Financial Performance of Local Governments in Indonesia

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Abstract— This study aims to identify the effects of local revenue, audit opinion, legislative size, and intergovernmental revenue towards the financial performance of Local Governments in Indonesia. This study uses all districts/cities within the island of Java as a sample. The sample identification uses the purposive sampling method. Secondary data used in this study originates from the report of examination of the local government financial report and the summary of examination published per semester by the national audit board of the Republic of Indonesia. A total of 108 samples were retrieved, resulting in a total of 120 samples. The hypothesis testing was done using the multiple linear regression analysis method. The results of this research show that local revenue, national audit board opinion, and legislative size has a significant relationship on the financial performance of local governments in Indonesia. However, Intergovernmental Revenue does not have a relationship on the financial performance of Local Governments in Indonesia.

Keywords— Financial performance, Local revenue, National audit board opinion, Legislative size, and Intergovernmental revenue.

I. INTRODUCTION

The performance of local governments is one of the key factors of the success of an organization to ensure the satisfaction of public service and the reaching of pre-established organizational goals. This performance can be measured from the financial side. The financial performance of local governments can become a region's benchmark of building, planning, service to the public, and other local activities. The form of financial performance in local governments is manifested in the Local Government Financial Report. Local governments have a smaller scope, and is therefore expected to be able to maximize its performance including local economic activities to reach evenly-distributed welfare.

Based on the National Audit Board's Examination Report of the First Semester of 2017 on the 3 E aspects (Economy, Efficiency, and Effectivity), there were 5 ineffectiveness issues in the Provinces and 7 in the Districts that caused a regional loss of IDR153,83 million. According to the National Audit Board's Examination Report of the Second Semester of 2017, as many as 479 Governmental Examination Reports and 181 Local Governmental Examination Reports regarding the Examination of Performance resulted in 1.796 finds. These finds had 2.176 issues. The aforementioned issue consists of 18 economic

issues, 3 inefficiency issues, and 2.056 infectivity issues. This proves that 94% of the issues are based on lack of effectivity of the financial performance of local governments. Therefore, the issues related to the lack of effectivity of the financial performance of local governments in 2017 resulted in 2.098.

Some finds that resulted in the lack of effectivity is the lack of standards or guidelines, lack of job and function coordination that resulted in an ineffective inspectorate governance, implemented mechanisms and procedures that are not yet in accordance with standards, lack of human resources in the education aspect, not implementing fundamental principles, lack of target reaching, and other factors that relate to the examination of effectivity (IHPS BPK, 2014).

The results of the study conducted by Darwanis and Saputra (2014), and Andrei (2013) state that Local Revenue affects the financial performance of local governments. In addition to that, the research conducted by Suryaningsih and Sisdyani (2016), state that the National Audit Board's opinion affects the financial performance of local governments found that audit opinion has a relationship with financial performance in the local government. However, this contrasts with re research conducted by Ilmiyyah, et al (2017) that states that the National Audit Board's opinion does not affect the financial performance of local governments. According to Kusumawardani (2012), legislative size affects the financial performance of local government. This differs with Sesotyaningtyas (2012), who stated that the number of members in the People's Representative Council (DPRD) had a negative effect on the financial performance of a local government. Patrick (2007) and Simanullang (2013), state that intergovernmental revenue affects the financial performance of local government. However, Sesotyaningtyas (2012) believes that intergovernmental revenue does not affect the financial performance of local government.

In particular, this paper focuses on the influencing factors which will lead to study in exploring the financial performance with a focus on the Indonesian local government. Furthermore, the objective of study is to examine the relationship between local revenue, national audit board opinion, legislative size, and intergovernmental revenue towards the financial performance of local governments in Indonesia.

II. LITERATURE REVIEW

A. Agency Theory

The agency theory in the public sector entrusts its welfare to the government to create methods of financial management, infrastructure building, and public service that are distributed evenly and optimally. Therefore, the

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government needs to accomplish its responsibility as a form of examination of financial performance in local governments. A good examination of financial performance of local governments indicate that local government is able to manage and increase its local revenue so that it will become a qualified opinion from the National Audit Board. The more qualified the audit opinion is, then the financial performance of that local government will also be better. Other than that, stakeholders are all internal and external parties that have direct or indirect relationships in a company (Hadi, 2014). Stakeholders require more varied information that is reliable and relevant for decision making (Mardiasmo, 2009). The central government as a representative of the people acts as a main stakeholder to give transfer funds to local governments to fund and sustain their local activities. The said fund is a balancing fund given from the central government to the local governments. Therefore, the legislative members of the Local People's House of Representatives (DPRD) has to be able to create good corporate governance and monitor local governments so that they achieve maximum performance in a specific period of time.

B. Financial Performance

Performance is the view of achievement the implementation of an activity in realizing the goals, objectives, mission, and vision of the organization (Bastian, 2006). According to Permendagri No.21 of 2011 article 1 paragraph (37) states that performance is the output /results of activities or programs that will or have been achieved in connection with the use of the budget with a measured quantity and quality.

Masdiyanti & Erawati (2016) states that the existence of accountability demands for financial performance by the community requires local governments to provide a clear picture of its performance. Financial performance can be said as the level of achievement of a work in the area of regional finance that uses financial indicators determined through a policy or statutory provisions during the budget period (Mulyani & Wibowo, 2017).

C. Local Revenue

Local revenue can be used as a tool to optimize the sources of regional original wealth carried out by local governments. Regional original income can be used as a goal to exercise its authority in funding the implementation of regional autonomy apart from the assistance of the central government in accordance with the potential of the region as a manifestation of decentralization. The greater the region's original revenue generated, the more it will improve the financial performance of the local government in financing the activities of government and its people. According to Halim and Kusufi (2012), it is stated that regional own-source revenue is all regional revenue that comes from the regional original economic sources.

D. Audit Opinion

According to Law No. 15 of 2004 concerning the Examination of Management and Responsibility of State Finance in article 1 paragraph (11) explains that opinions are professional statements as examiners' conclusions about the

level of reasonableness of the information presented in the financial statements. According to Law No. 15 of 2006 concerning the Supreme Audit Board of the Republic of Indonesia in article 1 paragraph (14) explains that the results of the examination are the final results of the process of evaluating the truth, compliance, accuracy, credibility, and reliability of data or information regarding the management and responsibilities of the state which are carried out independently, objective and professional based on inspection standards as outlined in the audit report as a decision of Supreme Audit Board of Republic of Indonesia.

E. Legislative Size

Legislative institution is a regional people's representative institution that is domiciled as an element of regional government administration (Law No. 23 of 2014). The relatively large number of members of the Regional Representative Council is expected to be able to increase supervision of regional governments so that it will have an impact on improving the performance of regional governments. This study using proxy to measure legislative size is high positions and low positions in the legislature (Gilligan, Thomas & Matsusaka, 2001; Sesotyaningtyas, 2012; Ilmiyyah, et al, 2017).

F. Intergovernmental revenue

Generally, in developing countries there is still a large dependence on the central government, because in developing countries there are still some regions that are lagging due to the lack of potential resources resulting in gaps with some other regions that have better growth. Intergovernmental Revenue in Indonesia can be said as a Balancing Fund. According to Government Regulation 55 of 2005 article 1 paragraph (8) states that the Balancing Fund is a fund sourced from APBN revenues allocated to the regions to fund regional needs in the context of the implementation of Decentralization. The balancing fund aims to assist the region in funding its authority and reduce disparities in funding sources between the central and regional governments and between regions.

III. HYPOTHESIS DEVELOPMENT AND CONCEPTUAL SCHEME

The Internal Ministry Laws No. 21 Year 2011, verse 1, sub-section 27 states that performance is the output or result from an activity or a program that will be or has been accomplished with regards to the use of the budget, as well as measured quality and quantity. Financial performance can be seen as the level of accomplishment of programs in local finances that uses a financial indicator that is established through a policy or constitutional requirement during the budget period (Mulyani & Wibowo, 2017).

Local revenue can be utilized as an instrument to optimize sources of welfare done by the local government. Local revenue can be made as a goal to implement their authorities in funding the regional autonomy without aid from the central government according to each region's potential as an implementation of decentralization.

UU No. 15 Tahun 2004 regarding the Examination of Management and Financial Responsibility in clause 1 section 11 explains that opinion is a professional statement used as a

conclusion of the examiner regarding the level of information quality that is disclosed in the financial report.

According to Noviyanti and Kiswanto (2016), legislative bodies or the Local People's House of Representatives are bodies that possess a position and strategic role regarding the monitoring of local finances. This monitoring is done by the DPRD in hopes of aiding and ensuring that the government fulfills its responsibility of public services and improving the welfare of the people (Ilmiyyah, et al, 2017).

Generally, developing countries are still mostly dependent on the central government, due to the existence of some less developed regions as a result of the lack of resources that trigger a social gap when compared to other regions with better development. Intergovernmental revenue in Indonesia can be seen as balancing funds (Simanullang, 2013).

Local revenue possesses components that manage to result in wealth in a certain region. Local revenue can be made as an important indicator in the financial report as a portrayal of the success of the local government in increasing financial performance. The local government needs to publicize the sum of local revenue that is received so that the public's trust in the management of local governmental funds, as has been discussed in the agency theory. Previous research done by Julitawati, et al (2012), Wenny (2012), Darwanis & Saputra (2014), Andrei (2013), and Simanullang (2013) state that local revenue has an effect towards the financial performance of local governments. Based on the explanation above, the following hypothesis can be formulated:

H1 : there is a relationship between local revenue and the financial performance of local governments

Audit opinions are objects that are always taken into account for from the end result of the examination of the entirety of the financial performance of local governments. The more qualified the resulted opinion, the more accountable the report is. Therefore, the public trust will increase. Previous research by Masdiantini & Erawati (2016), Suryaningsih & Sisdyani (2016) and Putry & Badrudin (2017) state that audit opinions have an effect towards the financial performance of local governments. The following hypothesis can be formulated:

H2 : there is a relationship between audit opinions and the financial performance of local governments

Legislative size plays an important role in monitoring and building financial performance in local governments. The DPRD must know and have approval permission on all activities and programs of local governments. Therefore, the DPRD gives authority for implementing financial performance of local governments according to the stakeholder theory. Previous research done by Noviyanti and Kiswanto (2016) shows that legislative size has an effect towards the financial performance of local governments. The following hypothesis can be formulated:

H3 : there is a relationship between legislative size and the financial performance of local governments.

Intergovernmental revenue is obtained from the central government, which is distributed to regions in order to close the social gap between regions. The central government holds

a role in controlling the finances of local governments, so that the central government must maximize jobs and responsibilities in lightening the workload of the central government to increase financial performance. The central government acts as an external party that has an indirect relationship that affects the financial performance of local governments that require cash flow information. This is in accordance with the stakeholder theory, previous research done by Simanullang (2013), Patrick (2007), and Ilmiyyah, et al (2017) shows that intergovernmental revenue has an effect towards the financial performance of local governments. The following hypothesis can be formulated:

H4 : there is a relationship between intergovernmental revenue and the financial performance of local governments.

Based on the explanation that has been described, the framework in the form of a research paradigm is as follows:

Fig. 1. Theoretical Framework

IV. RESEARCH METHODOLOGY

The population that will become the object in this research is all of the district regions in Indonesia, wherein each local government issues individual local government financial reports that has been audited by the Financial Examination Board of the Republic of Indonesia (BPK RI) which issues Examination Result Reports for the years 2017 and 2018. The sample in this research is 108 districts in the Java Island that has been audited by the BPK RI within the 2017 and 2018 periods. After data testing, the test results in data that is not distributed normally, due to the presence of an extreme value within the data. Outlier data uses the Z-Score technique. There are 51 data that had to be eliminated (outlier) so that the sample reduced to 120 samples.

Financial report measured through a calculation of value for money which is the efficiency ratio. Data is taken from the Budget Realization Report of every district that is under the Supreme Audit Board of the Republic of Indonesia.

Local revenue measured from the total realization of the result of total local revenue. Data is obtained from the local government's financial report, specifically the Budget Realization Report (LRA). The scale that is used is the ratio scale. The scales that are used are ratio scales.

Furthermore, *audit opinion* measured using the dummy scale. Data is obtained from the Examination Results Report (LHP) on the given audit opinion. The measurement of audit opinion according to Masdiantini and Erawati (2016) is: grade 5 Qualified Without Exceptions, grade 4 Qualified Without Exceptions with an Explanatory Paragraph, grade 3

Qualified with Exceptions, grade 2 Adverse, and grade 1 Disclaimer.

Legislative size measured by the number of members in the Local People's House of Representatives (DPRD). Data is obtained by the official website of each local government. The scale used is the nominal scale. This variable adopted by Noviyanti and Kiswanto (2016).

Intergovernmental revenue measured using the comparison of total balancing funds divided by total revenue. Data is obtained from the local government's financial report, specifically the Budget Realization Report (LRA). This variable adopted by Patrick (2007).

V. RESULTS AND DISCUSSION

A. Descriptive Analysis

Based on Table 2. results of descriptive statistics, a visualization of every tested variable can be obtained. The average of the dependent variable, financial performance of local governments in Java island in year 2015 and 2016 is 0,91719 or 91,71% which means that the financial performance of local governments is already in a good level of efficiency. The independent variable, local revenue, has an average value of 26,42306 or ±IDR 299.000.000. Next, the average value of legislative size is 47,00 which means that the amount of DPRD members is almost at a maximum in the districts of the Java island in the years 2015 and 2016. Lastly, intergovernmental revenue has an average value of 61446 or 61,44% for external funds obtained by the local government.

TABLE I: RESULTS OF DESCRIPTIVE STATISTICS

Variable	N	Min	Max	Mean	SD
FP	175	,771	1,072	,91719	,0586
LR	175	25,433	27,920	26,423	,4894
LS	175	35	50	47,00	3,903
IR	175	,380	,796	,61446	,0803
AO	175	3	5	4,51	,863
Valid N	175				

For the audit opinion variable, it can be seen in Table 1. frequency of audit opinion, which is 75,4% or as much as 132 samples having the opinion of qualified opinion. This means that the audit opinion of the districts in the Java Island in the years 2017 and 2018 almost unanimously have a good level of qualification. As much as 24,6 or 43 samples have the predicate of qualified with exceptions, since there are still records that are not according to standard as well as a material issue in the districts in the Java island in the years 2017 and 2018.

B. Results

The results of the hypothesis testing of this study can be seen in Table 2.

TABLE II: TESTING OF HYPOTHESIS OF DESCRIPTIVE STATISTICS

Coefficients ^a		
Model	t	Sig.
1 (Constant)	1,749	,082
LR	2,276	,024
AO	-2,010	,046
LS	-4,404	,000
IR	,497	,620

Bade on the Table 2. the result of the t test related to the local revenue variable shows an effect towards financial performance of local governments with a significance level of $0,024 < 0,05$ with $t_{\text{value}} 2,276$ with which H_{01} is rejected and H_{a1} is accepted. It can be concluded that (H_1): local revenue have a significant relationship with the financial performance of local governments. The result shows that the increase of local revenue will result in an increase in the financial performance of local governments. This result consistent with study by Darwanis and Saputra (2014) and Julitawati, et al (2012). Therefore, local revenue can be put as a goal in implementing a district's own activities and programs to increase the financial performance of that district's local government.

The second hypothesis, based on the t test result regarding the audit opinion shows that an effect towards the financial performance of local governments with a significance level of $0,046 < 0,05$ with $t_{\text{value}} -2,010$. With that H_2 is accepted. This result shows that the hypothesis audit opinion have a significant relationship with the financial performance of local governments. This study consistent with Suryaningsih & Sisdyani (2016) that states that audit opinion affects the financial performance of local governments. A qualified audit opinion does not guarantee that it will automatically improve the financial performance of local governments. This is due to the fact that a good audit opinion must also be equipped with supporting materials. However, at the implementation level, there are still program planning's that are not adequate or not according to needs which creates inefficiency of local finances. This reason is in accordance with the explanation regarding things that hinder the financial performance of local governments in the local governmental financial report.

The t test result shows that legislative size has an effect towards the financial performance of local governments with a significance level of $0,000 < 0,05$ with $t_{\text{value}} -4,404$ and H_3 is accepted. This result concludes that the hypothesis that legislative size have a significant relationship with the financial performance of local governments. Based on the result, it is indicated that the amount of DPRD members does not guarantee the automatic improvement of the financial performance of local governments. It may also disprove the financial performance of local governments. The monitoring done towards DPRD has to be towards work quality and not just quantity. This result is in accordance with the research conducted by Noviyanti and Kiswanto (2016) that states that legislative size affects the financial performance of local governments.

The t test result of the variable intergovernmental revenue shows that it does not have an effect towards the financial performance of local governments, with a significance level of $0,620 > 0,05$ with $t_{\text{value}} 0,497$. With that H_{a4} is rejected. This result concludes that the hypothesis that intergovernmental revenue have no significant relationship with the financial performance of local governments. Based on the results, intergovernmental revenue cannot yet be managed well and optimally by the local governments. External funds that are given without any repayment should be used as an addition to the lack of potential local resources and cover other needed costs so that it can improve the financial performance of local governments. This is in accordance with the research conducted by Sesotyaningtyas

(2012) which states that intergovernmental review does not affect the financial performance of local governments.

VI. CONCLUSION, LIMITATIONS AND RECOMMENDATIONS

Local revenue have a significant relationship with the financial performance of local governments. This shows that local revenue is a component that can create local wealth and can improve financial performance which could act as a portrayal of the program implementations in local governments in which local governments can manage their finances efficiently. Audit opinion have a significant relationship with the financial performance of local governments. This shows that audit opinion as an end result of the examination done by BPK RI is able to show accountability with regards to good reporting so that it can improve the financial performance of local governments.

Legislative size have a significant relationship with the financial performance of local governments. This shows that legislative size or the number of DPRD members actively implement monitoring to ensure a better financial performance. Intergovernmental revenue have no significant relationship with the financial performance of local governments. This shows that intergovernmental revenue is not yet completely able to improve the financial performance of local governments because external funds that are received are not managed optimally to fund the activity needs of the local government and also because there are still big social haps between the external funds given to a given district compared to another district.

Based on the result of this study, it can be concluded that this study can support the agency theory which states that it is the responsibility of local governments to issue reports, disclose every program and activity, and provide liability towards the people, because they have a right to know the implementation of those said responsibilities (Masdiantini & Erawati, 2016). If the funds managed by the local governments is not maximum enough to promote social welfare, then the agency problem will incur. Bearing that in mind, both the local governments (agent) and the people (principal) should make an effort as to not get involved in an agency problem.

The implications of this research towards practice is to give a contribution to local governments as the driver of financial performance in local governments to be able to pay attention to things regarding policies and laws and are able to both improve and increase the financial performance in the budget, more effectively and efficiently. Local governments should be stable in optimizing their pure local revenue and be able to manage external funds that are obtained economically. The DPRD members should also properly monitor the systems, as well as the National Audit Board must issue a valid audit opinion in order to obtain the peoples' trust, which will improve the financial performance of local governments.

The next study with the same dependent variables should add other independent variables outside of what has been used in this particular research, such as characteristics of local governments, local spending's, the size of local governments, leverage, as well as add the research samples and research time so that a better result can be obtained.

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