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The Influence of Government Size, Intergovernmental Transfers, Regional Expenditure, and Audit Findings on Local Government Financial Performance in Indonesia

Argianov Ramadhan, Sri Rahayu, Rico Wijaya Z
Universitas Jambi, Indonesia
argianov13@gmail.com; sri_rahayu@unja.ac.id

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Abstract

Local government financial performance is a key indicator for evaluating the success of regional autonomy and the effectiveness of public financial management. However, disparities in financial performance across Indonesian provinces reflect differences in fiscal capacity and the quality of regional financial governance. This study aims to analyze the effects of government size, intergovernmental transfers, regional expenditure, and audit findings on local government financial performance in Indonesia. A quantitative approach was employed using secondary data obtained from the Audit Reports of the Supreme Audit Board of the Republic of Indonesia for the 2022–2024 period. The sample comprised 34 provincial governments selected through purposive sampling, yielding 102 observations. Data were analyzed using panel data regression with EViews 13. The findings reveal that government size and regional expenditure have a significant negative effect on local government financial performance. In contrast, intergovernmental transfers have a significant positive effect, while audit findings have no significant effect. These results indicate that effective resource management and fiscal capacity play a more decisive role in

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strengthening financial performance than asset magnitude or the number of audit findings. This study contributes to public sector financial management literature by providing empirical evidence on the determinants of provincial financial performance in Indonesia. The practical implications emphasize the need to optimize asset management, utilize intergovernmental transfers effectively, and allocate regional expenditure toward more productive activities to improve financial performance and strengthen local fiscal independence.

Keywords: Government Size; Intergovernmental Transfers; Regional Expenditure; Audit Findings; Local Government Financial Performance

INTRODUCTION

Regional autonomy has become one of the most significant public sector reforms implemented in Indonesia to improve governmental effectiveness, strengthen public service delivery, and encourage regional self-reliance. Through decentralization policies, local governments are granted broader authority to manage governmental affairs, regional development, and public interests according to the characteristics and needs of their respective regions. The implementation of regional autonomy is expected to increase administrative efficiency while fostering accountability and responsiveness in public governance. Nevertheless, despite the extensive authority delegated to local governments, public dissatisfaction regarding the performance of regional administrations remains a persistent challenge in many provinces across Indonesia (Rahardjo & Putra, 2023). In the context of regional governance, financial performance serves as a crucial indicator for evaluating the success of local governments in managing public resources effectively and efficiently. Financial performance reflects not only the capability of regional governments to fulfill fiscal responsibilities but also their ability to support sustainable development and deliver quality public services. Consequently, measuring financial performance has become increasingly important in ensuring accountability, transparency, and good governance within the public sector (Mahmudi, 2016). The growing demand for transparent financial management has further emphasized the necessity of systematic monitoring and evaluation mechanisms capable of assessing the effectiveness of fiscal policies implemented by local governments (Noviyanti & Kiswanto, 2016).

As public entities entrusted with managing public funds, regional governments are required to prepare financial statements in accordance with Government Accounting

Standards and submit them for audit by the Supreme Audit Agency (BPK). Audited financial statements constitute a primary source of information for evaluating fiscal conditions and assessing the quality of public financial management. These reports provide stakeholders with valuable insights into the effectiveness of government programs, the efficiency of resource allocation, and the overall financial health of regional administrations (Halim, 2018). Therefore, the quality of financial performance achieved by local governments has become an important benchmark for determining the success of decentralization policies in Indonesia. One of the most commonly used indicators for measuring regional financial performance is the financial independence ratio. This ratio reflects the extent to which a regional government can finance governmental operations, development activities, and public services using its own revenue sources without excessive dependence on transfers from the central government. A higher financial independence ratio indicates stronger fiscal capacity and greater autonomy in managing regional development priorities (Mahmudi, 2016). Consequently, improving financial independence has become a major objective for regional governments seeking to achieve sustainable fiscal management and reduce reliance on external funding sources.

Despite continuous efforts to strengthen regional autonomy, significant disparities in financial independence remain evident across Indonesian provinces. Several provinces in western Indonesia, including Jakarta, East Java, and Riau, demonstrate relatively high levels of financial independence. In contrast, many provinces in eastern Indonesia continue to experience substantial dependence on central government transfers. These disparities indicate that the outcomes of decentralization have not been uniformly distributed across regions and suggest the existence of structural and managerial factors influencing regional financial performance (Rahardjo & Putra, 2023). The persistence of such disparities has generated considerable interest among scholars seeking to identify the determinants of local government financial performance. Previous studies have suggested that financial performance may be influenced by various organizational, fiscal, and governance-related factors reflected in regional financial statements (Wahyudin & Hastuti, 2020). Among these factors, regional government size, balancing funds, regional expenditure, and audit findings have received substantial attention in the literature due to their direct relationship with public financial management.

Regional government size is frequently considered an important determinant of financial performance. Government size is generally measured using total assets, which

represent the overall resources available to local governments for conducting administrative and developmental activities. Larger governments are often assumed to possess greater operational capacity, stronger institutional resources, and broader opportunities to improve public service quality and generate regional revenue (Masdiantini & Erawati, 2016). Consequently, larger governments are expected to achieve superior financial performance compared with smaller governmental entities (Meilanda et al., 2023). However, empirical evidence concerning the relationship between government size and financial performance remains inconclusive. Several studies have reported a positive association, arguing that larger asset ownership enhances managerial capacity and supports improved fiscal outcomes (Aziz, 2016). Conversely, other studies suggest that large asset portfolios may increase administrative complexity and create inefficiencies in resource management, ultimately weakening financial performance (Mulyani & Wibowo, 2017). These conflicting findings indicate that the influence of government size on financial performance remains an unresolved issue requiring further investigation.

Another important factor influencing regional financial performance is balancing funds. Balancing funds constitute fiscal transfers provided by the central government to reduce fiscal disparities among regions and support the implementation of regional autonomy. These transfers include Revenue Sharing Funds, General Allocation Funds, and Special Allocation Funds, which collectively represent a major source of revenue for many local governments (Millenia, 2022). The primary objective of balancing funds is to strengthen regional fiscal capacity and ensure equitable development across regions with varying economic potential (Insani et al., 2023). From a theoretical perspective, balancing funds should contribute positively to financial performance because they provide local governments with additional financial resources to finance development programs and public services. Empirical studies have demonstrated that balancing funds can improve fiscal capacity and enhance government performance by supporting infrastructure development and service delivery (Nugroho & Prasetyo, 2018). Nevertheless, other studies argue that excessive dependence on balancing funds may reduce fiscal independence and weaken incentives for local governments to maximize locally generated revenue, thereby limiting improvements in financial performance (Insani et al., 2023). These contradictory findings highlight the need for additional empirical evidence regarding the actual impact of balancing funds on regional financial performance.

Regional expenditure also represents a critical component of local government financial management. Regional expenditure encompasses operational expenditures, capital expenditures, unexpected expenditures, and transfer expenditures allocated to support governmental functions and development activities. Effective expenditure allocation is expected to improve infrastructure quality, human resource development, public service delivery, and overall community welfare (Dasmar et al., 2020). Consequently, expenditure decisions play a fundamental role in determining whether public resources generate meaningful socioeconomic outcomes. Although regional expenditure is generally expected to improve financial performance, previous studies have produced inconsistent results. Some researchers argue that higher expenditure levels contribute positively to financial performance by supporting development initiatives and expanding public service capacity (Angraini & Hidayat, 2023). In contrast, other studies indicate that excessive expenditure, particularly operational expenditure, may reduce fiscal efficiency and negatively affect financial performance when spending is not directed toward productive investments (Saputri & Kurnia, 2020). These divergent findings suggest that the effectiveness of expenditure allocation remains an important issue in public financial management research.

In addition to fiscal factors, governance mechanisms are equally important in influencing regional financial performance. One governance-related indicator frequently examined in the literature is audit findings. Audit findings represent violations of internal control systems and non-compliance with applicable regulations identified during financial audits conducted by the Supreme Audit Agency. Such findings provide evidence regarding the quality of financial management practices and the effectiveness of accountability mechanisms within local governments (Noviyanti & Kiswanto, 2016). Theoretically, a greater number of audit findings should indicate weaker governance quality and lower financial performance because audit findings reflect deficiencies in financial control systems and regulatory compliance (Kurnia, 2020). Nevertheless, empirical evidence concerning the effect of audit findings remains inconclusive. Some studies report a significant negative relationship between audit findings and financial performance, suggesting that poor governance practices hinder fiscal outcomes (Rasyid et al., 2022). Conversely, other studies find no significant relationship, implying that audit findings do not necessarily reflect overall fiscal health and may not directly influence financial performance indicators (Aziz & Kusumawati, 2024).

Despite extensive research on local government financial performance, several gaps remain evident in the existing literature. First, previous studies have produced inconsistent

findings regarding the effects of government size, balancing funds, regional expenditure, and audit findings on financial performance. While some studies report positive relationships, others identify negative or insignificant effects. These inconsistencies indicate the absence of a clear consensus regarding the determinants of regional financial performance. Second, most prior studies have focused on regency and municipal governments or have examined limited geographical areas, such as specific provinces or regions. As a result, existing findings may not adequately represent the conditions of provincial governments across Indonesia as a whole. The lack of nationwide evidence limits the generalizability of previous conclusions and highlights the need for broader empirical investigations (Dasmar et al., 2020). Third, the post-pandemic fiscal environment has introduced new challenges and opportunities for regional governments. Changes in expenditure priorities, revenue structures, and intergovernmental fiscal relations may have altered the relationships between financial determinants and performance outcomes. Consequently, updated empirical evidence is required to better understand local government financial performance in the contemporary fiscal context.

The novelty of this study lies in its comprehensive examination of the effects of regional government size, balancing funds, regional expenditure, and audit findings on the financial performance of provincial governments throughout Indonesia during the 2022–2024 period. Unlike previous studies that primarily focused on specific regions or local administrative units, this research adopts a national perspective encompassing all provinces that meet the sampling criteria. Furthermore, this study seeks to reconcile contradictory findings reported in previous research by simultaneously examining multiple fiscal and governance determinants within a single analytical framework. The investigation is conducted during a post-pandemic period characterized by significant fiscal adjustments, thereby providing more current and policy-relevant insights regarding the factors influencing regional financial performance.

This study is grounded in Agency Theory, which explains the relationship between principals and agents in organizational settings. In the public sector context, citizens and the central government act as principals who delegate authority to local governments as agents responsible for managing public resources. Agency theory suggests that conflicts of interest, information asymmetry, and opportunistic behavior may arise when agents possess greater information than principals regarding resource allocation and financial management (Noviyanti & Kiswanto, 2016). Consequently, effective governance mechanisms, transparent

reporting practices, and strong accountability systems are necessary to minimize agency problems and improve financial performance (Afifah & Adnan, 2022). Based on these considerations, this study aims to analyze the effects of regional government size, balancing funds, regional expenditure, and audit findings on the financial performance of provincial governments in Indonesia. The findings are expected to contribute to the development of public sector accounting literature while providing practical implications for policymakers seeking to strengthen fiscal sustainability, accountability, and the effectiveness of regional financial management.

METHODS

This study employed a quantitative approach to examine the relationships among variables. The scope of the study covered all provinces in Indonesia whose financial statements were audited by the Supreme Audit Board of the Republic of Indonesia (BPK RI) during the 2022–2024 period. These three years were selected because they represent the most recent audit periods for which complete and accessible data were available. Data were collected using a documentation method from the Audit Reports on Local Government Financial Statements issued by BPK RI.

The population of this study consisted of all provincial governments in Indonesia. The sampling technique used was purposive sampling, in which samples were selected based on specific criteria relevant to the objectives of the study. The criteria included provincial governments whose financial statements were audited and available for the fiscal years 2022–2024. Of the 38 provinces in Indonesia, four provinces were excluded due to incomplete data availability during the observation period. Consequently, 34 provinces met the sampling criteria. With a three-year observation period, the study generated a total of 102 observations.

Panel data regression analysis was employed as the primary analytical technique because the dataset combined both cross-sectional and time-series dimensions. Panel data analysis enables researchers to examine relationships among variables across different provinces and over multiple periods simultaneously. The dependent variable in this study was local government financial performance, while the independent variables consisted of local government size, intergovernmental revenue, regional expenditure, and audit findings.

Local government size was measured using total assets, including current assets, long-term investments, fixed assets, other assets, and investment properties (Masdiantini &

Erawati, 2016). Intergovernmental revenue was measured as the total amount of Revenue Sharing Funds (DBH), General Allocation Funds (DAU), and Special Allocation Funds (DAK) received by provincial governments in accordance with Law Number 23 of 2014. Regional expenditure was measured based on total regional expenditure, including operational expenditure, capital expenditure, unexpected expenditure, and transfer expenditure, as regulated by Government Regulation Number 12 of 2019 and Minister of Home Affairs Regulation Number 77 of 2020. Audit findings were measured using the number of cases related to internal control weaknesses and non-compliance with laws and regulations identified by BPK RI (Noviyanti & Kiswanto, 2016). Meanwhile, local government financial performance was measured using the financial independence ratio, which reflects the ability of local governments to finance governmental activities and public services independently without excessive dependence on central government transfers (Mahmudi, 2016).

Data analysis was conducted using EViews version 13 software. The analytical procedures consisted of descriptive statistical analysis, model selection tests, classical assumption tests, and hypothesis testing. In selecting the most appropriate panel data model, the Chow test, Hausman test, and Lagrange Multiplier test were employed following the procedures suggested by Basuki and Prawoto (2016). These tests were used to determine the most suitable model among the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). Subsequently, hypothesis testing was carried out to evaluate the effect of local government size, intergovernmental revenue, regional expenditure, and audit findings on local government financial performance in Indonesia.

RESULTS

1. Descriptive Statistics

Table 1. Descriptive Statistics Results

	X_1	X_2	X_3	X_4	Y
Mean	3.64E+13	1.00E+13	4.45E+12	18.794120	0.876569
Median	1.33E+13	5.93E+12	3.11E+12	18.000000	0.685000
Maximum	7.15E+14	6.68E+13	2.26E+13	45.000000	2.780000
Minimum	2.53E+12	1.82E+12	1.01E+12	7.000000	0.070000
Std. Dev.	1.09E+14	1.23E+13	3.96E+12	7.698963	0.632713

source: Compiled by the researcher (2026)

The descriptive statistics results in Table 1 show that Regional Government Size (X_1) has a mean value of 3.64E+13, with values ranging from 2.53E+12 to 7.15E+14 and a standard deviation of 1.09E+14. Intergovernmental Revenue (X_2) records an average value of 1.00E+13, with a minimum value of 1.82E+12 and a maximum value of 6.68E+13. Regional Expenditure (X_3) has a mean value of 4.45E+12, ranging from 1.01E+12 to 2.26E+13. Audit Findings (X_4) show an average of 18.79 findings, with values ranging from 7 to 45. Meanwhile, Regional Financial Performance (Y) has a mean value of 0.876569, with a minimum value of 0.070000 and a maximum value of 2.780000. Overall, these results indicate considerable variation among Indonesian provincial governments during the 2022–2024 observation period.

2. Analysis Multiple Regression

Table 2. Analysis Multiple Regression Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.796130	0.137054	5.808863	0.0000
X_1	-2.50E-15	1.12E-15	-2.226313	0.0283
X_2	1.06E-13	1.46E-14	7.293132	0.0000
X_3	-1.90E-13	2.65E-14	-7.160351	0.0000
X_4	-0.002672	0.004815	-0.554963	0.5802
Effects Specification				
Cross-section random	0.410504			0.7678
Idiosyncratic random	0.225722			0.2322
R-squared	0.426171	Mean dependent var	0.265235	
Adjusted R-squared	0.402508	S.D. dependent var	0.296549	
S.E. of regression	0.229226	Sum squared resid	5.096804	
F-statistic	18.00999	Durbin-Watson stat	1.427012	
Prob(F-statistic)	0.000000			

source: Compiled by the researcher (2026)

The Analysis Multiple Regression results in Table 2 show that Regional Government Size (X_1) has a coefficient value of -2.50E-15 with a probability value of 0.0283, indicating a significant negative effect on Regional Financial Performance. Intergovernmental Revenue (X_2) has a coefficient value of 1.06E-13 and a probability value of 0.0000, indicating a significant positive effect on Regional Financial Performance. Regional Expenditure (X_3) has a coefficient value of -1.90E-13 with a probability value of 0.0000, indicating a significant negative effect on Regional Financial Performance. Meanwhile, Audit Findings (X_4) have a coefficient value of -0.002672 and a probability value of 0.5802, indicating no significant effect on Regional Financial Performance. Furthermore, the F-statistic value of 18.00999

with a probability value of 0.0000 indicates that all independent variables jointly affect Regional Financial Performance. The Adjusted R-squared value of 0.402508 indicates that 40.25% of the variation in Regional Financial Performance can be explained by the independent variables included in the model, while the remaining 59.75% is explained by other factors outside the model.

3. Multiple Regression Analysis

Table 3. Multiple Regression Analysis Results

		Unweighted Statistics	
R-squared	0.446633	Mean dependent var	0.876569
Sum squared resid	22.37422	Durbin-Watson stat	0.325071

source: Compiled by the researcher (2026)

The multiple regression results presented in Table 3 indicate that Regional Government Size (X_1) has a significant negative effect on Regional Financial Performance, as evidenced by a coefficient of -2.50E-15 and a probability value of 0.0283. Intergovernmental Revenue (X_2) has a significant positive effect on Regional Financial Performance, with a coefficient of 1.06E-13 and a probability value of 0.0000. Similarly, Regional Expenditure (X_3) significantly affects Regional Financial Performance, with a coefficient of -1.90E-13 and a probability value of 0.0000, indicating a negative relationship. In contrast, Audit Findings (X_4) do not significantly affect Regional Financial Performance, as indicated by a coefficient of -0.002672 and a probability value of 0.5802. Furthermore, the F-statistic value of 18.00999 with a probability value of 0.0000 indicates that Regional Government Size, Intergovernmental Revenue, Regional Expenditure, and Audit Findings simultaneously affect Regional Financial Performance. The Adjusted R-squared value of 0.402508 indicates that 40.25% of the variation in Regional Financial Performance can be explained by the independent variables included in the model. The remaining 59.75% may be influenced by other factors, such as Regional Original Revenue (PAD), economic growth, fiscal capacity, governance quality, population size, Human Development Index (HDI), regional wealth, and the level of dependence on the central government.

DISCUSSION

Effect of Regional Government Size on Regional Financial Performance

The results indicate that Regional Government Size has a significant negative effect on Regional Financial Performance. This finding suggests that larger regional assets do not

necessarily improve financial performance. Although local governments with substantial assets possess greater economic resources, these assets may not contribute optimally to regional revenue if they are not managed effectively. Consequently, the accumulation of assets alone cannot guarantee higher fiscal independence or better financial outcomes. This finding is consistent with the studies of Mulyani and Wibowo (2017), Putri and Amanah (2020), and Saraswati and Rioni (2019), which reported that larger government size tends to reduce financial performance. However, the result contradicts the findings of Pradana et al. (2022) and Aulia and Rahmawaty (2020), who found no significant relationship between government size and financial performance. These differences may be attributed to variations in research scope, sample coverage, and observation periods. Unlike previous studies that focused on specific regions, this study covers all provincial governments in Indonesia during 2022–2024, thereby providing broader empirical evidence. From the perspective of agency theory, larger governments face greater managerial complexity and monitoring challenges. As asset ownership increases, the risks of information asymmetry, inefficiency, and agency conflicts also become greater. Local governments may encounter difficulties in ensuring that public assets are managed transparently and productively. Therefore, the findings imply that the effectiveness of asset utilization is more important than the quantity of assets owned. Strengthening asset management systems, improving accountability, and maximizing the productive use of public assets are essential for enhancing regional financial performance.

Effect of Intergovernmental Revenue on Regional Financial Performance

The findings reveal that Intergovernmental Revenue has a positive and significant effect on Regional Financial Performance. This result indicates that transfer funds from the central government continue to play an important role in strengthening regional fiscal capacity. The availability of these funds enables local governments to finance development programs, improve public services, and support regional economic activities. Consequently, regions receiving adequate transfer funds tend to demonstrate better financial performance and greater fiscal capacity. This finding supports the studies of Rahardjo and Putra (2023), Dasmar et al. (2020), Aziz (2016), and Nugroho and Prasetyo (2018), which concluded that intergovernmental revenue positively influences local government financial performance. Nevertheless, the result differs from those reported by Pradana et al. (2022), Rahayu et al. (2023), and Insani et al. (2023), who argued that transfer funds may increase regional dependence on the central government and reduce incentives for local revenue generation.

The differences suggest that the impact of intergovernmental revenue depends largely on the effectiveness of financial management and the capacity of local governments to allocate transfer funds efficiently. According to agency theory, the central government acts as the principal by providing fiscal resources to local governments as agents. In this context, transfer funds function as instruments to support regional development and public service delivery. However, the effectiveness of these funds depends on accountability, transparency, and appropriate supervision mechanisms. Therefore, local governments must ensure that transfer funds are allocated to productive programs that generate long-term benefits and strengthen fiscal independence. The findings highlight the continued importance of intergovernmental revenue as a policy instrument for reducing fiscal disparities among regions.

Effect of Regional Expenditure on Regional Financial Performance

The study finds that Regional Expenditure has a significant negative effect on Regional Financial Performance. This finding indicates that increasing government expenditure does not automatically improve financial performance. In many cases, expenditure growth is dominated by operational spending rather than productive expenditure that supports economic development and increases fiscal capacity. As a result, higher expenditure may reduce efficiency and weaken the ability of local governments to improve their financial performance. This result is consistent with the findings of Saputri and Kurnia (2020), Salsabila and Rahayu (2021), Wulandari (2021), and Amanda and Praptoyo (2023), which reported a negative relationship between regional expenditure and financial performance. However, it differs from the findings of Angraini and Hidayat (2023), who found a positive effect, as well as Dasmar et al. (2020) and Setiawan et al. (2020), who found no significant relationship. These inconsistencies indicate that expenditure effectiveness, rather than expenditure size, is the key factor influencing regional financial performance. Agency theory provides further explanation for this relationship. Local governments, as agents, may prioritize expenditures that serve administrative interests rather than development-oriented investments. Excessive operational expenditure can limit fiscal space for infrastructure development, education, healthcare, and other productive sectors that contribute to long-term economic growth. Therefore, improving expenditure quality through performance-based budgeting and increasing the proportion of development expenditure are crucial for achieving sustainable financial performance. The findings suggest

that local governments should focus not only on spending more resources but also on ensuring that expenditures generate measurable economic and social benefits.

The findings contribute to the development of agency theory by demonstrating that the effectiveness of public resource management plays a more important role than the quantity of resources owned by local governments. The study confirms that financial performance is influenced not only by fiscal capacity but also by the quality of governance, accountability, and resource allocation. Practically, the results provide important insights for policymakers regarding the need to optimize asset utilization, improve the effectiveness of transfer fund management, and prioritize productive expenditures. These efforts are expected to strengthen fiscal independence and improve regional financial performance. This study has several limitations. First, the analysis focuses only on provincial governments in Indonesia during the 2022–2024 period, limiting the generalizability of the findings to other levels of government. Second, the study examines a limited number of explanatory variables, whereas regional financial performance may also be influenced by factors such as local own-source revenue, economic growth, governance quality, fiscal independence, and audit opinions. Therefore, future studies are encouraged to include additional variables, extend the observation period, and examine district and municipal governments to obtain a more comprehensive understanding of the determinants of regional financial performance.

CONCLUSION

This study examined the effects of local government size, balancing funds, regional expenditure, and audit findings on the financial performance of provincial governments in Indonesia during 2022–2024. The findings reveal that local government size and regional expenditure have a significant negative effect on financial performance, while balancing funds have a significant positive effect. Audit findings, however, do not significantly influence financial performance. These results indicate that regional financial performance is not solely determined by the magnitude of assets or expenditure levels, but rather by the effectiveness of resource management and fiscal capacity.

The study successfully addresses its research objectives by demonstrating that fiscal factors contribute differently to regional financial performance. It provides empirical evidence that enriches the public sector finance literature, particularly regarding the determinants of financial performance at the provincial government level in Indonesia.

Moreover, by covering all Indonesian provinces, this study offers broader and more representative national-level insights compared with many previous studies that focused on specific regions.

From a practical perspective, the findings highlight the importance of optimizing asset management, utilizing balancing funds effectively, and directing regional expenditures toward productive and development-oriented programs. Strengthening transparency, accountability, and financial governance is also essential to support sustainable improvements in financial performance. Future research is recommended to incorporate additional variables, such as local own-source revenue, governance quality, regional prosperity, and economic growth, while extending the observation period and expanding the research scope to district and municipal governments in order to provide a more comprehensive understanding of regional financial performance determinants.

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