

BUDGET VARIANCES, FISCAL CAPACITY, AND FINANCIAL PERFORMANCE IN SOUTH SUMATRA LOCAL GOVERNMENTS

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Abstract

This study aimed to examine the effects of revenue budget variance, expenditure budget variance, fiscal capacity, and local government size on the financial performance of local governments in South Sumatra Province during the 2020–2024 period. The study employed a quantitative approach with an associative-causal design. The population consisted of 18 local governments in South Sumatra Province, and a saturated sampling technique was applied, resulting in 90 panel observations over five years. Secondary data were collected from Budget Realization Reports and Local Government Financial Statements. Financial performance was measured using the regional financial efficiency ratio, while the independent variables consisted of revenue budget variance, expenditure budget variance, fiscal capacity, and local government size. The data were analyzed using panel data regression with the Fixed Effect Model. The results showed that revenue budget variance had a significant negative effect on financial performance, with a regression coefficient of -1.476 and a significance value of 0.001 . Expenditure budget variance had a significant positive effect, with a regression coefficient of 1.855 and a significance value of 0.001 . Fiscal capacity had no significant effect, with a significance value of 0.520 . Local government size had a significant positive effect, with a regression coefficient of 0.440 and a significance value of 0.000 . The adjusted coefficient of determination indicated that 31.31 percent of the variation in financial performance was explained by the model, while the F-test confirmed that all independent variables simultaneously affected financial performance with a significance value of 0.000 . These findings implied that strengthening budget planning, expenditure control, and resource management may support more efficient and accountable financial management in local governments.

Keywords: Local Government Financial Performance, Revenue Budget Variance, Expenditure Budget Variance, Fiscal Capacity, Local Government Size

1. Introduction

Indonesia has implemented a decentralization system that grants local governments the authority to administer and manage regional affairs independently in accordance with regional needs and potential. Law Number 23 of 2014 concerning Regional Government defines decentralization as the transfer of governmental authority from the central government to autonomous regions to regulate and manage public affairs based on the interests of local communities. Within this framework, local governments are expected to improve the quality of public services, accelerate regional development, and enhance public welfare through accountable and effective financial management (Republic of Indonesia, 2014). Consequently, regional financial management has become an essential component of local governance because it reflects the capacity of local governments to



allocate and utilize public resources in achieving development objectives. Local government financial performance is measured using the regional financial efficiency ratio, which compares realized expenditure with realized revenue. A lower efficiency ratio indicates better financial performance because it reflects more efficient utilization of financial resources.

In the era of regional autonomy, local governments are required to demonstrate sound financial performance as evidence of effective, efficient, transparent, and accountable financial management. Financial performance constitutes an important indicator for evaluating the ability of local governments to manage public resources and fulfill their responsibilities in delivering public services (Hati et al., 2025). According to Hati, Sari, and AR (2025), local government financial performance can be measured using the regional financial efficiency ratio, which compares realized expenditure with realized revenue. A lower efficiency ratio indicates better financial performance because it reflects more efficient utilization of financial resources. Therefore, financial performance assessment extends beyond measuring the amount of public expenditure and evaluates whether public funds have been managed economically, efficiently, and effectively. Systematic performance measurement also enables local governments to identify weaknesses in budget planning and implementation, thereby supporting continuous improvements in regional financial management.

Despite continuous efforts to improve regional financial management, local governments in South Sumatra Province continue to encounter challenges in maintaining consistent financial performance. Audit findings issued by the Audit Board of the Republic of Indonesia indicated discrepancies between planned budgets and budget realization, both in terms of regional revenue and expenditure. These discrepancies suggest weaknesses in budget planning and implementation that may adversely affect local government financial performance. Based on the Budget Realization Reports of local governments in South Sumatra Province during the 2020–2024 period, the regional financial efficiency ratio fluctuated considerably. The efficiency ratio was recorded at 74.37 percent in 2020, increased to 104.68 percent in 2021, and subsequently improved to 96.28 percent, 97.79 percent, and 99.48 percent in 2022, 2023, and 2024, respectively. Although financial efficiency gradually improved after 2021, these fluctuations indicate that local governments still faced challenges in maintaining a consistent balance between realized revenue and expenditure. This phenomenon highlights the importance of improving budget management to ensure that public financial resources are utilized efficiently and effectively.

One factor presumed to influence local government financial performance is budget variance, which represents the difference between budgeted and realized financial outcomes. Budget variance consists of revenue budget variance and expenditure budget variance. Revenue budget variance is considered favorable when realized revenue exceeds the budgeted amount, whereas expenditure budget variance indicates more efficient financial management when realized expenditure remains below the approved budget (Afifah & Adnan, 2022). Nevertheless, substantial budget variances may also indicate weaknesses in budget planning, inaccurate revenue forecasting, or ineffective implementation of government programs. Hati et al. (2025) argued that high revenue budget variance reflects the inability of local governments to estimate regional revenue accurately, whereas expenditure budget variance represents deficiencies in budget planning and program implementation. Consequently, both revenue budget variance and



expenditure budget variance should be examined separately to determine their respective effects on local government financial performance.

Another factor that may influence local government financial performance is fiscal capacity. According to the Regulation of the Minister of Finance Number 116/PMK.07/2021 concerning the Regional Fiscal Capacity Map, fiscal capacity represents the financial capability of local governments measured by regional revenue after deducting earmarked revenue and specific expenditures. Regions with stronger fiscal capacity possess greater financial flexibility to finance development programs and public services using their own financial resources. Accordingly, higher fiscal capacity is expected to support more effective budget management and improve local government financial performance (Afifah & Adnan, 2022).

Local government size has also been identified as a potential determinant of financial performance. Afifah and Adnan (2022) measured local government size using total assets, arguing that governments with larger asset ownership generally possess greater operational capacity to support public service delivery. Greater assets enable local governments to perform governmental functions more effectively and facilitate the implementation of development programs. Therefore, local government size is expected to contribute to improved financial performance through more optimal utilization of regional resources.

The urgency of this research is driven by several critical factors. First, Indonesia has implemented a decentralization system that grants local governments the authority to manage regional affairs independently, yet many local governments in South Sumatra Province continue to encounter challenges in maintaining consistent financial performance. Second, audit findings issued by the Audit Board of the Republic of Indonesia indicated discrepancies between planned budgets and budget realization, both in terms of regional revenue and expenditure, suggesting weaknesses in budget planning and implementation. Third, the regional financial efficiency ratio of local governments in South Sumatra Province fluctuated considerably during the 2020–2024 period, indicating that local governments still faced challenges in maintaining a consistent balance between realized revenue and expenditure. Fourth, empirical evidence regarding revenue budget variance, expenditure budget variance, fiscal capacity, and local government size on financial performance remains inconclusive, with some studies reporting significant effects and others reporting insignificant or no relationship. Fifth, the local governments in South Sumatra Province during the 2020–2024 period represent a unique context characterized by post-pandemic recovery and evolving fiscal decentralization practices, yet empirical evidence on the determinants of financial performance in this region remains limited.

Previous research has shown significant but fragmented findings regarding the determinants of local government financial performance. Studies have demonstrated that revenue budget variance significantly influences financial performance (Hati et al., 2025; Afifah & Adnan, 2022), that expenditure budget variance affects financial performance (Hati et al., 2025), that fiscal capacity influences financial performance (Surya, 2016; Rusydi, 2015; Rahajaan et al., 2026), and that local government size affects financial performance (Aulia & Rahmawaty, 2020; Hati et al., 2025). However, other studies have reported contradictory findings, indicating that revenue budget variance, expenditure budget variance, and fiscal capacity do not significantly affect financial performance (Afifah & Adnan, 2022), and that local government size has no significant effect on financial performance (Maulina et al., 2021; Millenia, 2022). These inconsistencies



suggest that the relationships among revenue budget variance, expenditure budget variance, fiscal capacity, local government size, and financial performance remain underexplored, particularly in the context of local governments in South Sumatra Province.

The research gap in this study lies in the limited understanding of how revenue budget variance, expenditure budget variance, fiscal capacity, and local government size jointly influence local government financial performance, particularly in South Sumatra Province. While individual studies have examined the direct effects of these factors on financial performance, the integrated framework connecting these factors in a single analytical framework remains underexplored. Additionally, most previous studies have focused on various regions or other periods, leaving a significant gap in knowledge regarding the dynamics of financial performance in South Sumatra Province during the 2020–2024 period. Furthermore, empirical evidence on the determinants of financial performance in Indonesia remains limited, particularly in the context of fiscal decentralization and regional autonomy.

The novelty of this research lies in several aspects. First, this study focuses on local governments in South Sumatra Province during the 2020–2024 period, representing a unique context characterized by post-pandemic recovery and evolving fiscal decentralization practices. Second, this study develops an integrative model that simultaneously examines the influence of revenue budget variance, expenditure budget variance, fiscal capacity, and local government size on financial performance, providing a more comprehensive understanding of the determinants of financial performance in local governments. Third, this study contributes to the limited empirical evidence on financial performance in South Sumatra Province, providing insights into how budget variance, fiscal capacity, and local government size collectively influence financial performance. Fourth, this study extends the application of Agency Theory to the context of local government financial performance in Indonesia, validating theoretical predictions in an under-researched institutional context. Fifth, this study provides actionable insights for local governments, regulators, and academics in designing effective strategies to enhance financial performance and accountability in regional financial management.

The purpose of this study is to examine the effects of revenue budget variance, expenditure budget variance, fiscal capacity, and local government size on the financial performance of local governments in South Sumatra Province during the 2020–2024 period. Specifically, this research aims to analyze the effect of revenue budget variance on financial performance, analyze the effect of expenditure budget variance on financial performance, analyze the effect of fiscal capacity on financial performance, and analyze the effect of local government size on financial performance. The choice of this goal was driven by the limited understanding of how these factors collectively influence financial performance and the need for empirical evidence that can inform local governments, regulators, and academics in designing effective strategies to enhance financial performance and accountability in regional financial management.

The contribution of this research is multifaceted. From a theoretical perspective, this research contributes to the enrichment of literature on public sector accounting and financial management by proposing and testing an integrative model that links revenue budget variance, expenditure budget variance, fiscal capacity, and local government size with financial performance, extending the application of Agency Theory to the context of local government financial performance in Indonesia. The findings contribute to the understanding of how budget variance, fiscal capacity, and local government size



influence financial performance, providing a more nuanced theoretical framework for analyzing regional financial management. From a practical perspective, this study provides actionable insights for local governments, regulators, and academics in assessing and managing financial performance risk. For local governments, the results offer insights into the importance of accurate revenue planning, efficient expenditure management, and optimal utilization of regional resources in maintaining financial performance. For regulators, the results offer insights into the importance of budget planning and expenditure control in promoting accountability and transparency. For academics, this study contributes to the growing body of literature on public sector accounting and financial management, providing a foundation for future research on local government financial performance.

2. Theoretical Background

2.1 Agency Theory

Agency Theory explains the contractual relationship between a principal and an agent in which the principal delegates decision-making authority to the agent (Jensen & Meckling, 1976). In the public sector, the principal is represented by society and the central government, while local governments act as agents responsible for managing regional financial resources through the Regional Revenue and Expenditure Budget. This relationship creates the potential for agency problems arising from information asymmetry and differences in interests because local governments possess greater access to information than the principal. Consequently, accountability, transparency, and performance evaluation are essential mechanisms to ensure that public financial resources are managed in accordance with the interests of society. In this study, revenue budget variance, expenditure budget variance, fiscal capacity, and local government size function as mechanisms that influence the relationship between local governments as agents and society as principals. Revenue budget variance reflects the difference between budgeted and realized regional revenue, while expenditure budget variance represents the government's discipline in implementing approved budgets. Fiscal capacity reflects the financial capability of local governments to finance development activities, and local government size reflects the magnitude of economic resources managed by local governments. Accordingly, Agency Theory provides the theoretical foundation for this study by explaining how revenue budget variance, expenditure budget variance, fiscal capacity, and local government size influence local government financial performance.

2.2 Local Government Financial Performance

Local government financial performance represents the effectiveness of regional governments in managing public financial resources during a fiscal period. According to the Regulation of the Minister of Home Affairs Number 13 of 2006, performance refers to the measurable outputs or outcomes generated through government programs and activities funded by public budgets (Ministry of Home Affairs, 2006). Meilanda et al. (2023) defined local government financial performance as the level of achievement in regional financial management, including regional revenue and expenditure realized within one fiscal year. Financial performance can be objectively evaluated using Local Government Financial Statements, which comprise the Budget Realization Report, Balance Sheet, Cash Flow Statement, and Notes to the Financial Statements (Puspitasari et al., 2026). From the perspective of Agency Theory, financial performance reflects the outcomes of the agent's efforts to manage public resources in accordance with the



interests of the principal (Jensen & Meckling, 1976). In this study, local government financial performance is measured using the regional financial efficiency ratio. The efficiency ratio compares realized regional expenditure with realized regional revenue and evaluates the government's ability to control expenditure relative to available financial resources. A lower efficiency ratio indicates better financial performance because local governments are able to minimize expenditure while maintaining optimal revenue realization.

2.3 Revenue Budget Variance

Revenue budget variance refers to the difference between budgeted revenue and realized revenue at the end of the fiscal year (Afifah & Adnan, 2022). During the budgeting process, local governments generally apply a conservative approach by establishing minimum revenue targets to increase the likelihood of achieving or exceeding planned revenue. Consequently, revenue budget variance is considered favorable when realized revenue exceeds the approved budget and unfavorable when realized revenue falls below the planned target. Hati et al. (2025) argued that substantial revenue budget variance reflects weaknesses in revenue forecasting and unrealistic budget planning, which may ultimately reduce the efficiency of regional financial management. From the perspective of Agency Theory, revenue budget variance reflects the extent to which local governments as agents can translate planned revenue targets into actual realization (Jensen & Meckling, 1976). A larger variance indicates that the agent has not fully fulfilled its responsibility in achieving the agreed revenue targets, creating information asymmetry between planning and implementation. In this study, revenue budget variance is measured as the comparison between realized revenue and budgeted revenue. Empirical studies also support this relationship, with studies by Hati et al. (2025) and Afifah and Adnan (2022) finding that revenue budget variance significantly influences local government financial performance.

2.4 Expenditure Budget Variance

Expenditure budget variance represents the difference between planned expenditure and realized expenditure during a fiscal period (Hati et al., 2025). Government expenditure budgets function as the maximum limit of public spending, and local governments are considered to perform well when realized expenditure does not exceed the approved budget (Afifah & Adnan, 2022). Expenditure variance may indicate efficient budget utilization when expenditure remains below budget without compromising government program implementation. However, excessive expenditure variance may also reflect weaknesses in budget planning, inaccurate expenditure estimation, or low budget absorption. From the perspective of Agency Theory, expenditure budget variance reflects the government's discipline in implementing approved budgets and its ability to manage public expenditures responsibly and efficiently (Jensen & Meckling, 1976). In this study, expenditure budget variance is measured as the comparison between realized expenditure and budgeted expenditure. Empirical studies also support this relationship, with studies by Hati et al. (2025) finding that expenditure budget variance significantly influences local government financial performance.



2.5 Fiscal Capacity

Fiscal capacity reflects the financial capability of local governments to finance public services and regional development using their own financial resources. According to the Regulation of the Minister of Finance Number 116/PMK.07/2021 concerning the Regional Fiscal Capacity Map, fiscal capacity is measured by regional revenue after deducting earmarked revenue and specific expenditures (Ministry of Finance, 2021). Afifah and Adnan (2022) stated that higher regional revenue indicates stronger fiscal capability to finance development activities. Similarly, Chodariyanti (2015) explained that fiscal capacity reflects the ability of local governments to generate Regional Original Revenue and revenue-sharing funds sufficient to finance regional expenditure independently from central government assistance. From the perspective of Agency Theory, fiscal capacity reflects the financial potential available to local governments as agents to manage public resources in accordance with the interests of the principal (Jensen & Meckling, 1976). In this study, fiscal capacity is measured using the Regional Fiscal Capacity Ratio. Empirical studies also support this relationship, with studies by Surya (2016), Rusydi (2015), and Rahajaan et al. (2026) finding that fiscal capacity significantly influences local government financial performance.

2.6 Local Government Size

Local government size represents the magnitude of economic resources controlled by local governments and is commonly measured using total assets. Government Regulation Number 71 of 2010 concerning Government Accounting Standards defines assets as economic resources controlled or owned by government entities as a result of past events that are expected to provide future economic or social benefits (Ministry of Home Affairs, 2006). Total assets are considered a relatively stable indicator of government size compared with revenue or workforce size and have therefore been widely adopted in previous studies (Millenia, 2022). Hati et al. (2025) suggested that larger local governments generally possess greater operational capacity and are better able to provide public services because they manage more substantial economic resources. From the perspective of Agency Theory, total assets represent public resources entrusted to local governments for achieving development objectives and delivering public services (Jensen & Meckling, 1976). In this study, local government size is measured using the natural logarithm of total assets. Empirical studies also support this relationship, with studies by Aulia and Rahmawaty (2020) and Hati et al. (2025) finding that local government size significantly influences financial performance.

2.7 The Effect of Revenue Budget Variance on Local Government Financial Performance

Revenue budget variance refers to the difference between budgeted revenue and realized revenue at the end of the fiscal year (Afifah & Adnan, 2022). From the perspective of Agency Theory, revenue budget variance reflects the extent to which local governments as agents can translate planned revenue targets into actual realization (Jensen & Meckling, 1976). A larger variance indicates that the agent has not fully fulfilled its responsibility in achieving the agreed revenue targets, creating information asymmetry between planning and implementation. In this study, revenue budget variance is measured as the comparison between realized revenue and budgeted revenue. Empirical evidence supports this relationship, with studies by Hati et al. (2025) and Afifah and Adnan (2022) finding that revenue budget variance significantly influences local



government financial performance. However, other studies report contradictory findings, indicating that revenue budget variance does not significantly affect financial performance (Afifah & Adnan, 2022). Based on the theoretical explanation and empirical findings, the hypothesis proposed in this study is as follows:

H1: Revenue budget variance has a significant effect on local government financial performance.

2.8 The Effect of Expenditure Budget Variance on Local Government Financial Performance

Expenditure budget variance represents the difference between planned expenditure and realized expenditure during a fiscal period (Hati et al., 2025). From the perspective of Agency Theory, expenditure budget variance reflects the government's discipline in implementing approved budgets and its ability to manage public expenditures responsibly and efficiently (Jensen & Meckling, 1976). In this study, expenditure budget variance is measured as the comparison between realized expenditure and budgeted expenditure. Empirical evidence supports this relationship, with studies by Hati et al. (2025) finding that expenditure budget variance significantly influences local government financial performance. However, other studies report contradictory findings, indicating that expenditure budget variance does not significantly affect financial performance (Afifah & Adnan, 2022). Based on the theoretical explanation and empirical findings, the hypothesis proposed in this study is as follows:

H2: Expenditure budget variance has a significant effect on local government financial performance.

2.9 The Effect of Fiscal Capacity on Local Government Financial Performance

Fiscal capacity reflects the financial capability of local governments to finance public services and regional development using their own financial resources (Ministry of Finance, 2021). From the perspective of Agency Theory, fiscal capacity reflects the financial potential available to local governments as agents to manage public resources in accordance with the interests of the principal (Jensen & Meckling, 1976). In this study, fiscal capacity is measured using the Regional Fiscal Capacity Ratio. Empirical evidence supports this relationship, with studies by Surya (2016), Rusydi (2015), and Rahajaan et al. (2026) finding that fiscal capacity significantly influences local government financial performance. However, other studies report contradictory findings, indicating that fiscal capacity does not significantly affect financial performance (Afifah & Adnan, 2022). Based on the theoretical explanation and empirical findings, the hypothesis proposed in this study is as follows:

H3: Fiscal capacity has a significant effect on local government financial performance.

2.10 The Effect of Local Government Size on Local Government Financial Performance

Local government size represents the magnitude of economic resources controlled by local governments and is commonly measured using total assets (Millenia, 2022). From the perspective of Agency Theory, total assets represent public resources entrusted to local governments for achieving development objectives and delivering public services (Jensen & Meckling, 1976). In this study, local government size is measured using the natural logarithm of total assets. Empirical evidence supports this relationship, with



studies by Aulia and Rahmawaty (2020) and Hati et al. (2025) finding that local government size significantly influences financial performance. However, other studies report contradictory findings, indicating that local government size has no significant effect on financial performance (Maulina et al., 2021; Millenia, 2022). Based on the theoretical explanation and empirical findings, the hypothesis proposed in this study is as follows:

H4: Local government size has a significant effect on local government financial performance.

3. Methods

3.1 Research Design

This study employed a quantitative research approach with an associative-causal design to examine the effects of revenue budget variance, expenditure budget variance, fiscal capacity, and local government size on local government financial performance in South Sumatra Province. A quantitative approach was selected because the study utilized numerical data obtained from the Budget Realization Reports and Local Government Financial Statements, allowing the proposed relationships among variables to be tested statistically (Sugiyono, 2023). Panel data regression was applied because the dataset combined cross-sectional and time-series observations. The cross-sectional dimension consisted of 18 local governments in South Sumatra Province, while the time-series dimension covered a five-year period from 2020 to 2024, resulting in a total of 90 observations. The study relied exclusively on secondary data collected from official government publications, comprising audited Budget Realization Reports, Local Government Financial Statements, and Regional Fiscal Capacity Maps issued by the Audit Board of the Republic of Indonesia and other authorized government institutions.

3.2 Population and Sample

The population consisted of all local governments in South Sumatra Province, including one provincial government, thirteen regency governments, and four municipal governments. Because the population size was relatively small, this study employed a saturated sampling (census) technique, in which all members of the population were included as research samples (Sugiyono, 2023). Accordingly, the final sample comprised all 18 local governments observed over five consecutive fiscal years, producing 90 panel observations, as presented in Table 1.

Table 1. Sample Determination

No	Criteria	Quantity
1	Provincial government in South Sumatra Province	1
2	Regency governments in South Sumatra Province	13
3	Municipal governments in South Sumatra Province	4
4	Total local governments (saturated sampling)	18
5	Observation period (5 years × 18 local governments)	90

Source: Processed data (2026)

Table 1 presents the sample determination of this study. The population consisted of 18 local governments in South Sumatra Province, including one provincial government, thirteen regency governments, and four municipal governments. Because the population size was relatively small, the saturated sampling technique was applied, resulting in 18 local governments observed over five consecutive fiscal years, producing 90 panel observations.



3.3 Data Collection Techniques

Data collection was conducted using the documentation method. The required data were obtained from publicly available secondary sources, particularly Budget Realization Reports, Local Government Financial Statements, and Regional Fiscal Capacity Maps issued by the Audit Board of the Republic of Indonesia and other authorized government institutions. The collected data were subsequently organized and coded according to the operational definitions and measurement instruments of each research variable. The data collection process involved several sequential steps: (1) identification of local governments in South Sumatra Province during the 2020–2024 period; (2) collection of audited Budget Realization Reports and Local Government Financial Statements for each observation year; (3) collection of financial performance data from Budget Realization Reports using the regional financial efficiency ratio; (4) collection of revenue budget variance data from Budget Realization Reports; (5) collection of expenditure budget variance data from Budget Realization Reports; (6) collection of fiscal capacity data from Regional Fiscal Capacity Maps; (7) collection of local government size data from financial statements using total assets; and (8) documentation of all extracted data systematically organized into a panel dataset suitable for statistical analysis.

3.4 Operational Definition of Variables

Table 2. Operational Definition and Measurement of Variables

Variable	Definition	Measurement	Scale	Source
Local Government Financial Performance (Y)	The effectiveness of regional governments in managing public financial resources during a fiscal period (Meilanda et al., 2023)	Efficiency Ratio = $\frac{\text{Realized Expenditure}}{\text{Realized Revenue}} \times 100\%$	Ratio	Ministry of Home Affairs (2006); Meilanda et al. (2023); Puspitasari et al. (2026)
Revenue Budget Variance (X ₁)	The difference between budgeted revenue and realized revenue at the end of the fiscal year (Afifah & Adnan, 2022)	Revenue Variance = $\frac{(\text{Realized Revenue} - \text{Budgeted Revenue})}{\text{Budgeted Revenue}} \times 100\%$	Ratio	Hati et al. (2025)
Expenditure Budget Variance (X ₂)	The difference between planned expenditure and realized expenditure during a fiscal period (Hati et al., 2025)	Expenditure Variance = $\frac{(\text{Realized Expenditure} - \text{Budgeted Expenditure})}{\text{Budgeted Expenditure}} \times 100\%$	Ratio	Hati et al. (2025)



Variable	Definition	Measurement	Scale	Source
Fiscal Capacity (X ₃)	The financial capability of local governments to finance public services and regional development using their own financial resources (Ministry of Finance, 2021)	Regional Fiscal Capacity Ratio	Ratio	Afifah & Adnan (2022)
Local Government Size (X ₄)	The magnitude of economic resources controlled by local governments (Millenia, 2022)	SIZE = Ln(Total Assets)	Ratio	Aulia & Rahmawaty (2020); Millenia (2022)

Source: Developed for this research (2026)

Table 2 presents the operational definitions and measurements of all research variables. Local government financial performance is measured using the financial efficiency ratio, calculated as the ratio of total realized regional expenditure to total realized regional revenue. Revenue budget variance is measured as the comparison between realized revenue and budgeted revenue. Expenditure budget variance is measured as the comparison between realized expenditure and budgeted expenditure. Fiscal capacity is measured using the Regional Fiscal Capacity Ratio. Local government size is measured using the natural logarithm of total assets reported in the statement of financial position of the audited Local Government Financial Statements.

3.5 Data Analysis Techniques

Data analysis in this study was conducted using panel data regression with the assistance of EViews 12 software. The analysis stages included descriptive statistics, panel data model selection (Chow test, Hausman test, and Lagrange Multiplier test), classical assumption tests (normality, multicollinearity, heteroscedasticity, and autocorrelation), panel data regression analysis, coefficient of determination analysis, simultaneous F-test, and partial t-test. Descriptive statistics were employed to summarize the characteristics of the research variables by presenting the minimum, maximum, mean, and standard deviation values (Sugiyono, 2023). Panel data model selection was conducted to determine the most appropriate regression model among the Common Effect Model, Fixed Effect Model, and Random Effect Model. The Chow test was used to compare the Common Effect Model and Fixed Effect Model, the Hausman test was used to compare the Fixed Effect Model and Random Effect Model, and the Lagrange Multiplier test was used to compare the Common Effect Model and Random Effect Model (Widarjono, 2018).



Classical assumption tests were conducted to ensure that the regression model satisfied the required assumptions. The Jarque-Bera test was used to examine the normality of residuals, Variance Inflation Factor values were used to detect multicollinearity among the independent variables, the Glejser test was applied to identify heteroscedasticity, and the Chi-square probability test was employed to detect autocorrelation (Ghozali, 2018; Sugiyono, 2023). The explanatory power of the regression model was subsequently assessed using the coefficient of determination, which indicates the proportion of variation in local government financial performance explained by the independent variables.

The panel data regression model used in this study was formulated as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where:

- Y = Local Government Financial Performance
- α = Constant
- β_1 – β_4 = Regression coefficients
- X_1 = Revenue Budget Variance
- X_2 = Expenditure Budget Variance
- X_3 = Fiscal Capacity
- X_4 = Local Government Size
- ε = Error term

Hypothesis testing was conducted using t-tests and F-tests. The t-test was employed to examine the partial effect of each independent variable on local government financial performance, whereas the F-test was used to evaluate the simultaneous effect of all independent variables on the dependent variable. All statistical tests were conducted at a 5 percent significance level ($\alpha = 0.05$). A hypothesis was accepted when the probability value was less than 0.05, indicating a statistically significant relationship between the variables (Sugiyono, 2023).

4. Results and Discussion

4.1 Descriptive Statistics

Table 3. Descriptive Statistics of Research Variables

Description	X1	X2	X3	X4	Y
Mean	32.91978	30.25322	1.437333	2914.544	95.53467
Maximum	117.8300	96.53000	3.520000	3121.000	122.3800
Minimum	6.940000	7.380000	0.490000	2841.000	73.84000
Std. Dev.	39.34263	35.72311	0.578224	70.17717	9.433233
Observations	90	90	90	90	90

Source: Processed data from EViews 12 (2026)

Table 3 presents the descriptive statistics for all research variables based on 90 observations from 18 local governments across five years (2020–2024). Local government financial performance had a mean value of 95.535, with values ranging from 73.840 to 122.380. Revenue budget variance recorded a mean of 32.920, a minimum value of 6.940, and a maximum value of 117.830. Expenditure budget variance showed an average value of 30.253, ranging from 7.380 to 96.530. Fiscal capacity exhibited a mean value of 1.437, with minimum and maximum values of 0.490 and 3.520, respectively. Meanwhile, local government size, measured using total assets, had an average value of 2,914.544, with values ranging between 2,841.000 and 3,121.000.



4.2 Classical Assumption Tests

Table 4. Multicollinearity Test Results

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.207572	2239.943	NA
X1	0.014937	148.9459	1.298720
X2	0.047947	410.4150	1.279559
X3	0.000330	8.527244	1.177187
X4	0.000221	2025.549	1.166624

Source: Processed data from EViews 12 (2026)

Table 4 presents the multicollinearity test results. The multicollinearity test showed that all independent variables had centered Variance Inflation Factor values below 10, suggesting the absence of multicollinearity among the explanatory variables.

Table 5. Heteroscedasticity Test Results

Test	Value	Probability
F-statistic	1.270319	0.2882
Obs*R-squared	5.076640	0.2795
Scaled explained SS	4.967508	0.2906

Source: Processed data from EViews 12 (2026)

Table 5 presents the heteroscedasticity test results. The Glejser heteroscedasticity test generated an Obs*R-squared probability value of 0.2795, which is greater than 0.05, indicating that heteroscedasticity was not detected in the regression model. The Jarque-Bera normality test yielded a probability value of 0.261975, which is greater than 0.05, indicating that the residuals were normally distributed. These findings demonstrate that the regression model satisfied the required statistical assumptions for panel data analysis.

4.3 Panel Data Model Selection

Table 6. Panel Data Regression Model Selection

Test	Probability	Selected Model
Chow test	0.0000 < 0.05	Fixed Effect Model
Hausman test	0.0000 < 0.05	Fixed Effect Model

Source: Processed data from EViews 12 (2026)

Table 6 presents the results of the panel data model selection tests. The Chow test produced a Cross-section Chi-square probability value of 0.0000, which was lower than the significance level of 0.05, indicating that the Fixed Effect Model was preferred over the Common Effect Model. Subsequently, the Hausman test also generated a probability value of 0.0000, which is less than 0.05, confirming that the Fixed Effect Model was more appropriate than the Random Effect Model. Accordingly, the Fixed Effect Model was selected as the final estimation model for this study.

4.4 Panel Data Regression Analysis

Table 7. Panel Data Regression and Hypothesis Testing Results

Variables	Coefficient	Std. Error	t-statistic	Prob.	Decision
C	-1196.653	269.6358	-4.438034	0.0000	-
X1	-1.476478	0.414444	-3.562549	0.0007	Significant
X2	1.854595	0.512186	3.620941	0.0006	Significant
X3	1.280788	1.979033	0.647179	0.5197	Not Significant



Variables	Coefficient	Std. Error	t-statistic	Prob.	Decision
X4	0.440153	0.092421	4.762487	0.0000	Significant
F-test	-	-	2.931448	0.000431	Significant
R-Square	0.475148	-	-	-	-
Adjusted R-Square	0.313062	-	-	-	-

Source: Processed data from EViews 12 (2026)

Table 7 presents the results of the panel data regression analysis using the Fixed Effect Model. The estimated regression equation can be expressed as follows:

$$Y = -1196.653 - 1.476478X_1 + 1.854595X_2 + 1.280788X_3 + 0.440153X_4 + e$$

The estimation results indicate that revenue budget variance had a negative and statistically significant coefficient ($\beta = -1.476478$; $p = 0.0007$), suggesting that larger deviations between planned and realized revenue were associated with lower local government financial performance. Conversely, expenditure budget variance exhibited a positive and significant relationship with financial performance ($\beta = 1.854595$; $p = 0.0006$), implying that greater expenditure variance was associated with improved financial performance. Fiscal capacity produced a positive coefficient ($\beta = 1.280788$), but the probability value of 0.5197 exceeded the 0.05 significance threshold, indicating that fiscal capacity did not significantly affect local government financial performance. In contrast, local government size had a positive and statistically significant coefficient ($\beta = 0.440153$; $p = 0.0000$), demonstrating that larger local governments tended to achieve better financial performance.

4.5 Coefficient of Determination (R^2) and F-Test

Table 8. Coefficient of Determination and F-Test Results

Statistic	Value
R-squared	0.475148
Adjusted R-squared	0.313062
Std. Error of Regression	7.815853
F-statistic	2.931448
Prob(F-statistic)	0.000431

Source: Processed data from EViews 12 (2026)

Table 8 presents the coefficient of determination test results. The adjusted R-squared value of 0.313062 indicates that revenue budget variance, expenditure budget variance, fiscal capacity, and local government size jointly explained 31.31 percent of the variation in local government financial performance, while the remaining 68.69 percent was attributable to other factors outside the research model. The R-squared value of 0.475148 indicates that the model explained 47.51 percent of the variation in financial performance before adjustment for the number of explanatory variables. Furthermore, the F-statistic of 2.931448 with a probability value of 0.000431, which is less than 0.05, confirms that the independent variables simultaneously had a significant effect on local government financial performance. These results indicate that the regression model is statistically adequate and that the four explanatory variables collectively provide a meaningful explanation of the variation in financial performance among local governments in South Sumatra Province during the 2020–2024 period.



4.6 Hypothesis Testing Summary

Table 9. Hypothesis Testing Summary

Hypothesis	Statement	Result
H1	Revenue budget variance has a significant effect on local government financial performance	Accepted (Negative)
H2	Expenditure budget variance has a significant effect on local government financial performance	Accepted (Positive)
H3	Fiscal capacity has a significant effect on local government financial performance	Rejected
H4	Local government size has a significant effect on local government financial performance	Accepted (Positive)

Source: Processed data (2026)

Table 8 presents the hypothesis testing summary. Based on the partial test results, H1 is accepted because revenue budget variance has a significant negative effect on financial performance, with a significance value of 0.0007. H2 is accepted because expenditure budget variance has a significant positive effect on financial performance, with a significance value of 0.0006. H3 is rejected because fiscal capacity has no significant effect on financial performance, with a significance value of 0.5197. H4 is accepted because local government size has a significant positive effect on financial performance, with a significance value of 0.0000.

4.8 Discussion

4.8.1 The Effect of Revenue Budget Variance on Local Government Financial Performance

The empirical findings demonstrate that revenue budget variance has a negative and statistically significant effect on local government financial performance ($B = -1.476478$; $p = 0.0007$). This result indicates that greater discrepancies between planned and realized regional revenue are associated with lower financial performance. Revenue budget variance reflects the government's ability to estimate and achieve its targeted revenues. A substantial variance suggests that realized revenues fall short of planned targets, indicating weaknesses in revenue planning and execution. Consequently, insufficient revenue realization may reduce the fiscal resources available to finance public expenditure, implement development programs, and deliver public services, ultimately lowering the efficiency of regional financial management. These findings are consistent with Agency Theory proposed by Jensen and Meckling (1976), which views local governments as agents entrusted by the public and higher levels of government, acting as principals, to manage public resources effectively, efficiently, transparently, and accountably. Revenue budget variance reflects the extent to which local governments can translate planned revenue targets into actual realization. A larger variance indicates that the agent has not fully fulfilled its responsibility in achieving the agreed revenue targets, creating information asymmetry between planning and implementation. This finding is consistent with Afifah and Adnan (2022), who reported that revenue budget variance significantly affects local government financial performance, and Hati et al. (2025), who found a significant negative relationship between revenue budget variance and regional financial performance.



4.8.2 The Effect of Expenditure Budget Variance on Local Government Financial Performance

The results also reveal that expenditure budget variance has a positive and statistically significant effect on local government financial performance ($B = 1.854595$; $p = 0.0006$). This finding suggests that greater differences between budgeted and realized expenditures, where expenditure realization remains below the allocated budget, are associated with higher financial performance. In the context of this study, expenditure variance reflects the efficiency of budget utilization. Lower expenditure realization may indicate that local governments are able to control spending without substantially reducing the achievement of planned programs and activities, thereby improving financial efficiency. This result is also consistent with Agency Theory (Jensen & Meckling, 1976). As agents, local governments are expected to manage public expenditures responsibly and efficiently while ensuring accountability to the principals. Effective expenditure control demonstrates prudent financial management and reflects the government's ability to optimize available resources without unnecessary spending. The present finding supports the study conducted by Hati et al. (2025), which reported a positive and significant relationship between expenditure budget variance and local government financial performance. However, this finding differs from Afifah and Adnan (2022), who found that expenditure budget variance did not significantly influence financial performance.

4.8.3 The Effect of Fiscal Capacity on Local Government Financial Performance

Unlike the previous variables, fiscal capacity does not have a statistically significant effect on local government financial performance ($B = 1.280788$; $p = 0.5197$). Although fiscal capacity represents the ability of a region to finance its development and public services using its own financial resources, the results indicate that higher fiscal capacity does not necessarily translate into better financial performance. This finding suggests that financial resources alone are insufficient to improve financial performance unless they are supported by effective, efficient, and accountable financial management. Agency Theory provides a relevant explanation for this result. According to Jensen and Meckling (1976), the existence of adequate financial resources does not automatically guarantee that agents will manage those resources effectively in accordance with the interests of the principals. Fiscal capacity reflects financial potential rather than managerial performance. This finding differs from several previous studies. Afifah and Adnan (2022) reported that fiscal capacity negatively affects local government financial performance, while Surya (2016) found that fiscal capacity positively affected local governments' debt repayment performance, and Rusydi (2015) concluded that regional financial capacity significantly influenced financial performance.

4.8.4 The Effect of Local Government Size on Local Government Financial Performance

The analysis further indicates that local government size has a positive and statistically significant effect on financial performance ($B = 0.440153$; $p = 0.0000$). Local government size, measured by total assets, reflects the scale of resources controlled by local governments. Larger governments generally possess greater administrative capacity, more comprehensive infrastructure, and broader financial resources, enabling them to manage regional finances more effectively and efficiently. From the perspective of Agency Theory, total assets represent public resources entrusted to local governments for



achieving development objectives and delivering public services (Jensen & Meckling, 1976). The ability to manage larger asset portfolios effectively demonstrates the agent's capacity to fulfill its accountability to the principals. The present finding is consistent with Aulia and Rahmawaty (2020), who reported that local government size positively and significantly influences financial performance. However, it differs from Afifah and Adnan (2022) and Mahadewi and Indraswarawati (2023), who found a negative relationship, as well as Maulina et al. (2021) and Millenia (2022), who reported insignificant effects.

5. Conclusion

This study aimed to examine the effects of revenue budget variance, expenditure budget variance, fiscal capacity, and local government size on the financial performance of local governments in South Sumatra Province during the 2020–2024 period. Using a quantitative approach with panel data regression and the Fixed Effect Model on 90 observations from 18 local governments selected through saturated sampling, the study successfully tested the proposed hypotheses.

The results indicate that revenue budget variance has a significant negative effect on financial performance, with a regression coefficient of -1.476478 and a significance value of 0.0007 , indicating that H1 is accepted. Greater discrepancies between budgeted and realized revenues reduce financial performance, as insufficient revenue realization may constrain the fiscal resources available to finance public expenditure and deliver public services. Expenditure budget variance has a significant positive effect on financial performance, with a regression coefficient of 1.854595 and a significance value of 0.0006 , indicating that H2 is accepted. Efficient expenditure realization contributes to improved financial outcomes, as lower expenditure realization may indicate that local governments are able to control spending without substantially reducing the achievement of planned programs.

Fiscal capacity does not have a significant effect on financial performance, with a regression coefficient of 1.280788 and a significance value of 0.5197 , indicating that H3 is rejected. Stronger fiscal resources alone are insufficient without effective financial management, as fiscal capacity reflects financial potential rather than managerial performance. Local government size has a significant positive effect on financial performance, with a regression coefficient of 0.440153 and a significance value of 0.0000 , indicating that H4 is accepted. Governments with larger asset bases tend to achieve better financial performance, as larger governments generally possess greater administrative capacity and broader financial resources. The adjusted coefficient of determination indicated that 31.31 percent of the variation in financial performance was explained by the model, while the F-test confirmed that all independent variables simultaneously affected financial performance with a significance value of 0.000 .

The theoretical implications of this study extend the application of Agency Theory to the context of local government financial performance in Indonesia. The finding that revenue budget variance significantly influences financial performance supports Agency Theory's emphasis on the agent's responsibility to achieve agreed revenue targets. The finding that expenditure budget variance significantly influences financial performance supports the argument that effective expenditure control demonstrates prudent financial management and reflects the government's ability to optimize available resources. The finding that fiscal capacity does not significantly influence financial performance suggests that financial resources alone are insufficient without effective financial



management. The finding that local government size significantly influences financial performance supports the argument that larger governments possess greater operational capacity to manage public resources effectively. This study also contributes to the limited empirical evidence on the determinants of financial performance in South Sumatra Province, providing insights into how budget variance, fiscal capacity, and local government size collectively influence financial performance.

Based on these findings, several recommendations can be proposed. For local governments, the findings suggest that strengthening budget planning, improving expenditure control, optimizing the use of available fiscal capacity, and enhancing asset management can support more accountable and sustainable financial performance. For regulators, the results suggest that continued improvement in budget planning and expenditure control standards is important to ensure that regional financial resources are managed efficiently and accountably. For academics, this study contributes to the growing body of literature on public sector accounting and financial management, providing a foundation for future research on local government financial performance.

This study has several limitations that should be acknowledged. First, the study focuses only on local governments in South Sumatra Province, which may limit the generalizability of the findings to other regions or provinces. Second, the study uses a five-year observation period (2020–2024), which may not capture long-term changes in financial performance. Third, the study examines only four explanatory variables, without considering other potential determinants of financial performance such as locally generated revenue, intergovernmental transfers, financial independence, internal control systems, transparency, accountability, and governance quality. Fourth, the model's explanatory power is moderate, with an adjusted R-squared value of 0.313062, indicating that other factors not included in the model may still influence financial performance. Fifth, the study relies on secondary data from government publications, which may be subject to reporting limitations and data availability constraints.

For future research, it is recommended to expand the geographical coverage and observation period to provide a more comprehensive understanding of the determinants of local government financial performance. Future studies may also incorporate additional variables, such as locally generated revenue, intergovernmental transfers, financial independence, internal control systems, transparency, accountability, and governance quality, to provide a more nuanced picture of the factors that affect financial performance. Researchers should also consider employing qualitative or mixed-method approaches to gain deeper insights into the challenges and effectiveness of regional financial management practices.

This study contributes to the growing body of literature on public sector accounting and financial management by providing empirical evidence on the determinants of local government financial performance in South Sumatra Province. The findings suggest that revenue budget variance significantly reduces financial performance, while expenditure budget variance and local government size significantly improve it. Fiscal capacity does not significantly influence financial performance. As Indonesia continues to strengthen its fiscal decentralization and regional financial management practices, understanding these factors becomes increasingly important for developing effective strategies to enhance financial performance and accountability in local governments.



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