

DETERMINANTS OF REGIONAL GOVERNMENT FINANCIAL PERFORMANCE IN INDONESIA

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ABSTRACT

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The importance of local governments in providing public services and supporting national development goals is growing. As a result, systematic control, assessment, and performance measurement are crucial. This analysis aims to identify factors that affect the financial performance of provincial governments in Indonesia, focusing on local government size, balancing of funds, regional expenditures, and audit results. Financial performance is assessed through the independence ratio. Utilizing secondary data from Audit Reports of Provincial Government Financial Statements from 2021 to 2023, the study covers all 34 provinces selected through purposive sampling, resulting in 102 analysis units. Multiple linear regression using EViews version 13 reveals that local government size and regional expenditures harm financial performance, while balanced funds have a significant positive effect. Moreover, audit findings do not significantly influence financial performance. The analysis shows that increasing total assets does not guarantee better financial results due to ineffective asset management. The lack of correlation between audit findings and financial performance suggests that audit reports may not reliably indicate fiscal health. Policy recommendations emphasize the importance of efficient asset management, strategic utilization of balancing funds, and effective follow-up on audit recommendations to promote accountability and fiscal sustainability.

Keywords: Government Size, Balancing Funds, Regional Expenditure, Audit Findings, Financial Performance.

INTRODUCTION

Indonesia, a democratic state, comprises 38 provinces and operates under a regional autonomy system mandated by the 1945 Constitution. This system aims to give regions the freedom to manage government affairs, development, and public interests independently regional autonomy expected to improve public services and empower communities. However, in practice, there are still challenges, such as public dissatisfaction with the performance of local governments (Rahardjo & Putra, 2023). Local governments are obligated to adhere to Government Accounting Standards in their

financial reporting and have these reports audited by the Financial Audit Agency to improve accountability and transparency. The audited Local Government Financial Reports produce Audit Reports that form the basis for performance evaluation.

Performance refers to the level of accomplishment of an organization's vision, mission, and goals within a specific period. Financial performance, in particular, is measured in monetary terms and remains the duty of the local government as the representative of the community. Noviyanti & Kiswanto (2016) state that the financial statements audited by the Financial Audit Agency provide a basis for evaluating the performance of local governments in finance. It can be analyzed using specific financial ratios related to the Regional Budget to evaluate local financial management, as explained by Halim (2018). Many studies have concluded that local government financial performance can be influenced by data presented in financial reports and explained by financial ratios (Wahyudin & Hastuti, 2020). One method used to assess this financial performance is the independence ratio, which indicates the extent to which a region can finance government activities, development, and public services without over-reliance on transfers from the central government (Halim, 2018). The four categories for determining a region's financial independence and capability are as follows: very low, with a percentage between 0% and 25%; low, ranging from 25% to 50%; medium, between 50% and 75%; and high, covering percentages from 75% to 100%. The following details the financial performance results of Indonesia's provincial governments during the 2021-2023 timeframe.

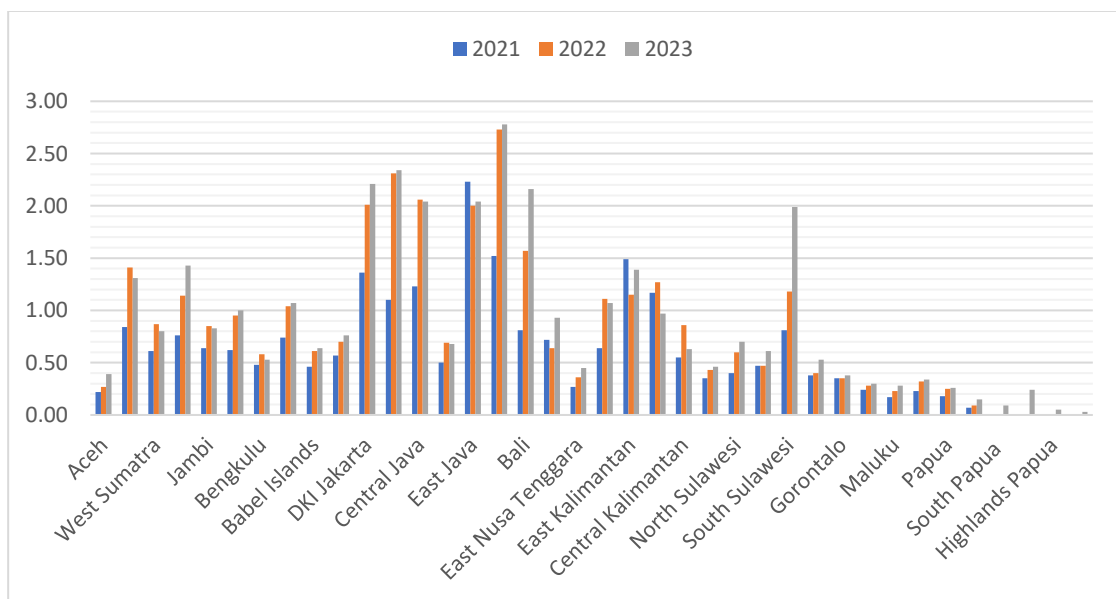


Figure 1. Financial Independence of Provinces in Indonesia

Some provinces in the western region, such as North Sumatra, Riau, DKI Jakarta, and East Java, have an independence ratio of more than 100%. In contrast, provinces in the eastern region, such as Papua and its surroundings, remain below 100%. Aceh recorded the lowest independence ratio among the other western provinces. This condition indicates an uneven distribution of financial independence among provinces, particularly in the eastern regions of Indonesia. Previous research has identified factors that influence provincial financial performance, including the size of local governments, balancing funds, regional expenditures, and audit findings.

The extent of local governments, measured through their total assets, can provide easier operational management, enable more effective public services, and increase

Regional Original Revenue. This large operational capacity supports improvements in services and financial performance, thereby encouraging regional development. Total assets are a crucial indicator for assessing a region's ability to perform government functions effectively. Based on the data, provinces such as DKI Jakarta recorded the most significant total assets compared to other provinces, with a value of IDR.715,498,299,812,408.00, having an average independence ratio of 186%. Meanwhile, Banten Province recorded total assets with a value of IDR.20,480,360,572,441.00, having the highest average independence ratio of 234%. Papua Province recorded total assets with a value of IDR.22,258,936,680,613.80, having a low average independence ratio of 23%. West Papua recorded an asset value of IDR.17,299,694,191,943.80, with an average independence ratio of 10%. Several provinces with total assets similar to Banten, such as Aceh, North Sumatra, West Sumatra, Riau, Jambi, South Sumatra, Lampung, West Nusa Tenggara, East Nusa Tenggara, and South Sulawesi, have average self-sufficiency ratios ranging from a low of 29% to a high of 136%.

Furthermore, several provinces with the lowest total assets, namely Gorontalo, South Papua, Central Papua, Highland Papua, and Southwest Papua, have low average self-sufficiency ratios, ranging from 3% to 36%. It illustrates that larger local governments, as reflected in higher total assets, will face greater challenges in managing and disclosing their financial performance. Thus, the size of local government plays a significant role in determining the level of complexity of financial management and its response to public demands for accountability.

Balancing funds represent financial transfers from the national government to finance programs and activities (Millenia, 2022). These balancing funds aim to reduce funding disparities between regions and enhance the capacity of local governments to explore their economic potential. A high level of balancing funds will increase oversight, which in turn encourages local governments to improve their financial performance (Mubarok et al., 2022). Based on the data, DKI Jakarta Province received the most significant amount of balancing funds, amounting to IDR.20,124,459,645,034.00 in 2023, and had an average independence ratio of 186%. Banten Province received balancing funds amounting to IDR.3,011,124,071,431.00 and had the highest average independence ratio of 234%. Several provinces that receive similar balancing funds to Banten Province, such as Aceh, North Sumatra, West Sumatra, Riau, Jambi, South Sumatra, Lampung, West Nusa Tenggara, East Nusa Tenggara, and South Sulawesi, have varying average independence ratios, ranging from a low of 29% to a high of 136%. Meanwhile, the Highlands Province of Papua received the lowest balancing funds, at IDR.659,637,986,350.00, and had a low independence ratio of 5%.

The differences in the amount of balancing funds received reflect the varying degrees of dependence between these provinces on the central government. Provinces with higher balancing funds, such as DKI Jakarta, demonstrate a greater degree of dependence on central government transfers and have a high financial independence ratio. In contrast, the Highlands Province of Papua has a lower level of dependence and also exhibits low financial independence.

Regional expenditures are significant because they help to develop infrastructure, improve human resources, and support other key aspects (Dasmar et al., 2020). It indicates that the local government recognized the need to improve its financial performance in a more positive direction (A. Aziz, 2016). Based on the data, several provinces, including DKI Jakarta, West Java, East Java, Central Java, East Kalimantan, North Sumatra, and Riau, recorded the most significant regional expenditure realization

in Indonesia, with an average independence ratio of 111% to 209%. Meanwhile, Banten Province recorded regional expenditure realization of only IDR.8,276,276,875,524.00 with a high average independence ratio of 234%. Several provinces with regional expenditure realization not significantly different from Banten Province, namely Aceh, South Sumatra, Lampung, South Kalimantan, and South Sulawesi, had an average independence ratio that varied from a low of 29% to a high of 133%. The provinces that recorded the lowest regional expenditure realization were Gorontalo, West Sulawesi, South Papua, and Highlands Papua, and had an average low independence ratio of 5% to 36%.

Audit findings reveal various instances of fraudulent activity in government economic reports, including violations of internal control provisions and statutory regulations. When these deviations are discovered, they reflect problems in regional financial management, such as a lack of commitment to rules and regulations, misuse of budget funds, or weaknesses in internal control systems. A large number of audit findings may indicate poor financial performance of local governments (A. A. Aziz & Kusumawati, 2024). Deviations identified during the audit process show that management of finances does not comply with set standards or regulations. The lack of adequate supervision by local governments over budget spending and the implementation of government activities can be a contributing factor (Dasmal et al., 2020). Based on the data, several provinces, such as DKI Jakarta, South Sumatra, West Sumatra, South Sulawesi, West Papua, Jambi, Maluku, Southwest Papua, Bengkulu, Lampung, Central Kalimantan, and East Borneo, recorded the highest number of audit findings, namely 20 to 40 findings, and had an average independence ratio of 3% to 186%. Meanwhile, Banten Province recorded eight findings and had a high average independence ratio of 234%. Several provinces, including West Sulawesi and South Papua, which had several findings not significantly different from those of Banten Province, had a low average independence ratio of 9% to 27%.

This research is significant and novel because it addresses the inconsistencies in findings from previous studies on factors influencing local government financial performance. Several previous studies, such as those by Aziz (2016), Nugroho & Prasetyo (2018), and Dasmal et al. (2020), focused primarily on district and city governments in specific regions, thus failing to provide a comprehensive picture representative of all provincial regions in Indonesia. This study expands the analysis to cover all 34 provinces in Indonesia for the period 2021 to 2023. By incorporating variables such as local government size, balancing funds, regional expenditures, and audit findings, this study provides a broader and nationally representative study of the determinants of local financial performance.

The primary motivation for this study stems from conflicting evidence in previous research regarding the role of balancing funds and regional expenditures, with some studies showing positive effects. In contrast, others indicate that there are negative or insignificant impacts on financial performance. Furthermore, local government size, although an important factor, remains underexplored in depth regarding its influence on fiscal outcomes. The novelty of this study also lies in its attempt to reconcile these conflicting results within the context of the current fiscally challenging period, including the ongoing impact of the COVID-19 pandemic. Therefore, this research fills an important gap by simultaneously evaluating these determinants across all Indonesian provincial governments, yielding novel insights relevant to improving policy and governance.

Furthermore, the importance of provinces as a level of government that plays a strategic role in public resource management and regional development is a key reason for this research. A deeper understanding of how these financial and governance factors influence performance can provide guidance for better fiscal management, strengthen regional autonomy, and enhance accountability mechanisms. Therefore, this research not only contributes to the academic realm but also supports policymakers in designing strategies that can strengthen the financial sustainability and public service delivery of local governments in Indonesia..

Agency theory examines the contractual relationship between two parties, specifically the principal and the agent, where the principal grants authority or power to the agent to act on their behalf. In organizations, this relationship is vertical, where the superior (principal) delegates authority to the subordinate (agent). In this context, the principal expects the agent to act in their best interests, but in reality, the agent may be more focused on their own interests. This relationship is known as agency theory, which explains the dynamics between the two parties as they work together to achieve common goals. In the context of public sector organizations, this is very relevant. It gives rise to conflicts of interest between the principal and the agent. Conflicts can also arise because the government, led by the regional head elected by the community, fails to act in accordance with community expectations regarding the provision of public services. As a form of accountability for financial management based on agency theory, the government must provide transparent and accurate financial reporting. Government financial reports are part of the public sector financial reports. Agency theory can also be applied in the analysis of regional government financial performance. In regional governance, conflicts of interest can arise between the regional head, acting as an agent, and the community, acting as a principal, which can impact regional financial management. The regional head is responsible for managing regional finances in accordance with the principles of transparency and accountability (Noviyanti & Kiswanto, 2016).

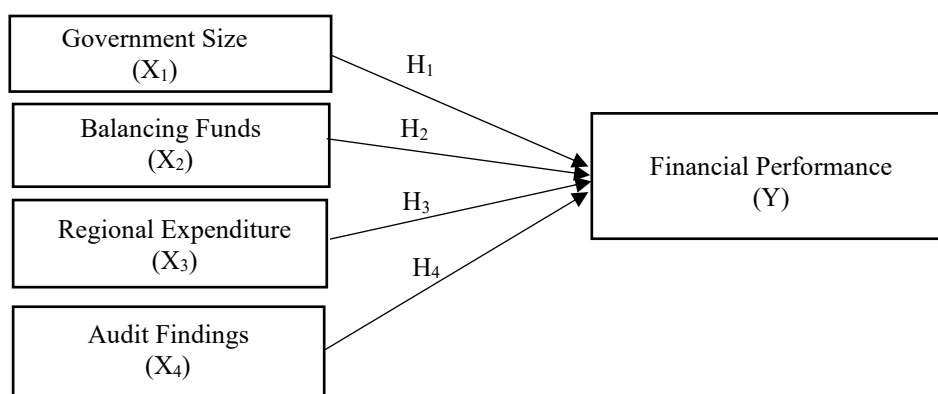


Figure 2. Theoretical Framework

The size of local governments is assessed by evaluating their total assets. These assets encompass current assets, long-term investments, fixed assets, other assets, and investment properties. Total assets are selected as a measurement because they tend to be more stable than revenue or the number of employees, which can vary over time (Masdiantini & Erawati, 2016). Balancing funds, as outlined in Law No.23 of 2014, aims to reduce financial disparities between central and local governments. These funds are measured by summing the Revenue-Sharing Funds, Special Allocation Funds, and General Allocation Funds. Regional expenditures are defined based on Government Regulation No.12 of 2019 and Ministry of Home Affairs Regulation No.77 of 2020,

which include operational expenditures, capital expenditures, unforeseen expenditures, and transfer expenditures. Audit findings, as reported by Tama & Adi (2018) and Noviyanti & Kiswanto (2016), have identified violations related to internal control systems and legislation. The financial performance of local governments is assessed using the independence ratio. This ratio reflects the ability of local governments to finance their activities and public services independently of external funding. It is calculated as the percentage of local revenue compared to central government transfers and loans, as noted by Mahmudi (2016).

The Influence of Regional Government Size on The Financial Performance of Local Governments

Regional Government Size refers to the extent of the area or population handled by the regional government (Meilanda et al., 2023). An expanded local entity facilitates the undertaking of its activities, which in turn can enhance community services. These improvements are evident in various indicators, including total revenue, employee count, production levels, and total assets. Assets are chosen because their value tends to be more stable compared to revenue and the number of employees, which can fluctuate depending on various economic factors and policies (Kusumasari & Kartika, 2022). Previous studies by Aziz (2016), Aulia & Rahmawaty (2020), and Meilanda et al. (2023) revealed a positive correlation between local government size and the fiscal performance of regional governments. From the perspective of agency theory, the regional government acts as an agent entrusted with managing resources on behalf of principals, i.e., the public or higher levels of government. Larger government entities typically possess greater resources and capacities, enabling them to manage finances more effectively and improve performance. However, increased size also introduces complexities, such as information asymmetry and potential conflicts of interest, that require vigilant supervision to ensure accountability and transparency. Given the above definition, the first hypothesis is:

H₁: The Size of Local Government has a positive effect on The Financial Performance of Local Government

The Influence of Balancing Funds on The Financial Performance of Local Governments

Balancing funds are regulated in Law No.23 of 2014, which aims to decrease financial capacity inequality among national and local governments. Funds are allocated from the state revenue and expenditure budget and distributed to the regions. The purpose of providing balancing funds is to support the implementation of government programs and promote regional autonomy, thereby enhancing services and community welfare (Insani et al., 2023). Therefore, large receipts of balancing funds ensure the local government's strong fiscal well-being. According to findings from Nugroho & Prasetyo (2018), Dasmar et al. (2020), and Rahardjo & Putra (2023), balancing funds has a positive influence on the fiscal performance of local governments. From the perspective of agency theory, local governments act as agents entrusted with managing and balancing funds on behalf of the central government, which serves as the principal. The central government supervises and evaluates the use of these funds to ensure accountability and efficient resource management. Effective management and reporting of balancing funds foster trust and demonstrate compliance with government regulations, thereby enhancing financial performance and credibility. Given the explanation above, the second hypothesis is:

H₂: Balancing Funds have a Positive Effect on The Financial Performance of Local Governments

The Influence of Regional Expenditure on The Financial Performance of Local Governments

Law No.23 of 2014 stated that regional expenditure is interpreted as the total portion of regional funds that reduced net assets in the pertinent fiscal year. Regional expenditure is included in the state budget for revenue and spending. It is used to finance the execution of administrative affairs that fall under the regional government's authority, in accordance with the principles of autonomy and assistance tasks. According to Wati & Fajar (2017), local government spending should prioritize the public interests so that the government's goal of improving public welfare can be achieved. If regional expenditure is well allocated for public interests, the region is likely to achieve good financial performance results. Research by Sari & Halmawati (2021), Angraini & Hidayat (2023), and Aziz (2016) indicates that regional expenditure has a positive influence on the fiscal performance of local governments. From the perspective of agency theory, the regional government acts as an agent responsible for managing public resources on behalf of the community, which serves as the principal. Effective use of regional expenditure reflects the agent's alignment with the principal's interests by ensuring transparency, accountability, and efficient public service delivery. Mismanagement or misallocation may lead to agency problems, such as moral hazard or opportunistic behavior, which can compromise financial performance. Given the explanation above, the fourth hypothesis is:

H₃: Regional Expenditure has a Positive Effect on The Financial Performance of Local Governments

The Influence of Audit Findings on The Financial Performance of Local Governments

Findings are the result of an Audit, which refers to cases of violations of internal control systems and applicable laws committed by local governments (Noviyanti & Kiswanto, 2016). These findings stem from the evaluation of evidence collected during the audit process, which indicates non-compliance or irregularities in regional financial management, including misuse of budgets, inaccurate reporting, or weaknesses in the internal control system. A substantial number of audit findings can harm government performance (Rasyid et al., 2022). The audit findings reported by the Financial Audit Agency indicate issues or cases identified in the local government's financial statements. These issues are related to violations of the internal control system and legal provisions, resulting in losses for the region. These findings led the Financial Audit Agency to conduct audits on the local government's financial statements. Thus, the more audit findings are discovered, the lower the government's performance. This finding is supported by studies from Rasyid et al. (2022), Kurnia (2020), and Kusumasari & Kartika (2022), which indicate that audit findings do not significantly impact the government's performance. From the agency theory perspective, local governments act as agents responsible for managing public resources on behalf of the community, which serves as the principal. Audit findings signal potential agency problems, such as information asymmetry or opportunistic behavior by agents that conflict with the principal's interests. Therefore, more audit findings indicate greater agency conflicts and lower accountability, which negatively impact financial performance. Given the explanation above, the fourth hypothesis is:

H₄: Audit Findings Harm The Financial Performance of Local Governments

RESEARCH METHODS

A quantitative approach was used as the research method to examine the correlation among variables. The study's scope includes all 38 provinces across Indonesia whose financial reports were audited by the financial audit agency from 2021 to 2023. These three years were chosen because they represent the most recent audit years for which complete and obtainable data are available. Data were collected through documentation. Samples were selected based on specific criteria using purposive sampling, which involved the Audit Reports on local government financial statements of the Provincial Governments in Indonesia during the 2021-2023 period.

Table 1. Sample Selection Criteria

Number	Criteria	Total
1	Number of Provinces in Indonesia 2025	38
2	Local Governments audited by the Financial Audit Agency, and those that did not submit local government financial statements for fiscal years 2021-2023	(4)
3	Number of Provinces that meet the criteria	34
4	Number of Years of Research	3
Total Unit of Analysis		102

Source: Data Processed, 2025

Panel data linear regression analysis has been selected as the method for data analysis due to the dataset's combination of cross-sectional and time-series elements. This analysis will examine the relationship between the factors being analyzed and the observed outcomes, utilizing E-Views 13 software. The process will include descriptive statistics, model selection, classical assumption tests, and hypothesis tests.

RESULTS AND DISCUSSION

Table 2. Descriptive Statistics Results

	X ₁	X ₂	X ₃	X ₄	Y
Mean	3.64E+13	1.00E+13	4.45E+12	18.794120	0.876569
Median	1.33E+13	5.93E+12	3.11E+12	18.000000	0.685000
Maximum	7.15E+14	6.68E+13	2.26E+13	45.000000	2.780000
Minimum	2.53E+12	1.82E+12	1.01E+12	7.000000	0.070000
Std. Dev.	1.09E+14	1.23E+13	3.96E+12	7.698963	0.632713

Source: Data Processed, 2025

The variable Size of Local Government (X₁) showed an average of 3,639,974,299,057.94. The highest value recorded was 715,498,299,812,408.00 from DKI Jakarta Province in 2023, while the lowest value was 2,525,461,941,112.24 from Gorontalo Province in the same year. The standard deviation obtained was 108,514,360,551,586.90. The variable Balancing Funds (X₂) showed an average of 10,010,060,535,462.32. The highest value was 66,770,609,628,414.00 from DKI Jakarta Province in 2023, while the lowest value was 1,815,906,697,868.19 from West Sulawesi Province in 2021. The standard deviation obtained was 12,340,830,952,081.28. The variable Regional Expenditure (X₃) showed an average of 3,110,005,300,288.50. The highest value was 22,630,423,484,052.00 from DKI Jakarta Province in 2021, while the lowest value was 1,011,942,246,000.00 from West Papua Province in 2023. The standard deviation obtained was 3,959,407,191,301,012.00. The variable Audit Findings (X₄)

showed an average of 18.794120. Jakarta Province recorded the highest value of 45.000000 in 2022, while the lowest value was 7.000000 from Central Java, Special Region of Yogyakarta, and Papua Provinces in 2021. The standard deviation obtained was 7.698963. The variable Financial Performance of Local Governments (Y) showed an average of 0.876569. Banten Province recorded the highest value of 2.780000 in 2023, while the lowest value was 0.070000 from West Papua Province in 2021. The standard deviation obtained was 0.632713.

In panel data analysis, selecting the appropriate statistical model is essential to ensure accurate and reliable results. As explained by Basuki & Prawoto (2016), there are three key tests commonly used to determine the most suitable model. The Chow test is the first, and it compares the CEM with the FEM. The second is the Hausman test, which helps in deciding between the FEM and REM. The third is the Lagrange Multiplier (LM) test, which is applied to choose between the REM and CEM. By systematically applying these three tests, researchers can select the most suitable panel data model, thereby ensuring the validity and robustness of their analysis.

The Chow test results report a probability value of 0.0000, indicating that it does not exceed the significance level of 0.0500 ($0.0000 < 0.0500$). Thus, FEM has been selected based on the Chow Test. The Hausman test yields a probability value of 0.1341, indicating that it exceeds the 0.0500 significance level ($0.1341 > 0.0500$). Thus, REM has been selected based on the Hausman test. The Lagrange multiplier test is 0.0000, since this does not exceed the 0.0500 significance level. Therefore, the REM is chosen for the Lagrange Multiplier test.

The regression model selection results indicate that the suitable regression model to utilize is REM, employing the Generalized Least Squares (GLS) method. This choice means that classical assumption tests, including heteroscedasticity, normality, autocorrelation, and multicollinearity, are not performed, which is based on the main argument that estimation using GLS already satisfies the Best Linear Unbiased Estimator (BLUE) criteria. GLS is intrinsically considered to have addressed the issues commonly tested in those classical assumptions, unlike OLS, which requires additional testing to ensure estimation reliability. Thus, the use of the REM with GLS provides reliability and efficiency in the regression parameter estimation process, simplifying panel data analysis without the need for separate classical assumption tests. The REM was the regression model chosen for this study, and the findings are summarized in Table 3, Regression Results, as follows:

Table 3.1. Results: Multiple Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.796130	0.137054	5.808863	0.0000
X ₁	-2.50E-15	1.12E-15	-2.226313	0.0283
X ₂	1.06E-13	1.46E-14	7.293132	0.0000
X ₃	-1.90E-13	2.65E-14	-7.160351	0.0000
X ₄	-0.002672	0.004815	-0.554963	0.5802
Cross-section random			0.410504	0.7678
Idiosyncratic random			0.225722	0.2322
R-squared	0.426171	Mean dependent var		0.265235
Adjusted R-squared	0.402508	S.D. dependent var		0.296549
S.E. of regression	0.229226	Sum squared resid		5.096804
F-statistic	18.00999	Durbin-Watson stat		1.427012
Prob(F-statistic)	0.000000			

Table 3.2. Results: Multiple Regression Analysis (Continuation)

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

Source: Data Processed, 2025

Given the data above, the panel data regression equation may be stated and formulated as follows:

Description:

Y: Financial Performance of Provincial Local Governments in Indonesia

X₁: Local Government Size

X₂: Balancing Funds

X₃: Regional Expenditure

X₄: Audit Findings

Based on the table above, the partial effects of the variables are detailed as follows: Size of Local Government (X₁), this variable has a t-value of -2.226313, which exceeds the critical t-value of 1.660710. Its significance value is 0.028300, which is less than 0.050000. Therefore, the Size of Local Government significantly impacts the financial performance of local governments. Balancing Funds (X₂) has a t-value of 7.293132, exceeding the critical t-value of 1.660710. The significance value of 0.000000 indicates a strong significance, as it is less than 0.050000. Thus, we find that Balancing Funds significantly affect the financial performance of local governments. Regional Expenditure (X₃), the t-value for this variable is -7.160350, which does not exceed the critical t-value of 1.660710. However, it has a significance value of 0.000000, which is below 0.050000. Regional expenditure has a significant impact on the financial performance of local governments. Audit Findings (X₄) have a t-value of -0.554963, which does not exceed the critical t-value of 1.660710. Its significance value is 0.580200, which is greater than 0.050000. Therefore, Audit Findings do not have a significant influence on the financial performance of local governments.

The calculated F-value of 18.009990 surpasses the F-table value of 2.470000 and a corresponding significance value of 0.000000 that does not exceed the significance value of 0.050000. It implies that the variables Size of Local Government, Balancing Funds, Regional Expenditure, and Audit Findings are significant factors in the Financial Performance of Local Governments. The Adjusted R-squared value of 0.402508 (40.25%) indicates that the research variables explain 40.25% of the variability in fiscal well-being among regional governments in Indonesian provinces. Conversely, variables outside of this model's scope account for the remaining 40%.

The Influence of Regional Government Size on The Financial Performance of Local Government

The analysis shows that the variable Local Government Size, as measured by total assets, has a significant adverse effect on the Financial Performance of Local Governments in various provinces in Indonesia. The coefficient of -2.496e-15, with a calculated t-value of -2.226313 (greater than 1.660710), indicates that an increase in the size of local government tends to reduce financial performance. Total assets include current assets, long-term investments, fixed assets, other assets, and investment property.

This study utilizes data from all provinces in Indonesia that meet specific criteria; therefore, the first hypothesis (H_1) is rejected.

This result supports the studies of Mulyani & Wibowo (2017), Putri & Amanah (2020), and Saraswati & Rioni (2019), which found a negative impact of using total assets as a measure of government size on financial performance. The primary factor contributing to this is that most local government assets tend to be less productive in enhancing financial performance, as many assets are not utilized or managed optimally, resulting in a lack of income for local governments.

However, the outcomes of this analysis differ from those of Pradana et al. (2022) and Aulia & Rahmawaty (2020). This suggests that there is no significant relationship between the size of local government and its financial performance. This difference is likely due to variations in sample coverage, as previous studies have focused on specific areas, such as provinces in Southern Sumatra (2017-2019) and Aceh Province (2014-2018). This analysis examines all provinces in Indonesia from 2021 to 2023 that meet the specified criteria, ensuring a broader data coverage.

This suggests that regional characteristics, combined with varying fiscal year contexts, may result in variations in research outcomes. The results indicate that as the size of local government increases, financial performance tends to decline. For example, DKI Jakarta Province has total assets of IDR 715.50 trillion, but achieved a financial performance ratio of only 221%. In contrast, Banten Province, which has significantly smaller assets amounting to IDR 20.48 trillion, recorded a higher financial performance ratio of 278%.

According to agency theory, the relationship between the principal (the public) and the agent (the local government) has the potential to create conflicts of interest. When local government assets are substantial, the complexity of management and oversight increases. As asset managers, agents have a greater opportunity to act in their own or the group's best interests rather than in the interests of the principal. This can lead to inefficiency and decreased financial performance, even when the assets under management are substantial. In other words, the larger the local government, the greater the risk of agency problems, which can degrade financial performance.

In this study, the size of the regional government was proxied using total assets. Large government size also faces significant accountability responsibilities due to the increased risk of authority and resource mismanagement, making transparency and accountability in financial management crucial. Furthermore, the public, as the primary beneficiary, has high expectations of government performance, especially in asset management. While public service facilities may be beneficial, the regional government may struggle to utilize these assets and become unproductive. Significant regional government assets do not necessarily guarantee improved financial performance if management and oversight are not effective.

Many assets are recorded but not utilized optimally, or they become dormant, making no real contribution to regional revenue. Weak management systems, limited competent human resources, and reduced maintenance budgets contribute to these conditions, resulting in significant assets becoming a burden for regional governments. Furthermore, transparency and accountability in asset management increase the potential for permit issuance and corruption, which can further degrade financial performance. Therefore, the primary focus should be on optimizing asset maintenance, supervision, and utilization so that these significant assets can be productive and support improved financial performance and regional government independence.

The Influence of Balancing Funds on The Financial Performance of Local Government

The results showed that the Balance Funds variable played a positive and considerable role in the Financial Performance of Local Governments in all provinces, with a coefficient of 1.06e-13 and a value of (7.293132 > 1.660710). Balancing funds include general allocation funds, revenue sharing funds, and special allocation funds. This research includes data from all provinces in Indonesia that meet the specified criteria. Thus, the second hypothesis (H₂) is accepted.

The results of this study align with those of previous research by Rahardjo & Putra (2023), Dasmal et al. (2020), Aziz (2016), and Nugroho & Prasetyo (2018), which indicate that Balancing Funds have a positive impact on Local Government Financial Performance. This is because the greater the balance of funds received by the local government, the more it can be used to improve various local government programs and activities. Thus, it can improve local government performance. However, the results of this study contradict those of research conducted by Pradana et al. (2022) and Rahayu et al. (2023), which suggest that the Balance Fund does not impact Local Government Financial Performance. They argue that this is due to the ineffective use of balancing funds. This includes inappropriate, consumptive, and speculative use, which reduces productivity and increases local revenue, increasing dependence on other parties, especially the central government, and resulting in balancing funds having no impact on regional government financial performance. Conversely, Insani et al. (2023) stated that balancing funds harms financial performance. They argued that the higher the balancing funds, the lower the regional government's financial performance. The main reason was that in 2020, the Transfer Fund Ceiling still dominated the state budget, accounting for 68.16%. This high portion of transfer funds reflects the regional government's high dependence on the central government.

According to data released by the Central Bureau of Statistics in 2024, the contribution of balancing funds reached 43.14% in 2023, compared to 44.30% in 2022. This figure indicates that the provincial government's reliance on central government aid funds is decreasing (BPS, 2024). This is supported by research data showing that the Balance Fund received by regions such as DKI Jakarta, amounting to IDR 20.12 trillion with a financial performance ratio of 221%, and Banten, amounting to IDR 3.01 trillion with a financial performance ratio of 278%, indicating that these funds can strengthen the fiscal capacity of the regions to finance their needs independently. On the other hand, Highlands Papua Province recorded the lowest Balancing Fund revenue, amounting to Rp659,637,986,350.00, with a very low financial performance of only around 5%.

According to agency theory, the central government, as the principal, provides mandates and resources in the form of balancing funds to regional governments, as agents, to carry out public service and regional development tasks. Balancing funds serve as an incentive that encourages regional governments to improve their performance in accordance with community expectations, as principals who desire transparent and accountable financial management. However, agency theory also warns of the risks of information asymmetry and moral hazard, whereby regional governments, as agents, possess more complete information and may act less than fully in accordance with key principles, for example, by misappropriating funds or managing them suboptimally. Therefore, the effectiveness of balancing funds in improving regional financial performance depends heavily on strong oversight and accountability mechanisms, such as the legislature's role in overseeing fund use and preparing transparent financial reports.

The results of this study clearly demonstrate that balancing funds received by regional governments has a significant positive impact on regional financial performance, measured through financial independence. The increase in balancing funds, which includes Revenue Sharing Funds, General Allocation Funds, and Special Allocation Funds, enhances the fiscal capacity of regional governments to effectively finance public service needs. This corresponds with evidence that regional spending supported by balancing funds is used efficiently to improve the quality of mandatory services such as education, health, and the provision of social and public facilities.

Furthermore, the management of balancing funds under strict central government oversight encourages regional governments to act more prudently and accountably in executing their work programs, fostering a climate of transparent and responsible financial management. Thus, the receipt of substantial balancing funds not only enlarges the regional budget but also drives improved financial performance and the attainment of regional fiscal independence.

The Influence of Regional Expenditure on The Financial Performance of Local Government

According to the panel data regression analysis, there is a significant negative influence between the regional expenditure variable and Local Government Financial Performance in the provinces, with a coefficient of $-1.895e-13$ and a calculated t-value ($-7.160350 > 1.660710$). This suggests that higher regional expenditure reduces regional financial performance. Regional expenditure includes operating expenditure, capital expenditure, unexpected expenditure, and transfer expenditure. This study includes data from all provinces in Indonesia that meet the specified criteria. Thus, the third hypothesis (H_3) is rejected.

This research is consistent with Saputri & Kurnia (2020), Salsabila & Rahayu (2021), Wulandari (2021), Amanda & Praptoyo (2023), who report that regional expenditure has a negative influence on Local Government Financial Performance. They contend that local governments often prioritize increasing regional operational spending over other types of expenditures. However, these results contradict research by Dasmal et al. (2020) and Setiawan et al. (2020), which stated that regional spending had no impact on local government financial performance. Furthermore, Angraini & Hidayat (2023) stated that regional spending had a positive effect on financial performance. They argued that the greater the funds allocated for regional spending, the greater the creation of infrastructure and facilities the greater the government's development efforts, the greater the potential for regional financial performance growth.

This is supported by research data showing that the operational expenditure of DKI Jakarta province is IDR.57,556,903,079,616.00 and capital expenditure is IDR.8,857,260,068,298.00 with a financial performance ratio of 221% while Banten province shows the realization of operational expenditure of IDR.6,752,118,691,378.00 with a financial performance ratio of 278%.

Agency theory can be explained through the basic assumption that agents (local governments) tend to prioritize personal or group interests (self-interest) (Aryani et al., 2023). This is also related to moral hazard, where agents use public resources for their own interests without adequate oversight, and information asymmetry, which allows agents to conceal or manage information non-transparently from their principals (the central government and the public) (Afifah & Adnan, 2022). Consequently, high personnel expenditures without adequate capital expenditures hinder improvements in regional financial performance, as funds that should be allocated to infrastructure

development and public services are instead absorbed by operational costs that do not enhance long-term fiscal capacity.

The real impact of this condition is the hampered development process and a decline in public welfare. This situation is further exacerbated if the allocation of the Regional Revenue and Expenditure Budget is used more for operational expenditures than for development expenditures. Operational expenditures primarily meet routine needs, making only a modest contribution to improving the capacity and quality of public services. Therefore, local government performance will not experience substantial improvement if the proportion of development expenditure is not given serious attention in the national Revenue and Expenditure Budget management. Optimizing budget allocation, particularly by increasing the portion of development expenditure, is crucial to promoting healthy and sustainable financial performance and achieving improved public welfare.

The Influence of Audit Findings on The Financial Performance of Local Government

Panel data regression analysis reveals that Audit Findings do not have a significant impact on Local Government Financial Performance in the provinces, as indicated by the negative coefficient of -0.0027 and the calculated t-value of $(-0.554963 < 1.660710)$. Audit findings encompass case findings on internal control systems, as well as laws and regulations. This research includes data from all provinces in Indonesia that meet the specified criteria. Thus, the fourth hypothesis (H_4) is rejected.

This finding aligns with previous research by Noviyanti & Kiswanto (2016), Dasmal et al. (2020), and A. A. Aziz & Kusumawati (2024), which suggests that Local Government Financial Performance is not significantly affected by Audit Findings. This is because local governments with numerous audit findings do not necessarily exhibit poor financial performance. Audit findings have minimal impact on local governments' financial performance.

Conversely, this result contradicts the conclusions drawn by Rasyid et al. (2022), Kurnia (2020), and Kusumasari & Kartika (2022), who argue that audit findings do affect local government financial performance. Audit findings can highlight problems that may occur, which can affect local government performance. Audit findings will be supported by strong and sufficient evidence. Similar to the previous variable, this study differs from earlier studies in the sample and year used. Not only does this study employ different methods for measuring audit findings, but it also diverges from previous studies in its approach. While previous studies have examined the value of audit findings, this study focuses on the total number of cases related to violations of the internal control system and applicable laws and regulations.

Evidence from the DKI Jakarta study data supports this finding, which has the highest number of audit findings, 40, but still maintains a high financial performance ratio of 221%. In contrast, Papua, which only has seven audit findings, has a low financial performance of 26%. Often, follow-up actions to revisions, criticisms, or recommendations provided by financial audit institutions are taken solely for administrative compliance without any genuine effort to improve financial management substantially. Therefore, regions with fewer audit findings do not necessarily show better financial performance compared to areas with more findings. This suggests that the number of audit findings is not a direct measure of the government's overall financial well-being.

Agency theory explains that conflicts of interest between the principal (the public or central government) and the agent (local government) are inherent in these relationships, because the agent has more complete information and interests that may differ from those of the principal. Therefore, oversight, including audits, is crucial to minimize the risk of disclosures, provisions, or actions that are detrimental to the principal. Even if audit findings do not significantly impact financial performance, oversight is still necessary because audits serve as an independent control tool to uncover potential irregularities and enforce accountability among agents. Without oversight, the risk of moral hazard and information asymmetry increases, allowing agents to act more freely in their own personal or group interests, ultimately harming the principal and the wider community. In other words, oversight is not only about the direct impact of audit findings on financial performance, but also serves as a preventive and corrective mechanism to maintain transparency and accountability in public financial management and mitigate conflicts of interest inherent in agency relationships. Therefore, although audit findings have not been proven to have a significant impact on financial performance, oversight remains an important instrument in implementing the principles of good governance theory and institutions.

This aligns with the theory proposed by Dasmal et al. (2020), which states that the Audit Board of the Republic of Indonesia's audit findings are obtained after an examination of the regional government's financial statements and are related to the opinion to be issued by the Audit Board of the Republic of Indonesia. An Unqualified Opinion is issued when the financial statements are deemed to present information fairly in all material respects, based on sufficient audit evidence and free from material misstatement. However, audit findings during the audit are usually considered immaterial and do not significantly impact the decision-making of financial statement users.

CONCLUSION

This study examines the impact of local government size, balancing funds, regional expenditure, and audit findings on the financial performance of provincial governments in Indonesia from 2021 to 2023. Our results indicate that the size of local government and regional expenditure has a significant adverse effect on financial performance, while balancing funds has a positive impact. However, audit findings do not significantly influence financial performance. Collectively, these variables provide meaningful insights into financial performance.

This study has practical implications for local governments with significant assets. It is recommended that they improve their internal control systems and strengthen transparency and accountability mechanisms in financial management. This is crucial for minimizing the risk of resource misuse and ensuring effective asset management, thereby improving regional financial performance. Local governments need to optimally utilize balancing funds by implementing strict oversight and professional financial management. Furthermore, the central government must continue to strengthen oversight mechanisms to ensure that balancing funds are used efficiently and accountably to support regional autonomy and improve public services. Local governments are advised to review the composition of spending in the regional revenue and expenditure budget, prioritizing increased development spending that can support long-term regional revenue. Spending management must be more proportional and focused on programs that have a significant impact on improving financial performance and public welfare. Local governments must

take audit findings seriously, not merely as a means of fulfilling administrative obligations. Substantial improvements to internal control systems and financial governance are necessary to minimize future audit findings and enhance the quality of regional financial reports. From a theoretical perspective, this research contributes to the literature on public financial management by elucidating the roles of government size, expenditure, balancing funds, and audit outcomes in influencing financial performance. It also highlights the limited explanatory power of these variables, underscoring the need for future studies to incorporate other factors, such as governance quality, local revenue efforts, and socio-economic conditions.

This study also acknowledges the limitations of its scope, which is confined to provincial governments; therefore, the results may not always be representative of districts/cities. The variables used are still limited to local government size, balancing funds, regional expenditures, and audit findings. These four variables contribute only 40% to financial performance, suggesting that the other 60% of important influences may not be included in the research model. Furthermore, the three-year observation period may not fully capture long-term or structural changes that affect performance. Future research is recommended to include additional factors, such as governance quality, efforts to increase regional revenue, socio-economic conditions, and districts/cities in Indonesia, as well as expand the observation period for a more comprehensive understanding.

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