity test indicates no heteroskedasticity, as the probability of Obs*R² equals 0.9442 (> 0.05). The Jarque-Bera test confirms

normally distributed residuals with a p-value of 0.639 (> 0.05). These results validate the reliability of the regression estimates.

Model selection was performed using Chow and Hausman tests. The Chow test shows a Chi-square probability of 0.0000 (< 0.05), suggesting that the Fixed Effect Model (FEM) is superior to the Common Effect Model. The subsequent Hausman test further supports FEM as the most appropriate estimator. Thus, all interpretations of regression parameters refer to the fixed-effect estimation.

Table 3. **Model Diagnostic and Goodness-of-Fit Tests**

Cross-section fixed (dummy variables)

| R-squared | 0.687580 | Mean dependent var | 0.261231 |
|---|---|---|---|
| Adjusted R-squared | 0.650546 | S.D. dependent var | 0.148681 |
| S.E. of regression | 0.025517 | Akaike info criterion | -4.290376 |
| Sum squared resid | 0.066413 | Schwarz criterion | -3.580198 |
| Log likelihood | 8.698004 | Hannan-Quinn criter. | -4.001779 |
| F-statistic | 9.983068 | Durbin-Watson stat | 1.874865 |
| Prob(F-statistic) | 0.000000 | | |

The goodness-of-fit statistics reveal that the model is well specified. The adjusted $R^2$ reaches 0.6505, indicating that approximately 65% of the variation in financial performance is explained by the six independent variables. The F-statistic of 9.983 with $p < 0.001$ confirms overall model significance.

**Regression Results**

The regression output indicates by following table 4:

Table 4. **Regression Test**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | 0.91533 | 0.34497 | 2.65337 | 0.00897 |
| Intergovernmental Transfers | -0.23584 | 0.03881 | -6.07692 | 0.00000 |
| Regional Expenditure | -0.00538 | 0.00103 | -5.22330 | 0.00000 |
| SILPA | -0.00879 | 0.00243 | -3.61728 | 0.00043 |
| Audit Opinion | 0.02540 | 0.00596 | 4.25960 | 0.00004 |
| Government Size | 0.00423 | 0.00145 | 2.91724 | 0.00417 |
| Legislative Size | 0.09557 | 0.07296 | 1.30978 | 0.19260 |

**Intergovernmental Transfers and Financial Performance**

Intergovernmental transfers are found to negatively and significantly influence financial performance. This supports concerns that heavy dependence on central funding may weaken fiscal autonomy. A negative coefficient of -0.23584 suggests that higher transfers reduce incentives to maximize own-source revenue or improve fiscal discipline. Similar empirical evidence has been reported in Wati et al., (2022). This finding supports the "flypaper effect" phenomenon, where transfers tend to discourage efforts to increase locally generated revenue (Wati et al., 2022). Regions reliant on DAU and DAK may reduce incentives to optimize PAD through taxation, service fees, or asset utilization.

From a decentralization perspective, excessive transfer dependence can weaken fiscal discipline, reduce accountability, and erode fiscal autonomy (Kiziltan & Yereli, 2023). The results confirm theoretical expectations that intergovernmental transfers can lead to moral hazard and inefficiencies when not accompanied by strong governance mechanisms. Higher transfers reduce the urgency for local governments to innovate in revenue generation, thereby decreasing their fiscal independence ratio.

**Regional Expenditure and Financial Performance**

Regional expenditure also demonstrates a significant negative effect (-0.00538). Although theoretically spending should stimulate growth and service provision, inefficiencies in budget execution, such as poor program planning or disproportionate operating expenditures, may

undermine overall fiscal capacity. This aligns with prior studies emphasizing that expenditure expansion without revenue strengthening tends to deteriorate fiscal sustainability.

Many local governments allocate a high proportion of their budgets to personnel and operational spending rather than capital expenditure, reducing fiscal sustainability. This finding aligns with Neuhuber et al. (2025), who argue that expenditure expansion without productivity improvements deteriorates fiscal health.

In the context of West Java, regions with rapidly increasing expenditure during the pandemic period often failed to match this with commensurate revenue increases, thereby weakening the fiscal independence ratio. High expenditure without strong PAD growth leads to structural deficits and weaker fiscal performance.

**SILPA and Financial Performance**

SILPA is negatively associated with financial performance (–0.00879). High SILPA indicates underutilized budgets, procurement delays, or weak administrative capacity. Although SILPA can represent fiscal space, persistent surpluses typically reflect inefficiency rather than sound financial management. The finding is consistent with Andonoska & Alda (2025), who argue that excessive SILPA correlates with budget absorption issues.

According to (Andonoska & Alda, 2025), persistent surpluses in local governments usually reflect inefficiencies rather than prudent financial management. During the COVID-19 recovery years, SILPA increased in several regions due to delays in social programs, infrastructure projects, and changes in procurement policies. High SILPA reflects weak planning and reduces fiscal performance due to underutilization of development funds.

**Audit Opinion and Financial Performance**

Audit opinion exhibits a positive and statistically significant coefficient (+0.02540). This outcome reinforces signalling theory, where higher-quality audit assessments signal credibility, transparency, and effective internal controls. Local governments with clean audit opinions tend to maintain better financial governance practices, enhancing their fiscal performance. The result is consistent with Zhen Li et al (2023).

From a signalling theory perspective, high-quality audit results signal stronger internal control, compliance, and reliability of financial reporting (Chen & Hu, 2025). Further highlight that cleaner audit results encourage stakeholder trust, improve creditworthiness, and reduce the risk of misallocation of resources (Zhen Li et al., 2023).

In West Java, regions with consistent WTP opinions also tend to exhibit higher PAD growth and better expenditure efficiency. Audit quality strengthens public trust and institutional governance, thereby improving local fiscal outcomes.

**Government Size and Financial Performance**

Government size significantly improves financial performance (+0.00423). Larger governments typically manage broader resources and more sophisticated administrative structures, providing capacity advantages in budgeting, revenue mobilization, and service delivery. Zafra-Gómez et al (2023) similarly find that administrative scale often correlates with stronger fiscal outcomes.

Larger governments tend to possess More diversified assets, Higher administrative capacity, Larger potential tax bases, More sophisticated information systems. This finding aligns with (Han & Kou, 2022), who show that government size often correlates with better administrative efficiency and service delivery. The result also supports (Luo, 2024), who finds that regions with larger asset portfolios tend to demonstrate more stable revenue streams. Larger administrative and asset structures help local governments generate and manage revenue more effectively.

**Legislative Size and Financial Performance**

Although the coefficient is positive (+0.09557), legislative size does not significantly affect financial performance. This suggests that the number of legislators alone does not translate into better

fiscal oversight. The effectiveness of legislative control depends more on competence, transparency, and institutional checks rather than size. This aligns with Zafra-Gómez et al (2023), who found mixed evidence on legislative size as a determinant of financial performance.

This suggests that increasing the number of DPRD members does not necessarily improve financial oversight or budgeting effectiveness. Several factors may explain the lack of significance Political fragmentation within DPRD, Variations in legislative competence, Conflicts of interest,Weak institutional checks and balances. (Zafra-Gómez et al., 2023) find mixed evidence regarding the relationship between legislative size and fiscal outcomes, emphasizing the role of institutional quality rather than numerical representation.More legislators do not automatically translate into better fiscal performance, quality matters more than quantity.

**Overall Interpretation**

The empirical findings collectively reveal a consistent structural pattern in the determinants of local government financial performance. Financial variables, specifically intergovernmental transfers, regional expenditure, and SILPA, tend to exert a constraining effect on fiscal independence when they are not managed strategically. The negative coefficients associated with these financial indicators demonstrate that subnational governments in West Java continue to face systemic challenges rooted in dependency, inefficiency, and weak planning capacity. High transfer reliance suggests that local governments may be trapped in a cycle of fiscal dependence wherein central government funds replace the need for proactive revenue mobilization. This phenomenon aligns with the classical "flypaper effect," which implies that regions become less motivated to optimize their own-source revenues when external transfers dominate their budgets. Similarly, the negative effect of regional expenditure signals that spending patterns remain skewed toward routine and operational expenditures rather than productive investments, which ultimately diminishes the regions' ability to enhance.

In contrast to the inhibitory nature of financial variables, institutional quality variables such as audit opinion and government size display a positive and reinforcing influence on financial performance. These results underscore the critical role of governance capacity, administrative resources, and accountability mechanisms in shaping the fiscal outcomes of local governments. A favorable audit opinion not only reflects compliance with accounting standards but also signals a broader commitment to transparency, internal control, and responsible stewardship of public resources. This finding strengthens the argument within signaling theory that audit quality serves as an essential mechanism through which governments communicate credibility and reliability to stakeholders. Meanwhile, the positive impact of government size indicates that regions with broader asset portfolios, larger revenue bases, and more extensive administrative structures are better equipped to manage their finances, innovate in service delivery.

Taken together, these findings contribute meaningfully to the international discourse on fiscal decentralization and regional governance, particularly in the context of post-pandemic recovery. The COVID-19 period has exposed structural weaknesses in local financial management, especially regarding budget absorption and local revenue generation. By providing empirical evidence from Indonesian subnational governments during and after the pandemic, this study enhances understanding of how financial behavior and institutional capacity interact under conditions of fiscal stress. The results highlight the importance of transitioning from a transfer-dependent model toward a more autonomous and capability-driven fiscal framework. Moreover, the prominence of audit quality and government size in influencing fiscal performance underscores the need for strengthening governance institutions, improving internal control systems, and investing in administrative capacity at the regional level.

Overall, the study underscores an urgent need for policy reforms aimed at: (a) enhancing local fiscal capacity through stronger PAD innovation and diversification; (b) improving expenditure quality by shifting budgets toward developmental rather than operational priorities; (c) reducing SILPA through better financial planning and timely budget execution; and (d) reinforcing institutional governance through sustained improvements in audit quality and administrative resources. These strategic reforms will not only address the structural inefficiencies identified in this research but will

also help local governments build a more resilient, accountable, and sustainable fiscal framework aligned with the principles of effective decentralizat

## CONCLUSION

This study investigates the determinants of local government financial performance in West Java Province using panel data from 27 regencies and cities over the 2019-2023 period. Based on the Fixed Effect Model, the findings reveal that intergovernmental transfers, regional expenditure, and SILPA exert a negative and statistically significant effect on financial performance. These results suggest that high dependency on central government funding, expanding expenditure without proportional revenue growth, and recurring budget surpluses signal inefficiencies that hinder fiscal independence.

Conversely, audit opinion and government size positively and significantly influence financial performance. This indicates that better audit quality and larger administrative capacity enhance governance quality and fiscal management. Meanwhile, legislative size has a positive but statistically insignificant impact, indicating that representation quantity alone does not guarantee improved fiscal oversight.

Collectively, the study concludes that strengthening institutional capacity and enhancing budget management discipline are essential to improving the financial performance of local governments.

## POLICY IMPLICATION

### Strengthening Fiscal Independence

The negative effect of intergovernmental transfers underscores the need to reduce fiscal dependency by increasing locally generated revenue. Local governments should diversify tax bases, innovate in service-based revenue, and optimize asset utilization.

### Improving Expenditure Quality

Since regional expenditure negatively influences financial performance, policymakers must prioritize value-for-money principles, performance-based budgeting, and tighter monitoring of operational spending to ensure that expenditure contributes effectively to development outcomes.

### Enhancing Budget Execution to Reduce SILPA

Persistent SILPA indicates weaknesses in planning and implementation. Strengthening procurement systems, accelerating project preparation, and enhancing internal coordination can help improve budget absorption and reduce inefficiencies.

### Promoting Audit Quality and Internal Control

The positive role of audit opinion highlights the importance of accountability. Local governments should improve internal audit functions, comply with accounting standards, and strengthen transparency mechanisms to sustain high-quality audit outcomes.

### Optimizing Administrative Capacity

The significant effect of government size suggests that investment in administrative capability, such as digital financial systems, trained human resources, and integrated financial planning, is essential for long-term fiscal sustainability.

## LIMITATIONS

This study acknowledges several limitations that may inform the interpretation of its findings:

### Single Province Scope

The sample is limited to West Java, which may not fully represent fiscal conditions in other Indonesian regions with different institutional, demographic, or economic characteristics.

### Use of Secondary Financial Data
The analysis relies solely on audited financial statements, which, although standardized, cannot capture qualitative factors such as leadership quality, governance processes, or political dynamics.

### Static Measurement of Variables
Several variables, such as audit opinion, are treated as categorical annual outcomes and may not fully reflect intra-year changes in financial management practices.

### Potential Endogeneity
Although panel fixed-effects reduces omitted variable bias, the study does not employ advanced techniques such as dynamic panel models that could further address endogeneity concerns.

## DIRECTIONS FOR FUTURE RESEARCH
Future studies may explore several opportunities to enhance the understanding of subnational fiscal performance:

### Expanding Geographical Coverage
Including more provinces or performing cross-provincial comparisons would improve generalizability and enable identification of regional disparities in fiscal capacity.

### Incorporating Governance and Political Variables
Variables such as leadership quality, political competition, transparency indices, and citizen participation may enrich the analysis of institutional determinants of financial performance.

### Applying Dynamic Panel Approaches
Methods such as GMM (Generalized Method of Moments) could more robustly capture the dynamic nature of financial performance and address potential endogeneity.

### Exploring Sectoral Expenditure Efficiency
Future studies may examine whether specific expenditure categories education, health, infrastructure, have different impacts on financial performance.

### Integrating Digital Governance Indicators
As many regions are adopting e-budgeting and e-government platforms, future research could evaluate the role of digitalization in improving fiscal outcomes.

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