# DETERMINANTS OF FINANCIAL PERFORMANCE : STUDY OF LOCAL GOVERNMENTS IN WEST NUSA TENGGARA

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## Abstract

The financial performance is not only influenced by financial factors but also non-financial factors. Financial factors which are components of the budget consists of revenue (PAD and Balanced Funds) and expenditure (capital expenditure), while non-financial factors namely environmental factors (population and GDRP). This study aims to examine and provide empirical evidence about the influence of the PAD, Balanced Funds, Capital Expenditure, Population and GDRP to financial performance of local governments in West Nusa Tenggara. Partial least squares (PLS) is used in analysing data. Data are collected from 8 regencies and 2 cities in West Nusa Tenggara Province for 5 (five) years from 2011 to 2015 respectively. The results shows that the PAD has a significant positive effect on the financial performance of local governments in West Nusa Tenggara, as measured by the ratio of its effectiveness and the ratio of capital expenditure, mean while the Balanced Funds, Capital Expenditure, Population and GDRP has no effect to financial performance. Contributions of research reveals that the local government's financial statements can be used in assessing financial performance of local government, so it useful in making decisions. PAD influence on the financial performance provides evidence that local governments can improve its financial performance through the potensial revenue optimalization, such as tax extensification and intensification.

**Keywords** :   Balanced funds, capital expenditure, financial performance, PAD, population, GDRP

## 1. Introduction

Performance of local governments as indicated by financial measurement tools is considered important because the mobilization of financial resources as the most crucial part in local governments. Local governments will not be able to carry out their functions effectively and efficiently without considerable expense to provide services. The ability of local governments to fulfill their obligations will be done if it is supported by the management of regional potentials optimally so it can improve the public service and social welfare. Financial performance not only as a form of financial management, but also important to know the various parties involved in the decision.

The phenomenon that occurs in local governments in West Nusa Tenggara related to the financial performance in the form of an opinion on the financial statements prepared significantly increased as indicated by the achievement of unqualified opinion by 10 local governments out of 11 local governments in West Nusa Tenggara in 2015 (IHPS I 2016). This leads the financial statements of local governments in West Nusa Tenggara are relevant to be used for analysis.

In addition to improving financial performance in the form of the acquisition of opinions, the local government has to be able to conduct in-depth assessment of the financial condition as a measure for the implementation of regional autonomy related to the region's autonomy and management of available resources. One of the phenomenon of local financial problems faced by local governments in Indonesia, is the dependence of local governments to the central government and lack of local ability to explore potential sources of revenue.

These problems become one of the basic issuance of Act No. 28 of 2009 on Local Taxes and Retribution on September 15, 2009 and started to become effective on 1 January 2010. The results of the evaluation conducted by the Ministry of Finance Sector Assistance Team Fiscal Decentralization indicate that Act No. 28 of 2009 has been able to increase the local fiscal capacity and some indicators such as revenue growth and the ratio of revenue to total regional expenditure has increased in 2011. The different results obtained by Islamiyah and Amelia (2015) on the parking tax revenue in Jakarta which indicates that the implementation of the Act No. 28 of 2009 has no direct impact on tax revenue.

Description and analysis of the budget issued by the Directorate General of Fiscal Balance, Ministry of Finance of the Republic of Indonesia, for the area in the islands of Nusa Tenggara, Maluku and Papua in the year 2011-2014 has always been at the lower level of independence than other regions. The ratio of revenue to total revenue area for the region, noted that in 2014 reached 7.08%. The development of the financial performance of district and municipal governments in NTB can be seen in Table 1, as follows:

Table 1.
The Fluctuation of Financial Performance of The Regencies and Cities in West Nusa Tenggara

| Year | Independence Ratio | Effectiveness Ratio | Efficiency Ratio | Ratio of capital expenditure |
|------|--------------------|--------------------|------------------|------------------------------|
| 2011 | 8,88% | 96,88% | 97,11% | 19,90% |
| 2012 | 7,45% | 97,16% | 98,21% | 18,50% |
| 2013 | 8,13% | 95,47% | 98,87% | 20,83% |
| 2014 | 11,11% | 98,32% | 95,88% | 19,98% |
| 2015 | 10,66% | 97,53% | 98,53% | 20,00% |

Source: DJPK, (processed data, 2016)

The development of financial performance seen from the level of local autonomy is category of very low (0-25%). The effectiveness ratios are in the effective category (> 90-100), while the financial performance in terms of the ratio of efficiency shows that regencies and cities in West Nusa Tenggara are less efficient (90% -100%). The financial performance in terms of the ratio of capital expenditure activities for regencies and cities in West Nusa Tenggara development ranged from 18.50% to 20.83% and fluctuated annually.

Based on the framework of ICMA *(International City/County Management Association)*, the financial conditions are influenced by combination of environmental factors, financial and organizational, (ICMA Framework, 2003, in DiNapoli). Related research reveals that variables affecting financial performance, researcher using financial factors in influencing the financial performance of them use the components in the budget realization report consisting of revenues and expenditures.

The contradictory research results used PAD (Regional Income) and Balanced Fund. PAD has influenced to the financial performance it is proved by Julitawati at al. (2012), Junarwati et

al. (2013), Simanullang (2013), Manik (2015) and Amrozi (2016). Different results obtained by Noviyanti and Kiswanto (2016). Amrozi (2016) states that PAD has positively effected on self-reliance and the ability to mobilize the area but did not affect the efficiency budget and the rest of the budget expenditure. In relation to PAD some researchers also tested the PAD components of financial performance, such as Junarwati et al. (2013) which indicates that the PAD components affect the financial performance Sesotyaningtyas (2012) examined the effect of local taxes in terms of efficiency ratio with negative results to the financial performance of government.

The regional governments was supported by a financial fund balanced between the center and local governments as a consequence of decentralization. The greater the fund balanced, the more increase local government funding source in performing the duties and functions assigned. The huge amount of balanced funds in the structure of the budget shows that the region has a high dependence on the central government to finance the needs of the region. Research the effect of Balanced Funds variables to financial performance has used different. The positive results of the Balanced Fund are conducted by Julitawati et al. (2012), Simanullang (2013), and Manik (2015) conversely, Ariwibowo (2015) has proved that Balanced Funds has negative results. Other researchers tested the components of the Balanced Fund of financial performance is Tahar and Zakhiya (2011). He has proved that DAU has negative results to financial performance. Other researchers use a comparison of total revenue, that is Sesotyaningtyas (2012) with the result of no effect, while Noviyanti and Kiswanto (2016) and Maiyora et al. (2015) with the results of positive influence.

The financial performance of local governments can also be influenced by the amount of local expenditure for the implementation of the government's work program. An efficient and appropriate expenditure management can improve the financial performance of local government, so the expenditure has a positive influence on the financial performance of local

governments (Noviyanti and Kiswanto, 2016). Different results obtained by Suyono (2010) that the expenditure does not affect the financial performance, because the amount of expenditure has not been able to produce the optimum output and not yet fully efficient. Local governments has to consider the composition of the region's expenditure, so it will be able to increase public confidence in the performance of local governments. Research conducted by Manik (2015) showed that capital expenditure affected the financial performance, Simanullang (2013) and Hasthoro and Suhardjanto (2014) has proved that there is no effect, while Imawan and Wahyudin (2014) resulted negative effect. Darwanis and Saputra (2014) obtained different effect on the financial performance of capital expenditure, with direct testing of capital expenditure has no effect but has indirectly effect through the PAD as well as Amrozi (2016).

Determinants of financial performance that is viewed in terms of revenue and expenditure in this regard PAD, Balanced Funds and Capital Expenditure has been done by Simanullang (2013) and Manik (2015), so this research is a replication study to with some modifications. Novelty of this study include testing and proving the previous research results to the city and regions in the province of West Nusa Tenggara. This study uses observation period after the enactment of Act No. 28 of 2009, for local government in Indonesia has entered a new phase in supporting the process of fiscal decentralization with increased local tax power for local governments. The period of observation conducted over the last five years, that is 2011 to 2015.

The development of variables has not only uses financial factor in terms of revenue and expenditure but also non-financial factors. The empirical evidence using non-financial factors in some countries such as research conducted by Cohen (2008) related to financial performance, Trussell and Patrick (2014) related to financial distress and Bolívar et al. (2015) related to the financial sustainability of local government. The empirical evidence on some local governments in Indonesia related to the financial performance conducted by Kusumawardani (2012), Maiyora et al. (2015),

Hasthoro and Suhardjanto (2014), Imawan and Wahyudin (2014), Susan (2015), Noviyanti and Kiswanto (2016), Prayitno (2012), Gomes et al. (2013), and Misdi (2015).

It can be concluded that in addition to financial factors, the financial performance of local governments can be affected by non-financial factors. Researchers in this study developed a variable by adding a variable number of the population and the GDRP. The selection of population and the GDRP variable has been chosen consideration that it represents environmental factors affecting financial performance.

This study uses independence ratio, efficiency ratio, effectiveness ratio and activity ratio, while research conducted by Simanullang (2013) and Manik (2015) only uses the efficiency ratio in measuring the financial performance area. Financial performance measurement in this study represents the ratio of the budget analysis. Another differences between this study and Simanullang (2013) and Manik (2015) are related to the analysis tools which is used, the multiple linear regression analysis, while this study uses the analysis of partial least square (PLS). The PLS analysis tool is used in order to understand the complexity of the relationship between construct and other constructs as well as the relationship of the constructs and their indicators.

Based on the discussion above, the problem in this research is: "Do PAD, Balanced Fund, Capital Expenditure, Population and GDRP affect the financial performance of local governments in West Nusa Tenggara?".  The Objective of this research is to examine and to provide empirical evidence about the influence of the PAD, Balanced Funds, Capital Expenditure, Population and GDRP affect the financial performance of local governments in West Nusa Tenggara.

## 2.  Theoretical Framework and Hypothesis Development

Accountability and transparency of local government can be attained by presenting local government financial reports. The financial statements provide accounting information used by other

interested parties as a basis for decision-making and demonstrating accountability of reporting entity for the resources entrusted to it. Local government financial statement are prepared based on Government Accounting Standards in order to meet the qualitative characteristics that provide useful accounting information for users.

Based on Act No. 15 of 2004 about Audit and Financial Responsibility State. Audit Board (BPK) audited the management of state finances and the financial responsibility of the state, one of them is the examination of the financial statements. Audit is conducted in order to provide a statement of opinion on the fairness of the information presented in the financial statements of the government. Opinion obtained as one of the government's assessment of financial performance shows the quality of the presentation of financial statements have been prepared by the government.

In addition to improve the quality of its financial statements, the local government has to improve financial performance through getting best opinions, it has to be able to conduct in-depth assessment of the financial condition as a measure for the implementation of regional autonomy related to the region's autonomy and management of available resources. The financial performance of local governments can be determined by using the financial statements and the local governments can use financial ratios to measure it. The importance of regional financial performance related to the fact that the mobilization of the financial resources of the area is seen as the most crucial part in local governance.

Further review on financial performance of local governments is to analyse the determinants of a local government's financial performance so that they can make the right decisions in order to improve the financial performance of local governments. Based on the literature and previous studies it is known that financial performance is influenced by both financial variables and non-financial variables. Financial variables included in the income component of the budget consists of local revenue and the balance funds and expenditure i.e.

capital expenditure, meanwhile non-financial variables describe the environmental factors of population and the GDRP.

The greater PAD amount in APBD, the less dependent regional government to the central government. It demonstrates the ability to manage the potential areas in the region. Balanced Fund as a source of local revenue will increase the local government funding sources in performing the duties and functions assigned. It shows that the region has a high dependence on the central government to finance the needs of the region.

The financial performance of local governments can also be affected by the local goverments expenditure, through the composition of their expenditure more to support fulfillment of public facilities or priority on capital expenditure, in addition to the expenditure with efficient management and appropriate to improve the financial performance of local governments. Population has a correlation to regional revenue and affect the services provided by local governments. The GDRP as an illustration related to the local productivity increase local revenues. Based on the description above, the conceptualization of this study can be depicted as follows:

Figure 1.

Conceptual Framework
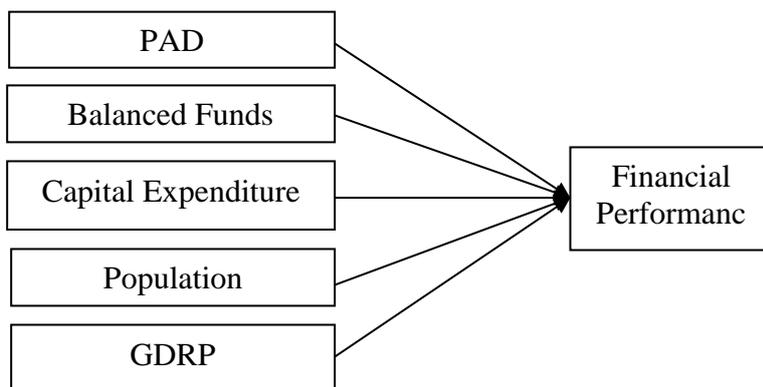


2.1. *The influence of PAD to Financial Performance*

Local government manage all its potential in improving its ability to fund local expenditure and provide services to the public as well as to reduce its dependence on central government especially with the central tax became local tax will further increase revenue. According to Halim (2007:96) local revenue is all local revenues derived from the original source local economy and Act No. 33 of 2004 states that the local revenue is defined as revenue that earned according to the local regulations in accordance with the legislation.

The local government continues its efforts to improve its ability to increase revenue that can be absorbed by the region's potential to the maximum, as the higher PAD owned by local government, the greater the local government can finance their expenditure. PAD shows the independence of a region since local government can use more freely PAD unlike the case with funding from external sources.

This is in line with the results of research conducted by Junarwati et al. (2013) to the non-employee ratio of recurrent expenditure, Tahar and Zakhiya (2011) on the independence ratio, Julitawati et al. (2012), Simanullang (2013) and Manik (2015) on the efficiency ratio. Financial performance by Andriyani and Siregar (2013) measured by dependency ratio, the ratio of effectiveness, the ratio of capital expenditures and the ratio of taxes to PAD, while Suyono (2010) with the component principal on the current ratio, debt to equity ratio, asset turnover, the operating revenue to total revenue and operating revenue to operating expense.

The different results obtained by Maiyora et al. (2015) that the PAD does not significantly influence to the efficiency ratio. Noviyanti and Kiswanto (2016), measures the value of revenue to total local revenue as the level of regional wealth to the efficiency ratio and PAD, as measured by the rate of growth of PAD as prosperity (Masdiantini and Erawati, 2016) with results that it do not affect the financial performance as measured by the principal component of self-sufficiency ratio, economy, efficiency and effectiveness.

Darwanis and Saputra (2014) showed that PAD affects the financial performance directly and as variables that make capital expenditures may affect financial performance. Amrozi (2016) further examine the PAD to several ratios to measure financial performance that's getting results that PAD has positive and significant effect on the growth of financial performance that is the ratio of self-reliance

and the ability to mobilize the area but had no effect on the growth of the financial performance of the efficiency budget and the rest of the budget expenditures.

It can be concluded that the original income is all revenues derived from the original economic resource areas: local taxes, retribution, wealth management outcomes separated areas and other legitimate PAD. The greater the contribution of local revenues to finance the construction and public services the more increase financial performance of local governments.

Based on a theoretical basis and the results of research that has been stated previously, the hypothesis can be drawn as follows:

**H1.** *PAD is postively associated with financial performance*

*2.2. The influence of Balanced Funds to Financial Performance*

Balanced Funds is a fund of APBN allocated to local government to fund the needs of the region in implementation of Decentralization. Balanced Funds consisted of revenue sharing funds or DBH, General Allocation Fund or DAU and Special Allocation Fund or DAK. The balanced funds aims to reduce the fiscal gap between central government and local government and among local governments.

The greater balanced funds that earned it, the more increase local government funding sources, so it can conduct the government and accelerate the realization of welfare and regional competitiveness. Local governments manage the utilization of external funds in accordance with the duties and functions assigned. DAU will improve the distribution of financial capability among the local government in financing the needs of the region for the implementation of decentralization, DAK will help the local government to fund specific activities under the authority of the area, while the DBH will reduce the imbalance between the financial ability of central and local governments.

Local governments with funding a large balanced funds in APBD structure on the other hand shows that the local government has a high dependence on the central government to finance the needs of the local government. It demonstrates the ineffectiveness of autonomy. The local government then in terms of the region's autonomy will be very low.

The results of research conducted over the Balanced Funds showed contradictory results. Exemination of Balanced Funds to financial performance by Julitawati et al. (2012),

Simanullang (2013) and Manik (2015) showed positive results as measured by the efficiency ratio. Other researchers tested components of the Balanced Funds to financial performance by Tahar and Zakhiya (2011) that DAU with negative results, as measured by the region's autonomy. It also uses the ratio of the total revenue Sesotyaningtyas (2012) with the results did not affect the financial performance as measured by the efficiency ratio, while Noviyanti and Kiswanto (2016) with the results of positive influence.

The higher amount of Balanced Funds received by the local government in the form of DAU, DAK and DBH of the central government, the higher financial performance of local governments. Based on a theoretical basis and the results of research that has been stated previously, the hypothesis to be tested is expressed as follows:

**H2.** *Balanced Funds is positively associated with financial performance*

*2.3.The influence of Capital Expenditure to Financial Performance*

In conducting the local government and meet the provision of services to the community, the local government made a number of expenditure. In one side, expenditure has an influence on the reduction of available funds on the other side it can improve the service provided to the public. The management of expenditure can be effective and efficient. Furtermore, it can improve the financial performance of local governments.

In this line with the research conducted by Noviyanti and Kiswanto (2016), that expenditure has positive effect on the financial performance of local governments, but the different results obtained by Suyono (2010). In terms of expenditure type then expenditure that more support fulfillment of public facilities will be able to increase public confidence in the performance of local governments. So that regional expenditure should prioritize the allocation of expenditure on public services in the form of an increase in capital expenditure.

Some studies show different results about the effect of capital expenditure to financial performance, as it is done by Manik (2015) showed that capital expenditure affect the financial performance, but Simanullang (2013) and Hasthoro and Suhardjanto (2014) has no effect while

Imawan and Wahyudin (2014) has negative effect. It also Darwanis and Saputra (2014) obtained different effect on the financial performance of capital expenditure, with direct testing of capital expenditure has no effect but have the effect of indirectly via the PAD as well as Amrozi (2016).

The higher expenditure of local governments in the form of capital expenditure, the higher the financial performance of local governments. Based on the theoretical basis and the results of research that has been stated previously, the hypothesis is expressed as follows:

**H3.** *Capital Expenditure is positively associated with financial performance*

*2.4. The Population's effects to the Financial Performance*

As a government administrator, The local government has the authority to regulate and manage their own government affairs. On the granting of the mandate, the local government is required to improve its performance in managing the resources entrusted. Each of local government has differences with other local governement, and one of it is their population.

The population is those who have settled in the region of at least 6 months or less than 6 months but intends to settle (www.bps.go.id). The population is the total of people living in a certain area (Hasthoro and Suhardjanto, 2014).

The Population of a local government can contribute to the regional revenue, the more of population's number, the greater the potential revenue for a region that can be extracted through taxes and retribution. It also will affect the services provided by local governments, the larger the population of a local government that would require local governments to improve the public services can be better with the demands of the government will be compelled to improve their performance in delivering services to the public.

Cohen (2008) proven that the population has significant effect on the financial performance, as well as Gomes et al. (2013), Hasthoro and Suhardjanto (2014) showed that the number of positive and significant effect on financial performance. In otherwise, the poposite result was

obtained by Susanto (2015), that the population had no effect on the financial performance of local governments.

The population has also a significant effect on the financial condition of local government as practiced by Ritonga (2014) and Rusmin et al. (2014). Rusmin et al. (2014) in addition to validating that the larger the population of local government, the higher its liquidity position, the stronger its ability to funding general services and the greater its possibility earning revenues from its local sources . The Research of Rusmin et al. (2014) showed an interesting evidence that the proportion of local governments with more women will have better financial condition than areas with a high proportion than the male population. The local governments with a population of more women than men have a better financial situation, it's because of they had a greater ability to managed the fund public services from unrestricted net assets and have a greater ability to earn revenue from existing sources in the area.

Based on a theoretical basis and the results of research that has been stated previously, the hypothesis to be tested is expressed as follows:

**H4.** *Population is positively associated with financial performance*

*2.5. The influence of GDRP to Financial Performance*

The GDRP is gross added value all goods and services that are created or produced by the domestic territory of a country arising from economic activity in a given period regardless of whether the factors of production owned by residents or non-residents (BPS, 2016). The GDRP reflects a person's income, which is one measure of prosperity of a region. Regional income sourced from public activity in the regional economy to the GDRP to contribute to local revenue.

Cohen (2008) examined the wealth one of which is proxied by the gross domestic product (GDP) and Imawan and Wahyudin (2014) with the GDP positive effect on financial performance while Kusumawardani (2012) uses the prosperity as measured by GDRP has no

effect. Furthermore, the GDRP component related Susanto (2015) examines the effect of the GDRP by sector on the financial performance. The results shown that the GDRP by sector only industry and trade, hotels and restaurants that affect financial performance, while the GDRP of agriculture, mining, construction, electricity, gas and water, transportations and communications, financial services and leasing, the services sector has no effect.

GDRP as a measurements of regions wealths so that the high GDRP will contribute enough revenues to funded the local expenditure so as not to depend on the administration of the center. GDRP can contribute to local revenue, this is in line with the results of the research of Andriyani and Siregar (2013) proven that the GDRP positive and significant impact on the financial performance area via the PAD as an intervening variable.

Based on a theoretical basis and the results of research that has been stated previously, the hypothesis to be tested is expressed as follows:

**H5.** *GDRP is positively associated with financial performance*


## 3.   Research Method

*3.1. Data selection and Collection Approach*

The study was conducted at the regencies and cities government in West Nusa Tenggara with details of 8 regencies and 2 cities with equity considerations authority which does not include the provincial government. The research data using financial data in the form of financial statements of local governments obtained from the pages of the Directorate General of Fiscal Balance and non-financial form of population and GDRP is derived from the website of the Central Board of Statistics of the regencies and cities over a period of 5 (five) years, namely from 2011 to 2015 so that the number of analysis units 50 units.

3.2. *Measurement and Operational Variables*

There are six variables are used in this study, while the conceptual and operational definitions of the variables are as follows:

1. Local Revenue or PAD

   Local revenue as earned income withheld region according to local regulations in accordance with the legislation (Act No. 33 of 2004). PAD measured using actual numbers Local Taxes, Retributions, results of the separated regional wealth management and other legitimate PAD on budget realization reports regencies and cities in West Nusa Tenggara fiscal year 2011-2015.

2. Balanced Funds or DP

   Balanced Funds is a fund that sourced from APBN allocated to regions to fund the needs of the region in implementation of Decentralization (Law No. 33 of 2004). Balanced Funds are measured by using an actual amount of realization budget from DBH, DAU and DAK report provides budget realization regencies and cities in West Nusa Tenggara fiscal year 2011-2015.

3. Capital Expenditure or BM

   Capital expenditure is expenditure made in the framework of the purchase / acquisition or construction of tangible fixed assets that have a value of benefits more than twelve (12) months to be used in government activities (Regulation of the Minister of Home Affairs No. 13 of 2006). The Capital expenditure was measured using actual expenditure figures soil; equipment and machinery; building and construction; roads, irrigation and networks/ installations; and other fixed assets that exist on budget realization reports regencies and cities in West Nusa Tenggara fiscal year 2011-2015.

4. Population or JP

   The population is the total of people who living in a certain area (Hasthoro and Suhardjanto, 2014). The population is measured by the number of population by gender in the regencies

and cities in West Nusa Tenggara based on data from the Central of Statistics Board year of 2011-2015.

5. Gross Domestic Regional Product or GDRP

The GDRP is gross added value all goods and services produced in the region that is created in regencies and cities government. The GDRP is measured by using a digit GDRP at current prices by the business field of agriculture, forestry and fisheries; mining and excavation; processing industry; provision of electricity and gas; water supply, waste management and recycling; construction; trade, retail, repair and maintenance of cars and motorcycles; transportation and warehousing; provision of accommodation and foods and drinks; Information and communication; financial services; real estate; corporate services; public administration, defense and compulsory social security; education services; health services and social activities; and other services regencies and cities in West Nusa Tenggara, based on data from the Central Statistics Board or BPS year 2011-2015.

6. The financial performance of local governments or KK

The financial performance of local government is the level of achievement of local governments using financial indicators. The financial performance of the region in this study was measured by:

a. Regional Financial Independence ratio, calculated by the formula:

$$\text{Inndependence Ratio} = \frac{\text{PAD}}{\text{Total of Regional Income}} \; x \; 100\% \; (\text{Halim, 2007})$$

b. Regional Finance Effectiveness Ratio, calculated by the formula:

$$\text{Effectiveness Ratio} = \frac{\text{Revenue Realization}}{\text{Revenue Targets}} \; x \; 100\% \; (\text{Halim, 2007})$$

c. Regions Financial efficiency ratio, calculated by the formula :

$$\text{Efficiency Ratio} = \frac{\text{Expenditure Realization}}{\text{Revenue Realization}} \; x \; 100\% \; (\text{Halim, 2007})$$

d. Activity Ratios (Harmony Expenditure), in this study the activity ratio is used only for capital expenditure ratio in consideration of the importance of capital expenditure to improve public welfare, public services and the implementation of government so that it can be seen how active the local government to make capital expenditures, calculated by the formula:
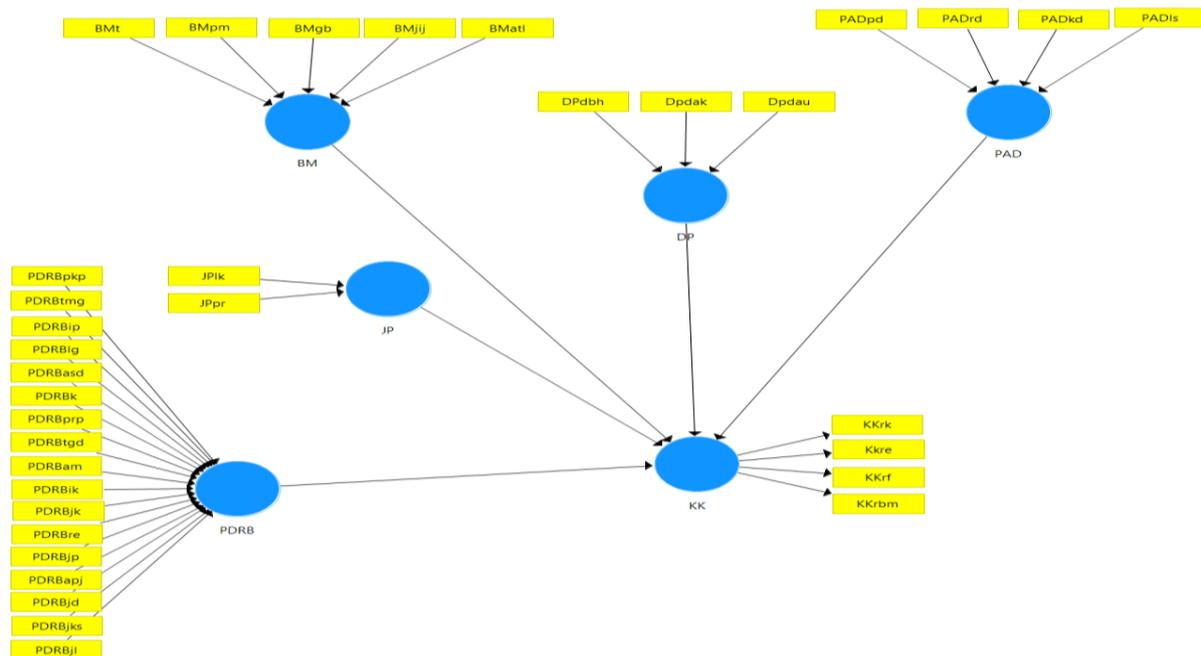
$$\text{Capital Expenditure Ratio} = \frac{\text{Capital Expenditure Realization}}{\text{Total expenditure}} \; x \; 100\% \text{ (Mahmudi, 2016)}$$

### 3.3. Data Analysis Method

Analysis of the data in this study using the analysis of Partial Least Square (PLS) with the software application SmartPLS 3.0. Measurement and structural models in this study can be described as follows:

Figure 2.
Measurement and Structural Model



## 4. Results

### 4.1. R Square

The results of PLS show that R- *square* obtained at 0.563 (Table 4.1). These results suggest that the magnitude construct financial performance can be explained by the construct PAD, Balanced Funds, Capital Expenditures, Population and GDRP by 56.30% while the remaining 43.70% is explained by other constructs that do not include the research model. Rated R- *square* of 56.30% indicates structural model into the moderate category. According to Chin, 1998 in Ghozali (2015: 81) the moderate category is greater than 0.33 and less than 0.64.

Table 4.1.
R *Square*

|  | R *Square* |
| --- | --- |
| KK | .563 |

Source: Data of secondary processed, 2016

*4.2. Hypothesis testing*

Hypothesis testing is done by statistical test t ( *t-test* ), by looking at the value of t statistics obtained. Significance size hypothesis by comparing the t statistic with a value of t table or you can also compare the p- *value* with the value of α. The estimation results can shows from t-statistics in Table 4.2.

Table 4.2.
*Path Coefficients*

|  | Original Sample (O) | Sample Mean (M) | Standard Deviation (STDEV) | T Statistics ($|O/STDEV|$) | P Value |
| --- | --- | --- | --- | --- | --- |
| PAD -> KK | .207 | 0,019 | 0.121 | 1,712 | 0,044 |
| DP -> KK | -0.201 | -0.100 | 0.151 | 1.334 | 0.091 |
| BM -> KK | -0.232 | -0.112 | 0.171 | 1,357 | 0.088 |
| JP -> KK | -0.129 | 0,025 | 0,125 | 1.032 | 0.151 |
| GRDP -> KK | -0.595 | -0.090 | .786 | .757 | 0,225 |

Source: Data processed, 2016

The results of the analysis with *bootstrapping* of PLS analysis in Table 4.2 above are as follows:

1. Variable PAD has a coefficient of 0.207 and the value of t statistic of 1.712 (p value = 0.044). These results indicate that the PAD has a positive significant effect on financial

performance. The increase in revenue will lead to financial performance will increase and otherwise. These results are also indicate that H1 is accepted in this study.

2. Variable DP has a coefficient of -0.201 and the value of t statistic of 1.334 (p value = 0.019). These results indicate that the effect is not significant DP negatively affect financial performance. These results also indicate that H2 rejected in this study.

3. Variable BM has a coefficient of -0.232 and the value of t statistic of 1.357 (p value = 0.088). These results indicate that BM is not significantly negative effect on the financial performance. These results also indicate that H3 rejected in this study.

4. JP variable has a coefficient of -0.129 and the value of t statistic of 1.032 (p value = 0.151). These results indicate that the effect is not significant JP negatively affect financial performance. These results also indicate that the H4 rejected in this study.

5. The GDRP variable has a coefficient of -0.595 and the value of t statistic of 0.757 (p value = 0.225). These results indicate that the GDRP is not significantly affect on financial performance. Increase in the GDRP will lead to financial performance will decline and vice versa. These results also indicate that H5 rejected in this study.

### 5. Conclusion, Implication and Limitation

*5.1. Conclusion*

Based on the results of research conducted, it can be concluded as follows:

1. PAD has positive significant effect on the financial performance of the regencies and cities in West Nusa Tenggara. This indicates that the PAD into the determinants of financial performance on regencies and cities in West Nusa Tenggara, with increasing PAD the financial performance as measured by the ratio of its effectiveness and the ratio of capital expenditure will also increase. Regencies and cities in West Nusa Tenggara therefore to continue on increase the acceptance of PAD in accordance with the existing provisions and

with regard on the conditions and society economic potential so as to improve financial performance in terms of effectiveness and ratio and ratio of capital expenditure.

2. Balanced Funds did not affect on the financial performance of the regencies and cities in West Nusa Tenggara. This indicates that the Balanced Funds is not a determinant of financial performance in the regencies and cities in West Nusa Tenggara. Balanced Funds did not affect to the effectiveness of local financial and capital expenditure allocation on regencies and cities in West Nusa Tenggara. This is because the Fund Balance at regencies and cities in West Nusa Tenggara are dominated by the reception of the DAU. DAU aims to balance the financial capacity to fund the needs of the region. The expenditure of regencies and cities in West Nusa Tenggara is still dominated to funding the operating expenditures.

3. Capital expenditure does not affect on the financial performance, capital expenditure is not a determinant of financial performance in the regencies and cities in West Nusa Tenggara. This is due to the realized capital expenditures had not been able to meet the needs of the community in boosting productivity in society. Realized capital expenditures regencies and cities in West Nusa Tenggara in more emphasis on improving the allocation of capital expenditure of land, capital expenditure of equipment and machinery as well as capital expenditures of buildings. Regional capabilities in infrastructure development, facilities and infrastructure in the region is uneven, but it expenditure more dominated government operating expenditures in carrying out the government realized that the capital expenditures be not optimal to improve financial performance.

4. Population does not affect the financial performance of regencies and cities in West Nusa Tenggara, so that the total population is not a determinant of financial performance in the regencies and cities in West Nusa Tenggara. Its because the population as one of the factors that represent environmental factors, regencies and cities in West Nusa Tenggara can not be

managed optimally as a potential source of local revenue. The amount of population in every local government doesn't created a good financial performance because it needs to be supported by improving the quality of the population to become driver of financial performance for the better area.

A regional differences related problems were facing their areas of population, which are related to the population density, population dependency ratio, the unemployed, migrants, education and health so that the potential number of people in influencing financial performance cannot be optimal. The population is an environmental factor that is relatively can generate revenue for the regions that have a direct bearing on local revenue due to the greater number of the population, the greater the revenue potential for a region that can be extracted and on the other hand has an influence on expenditure in order to meet the needs of community to improve the public services that the population does not directly affect to the financial performance.

5. Gross Domestic Regional Product does not affect to the financial performance of the regencies and cities in West Nusa Tenggara, so that the Gross Domestic Regional Product is not a determinant of financial performance in the regencies and cities in West Nusa Tenggara. This indicates that the added value resulting from the business field that make up the GDRP has not a major economic impact on the population and local finances. The GDRP as an illustration of the productivity of the region have a relation with the increase in the reception area, so that the impact on financial performance is not directly but through local revenue in the form of revenue received by the top area of taxation, retribution, the results of the wealth management area and other PAD legitimate, as well as the transfer of the center which is the primary measure of allocation of funds that will be accepted for the regions of the central government.

*3.2. Implication*

The implication of this study is to prove the usefulness of the financial statements of local governments in analyzing the financial performance of local governments, thus providing a basis for decision making. The Assessment of financial performance that comes from quality financial reports that will provide a quality assessment results so that it can support the decision-making generated precisely. Local revenue into variables influencing the improvement of financial performance as measured by the ratio of its effectiveness and the ratio of capital expenditure. Results of the study's findings can be taken into consideration for regencies and cities in West Nusa Tenggara management of PAD. Optimalization diversion taxes into local taxes through the intensification and extensification of the tax, so as to increase the capacity of local governments, but certainly not burdensome to society.

### 3.3. Limitation

This study has limitations that can be improved in future studies. Limitations of this study are:

1. This study examined only three financial variables derived from Budget Realization Reports and two variables representing the environmental factors affecting financial performance, making it less explores the factors that may be influential.

2. The scope of this research is only done at the regencies and cities in West Nusa Tenggara, thereby generalizing the findings and recommendations of this study are less able to apply for regencies and cities in other provinces.

3. This study only uses self-sufficiency ratio, the ratio of effectiveness, efficiency ratio and the ratio of capital expenditure as well as of the ratio only two ratios that pass the test is effectiveness ratio and the ratio of capital expenditure can therefore add other financial performance indicators.

Based on the results and limitations of research that has been done, then submitted suggestions for further research are:

1. Future studies can use variables in this study with different measurements, for example in terms of financial revenue by not only using the size of the PAD and Balanced Funds but can use other measurements such as income transfers because the local governments are not only obtain the transfer of the center in the form of funds balance but also be able to receive in the form of other central government transfers and the transfer of the provincial government facilities and other legitimate income. Expenditure in this study only measured by capital expenditure, so for further research can use the shopping area as measured by capital expenditure, operating expenditure and unexpected. Another component in the LRA also be used as financing. Other financial aspects can also be obtained from the components on the balance sheet as assets or liabilities. Environmental factors that describe the needs and resources not only the number of residents can also use other sizes, such as poverty, inflation, employment, unemployment and  others  besides  environmental  factors  may include the political culture and the external conditions of the economy. In addition, the form factor of the local government organizations such as the local government management practices and policies in response to environmental and political factors.

2. Researchers can further expand the research object, for example by using regencies and cities in Indonesia or the local government in Indonesia as an object of research. It can also be tested with the classification of local governments based on opinions are obtained.

3. Further studies can use other criteria such as financial performance operating expenditure ratio, liquidity ratio, solvency ratio and liability ratio.

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