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THE INFLUENCE OF GOOD GOVERNANCE ON THE FINANCIAL PERFORMANCE OF LOCAL GOVERNMENT AGENCIES IN BONTANG CITY WITH RISK MANAGEMENT AS A MEDIATING

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Abstract : The financial performance of local governments plays a critical role in supporting development objectives and improving the quality of public services. However, in practice, challenges such as budget realization deviations, weak accountability, and the limited integration of risk management highlight a research gap in understanding how governance and risk practices jointly influence financial performance. This study aims to examine the effect of Good Governance (GG) on the financial performance of local government agencies in Bontang City, with Risk Management (RM) as a mediating variable. A quantitative approach was employed using Structural Equation Modeling (SEM) through WarpPLS 3.0. The population consisted of 31 government agencies, all of which were included as the research sample through a census method with secondary data such as financial reports, performance reports, and audit evaluations from BPKP and the Regional Inspectorate. The results reveal that GG has a positive and significant effect on RM ($\beta = 0.397$; $p < 0.05$), but does not have significant affect on financial performance ($\beta = -0.211$; $p = 0.150$). Similarly, RM does not significantly influence financial performance ($\beta = 0.120$; $p = 0.139$) and does not mediate the relationship between GG and financial performance ($p = 0.135$). These findings suggest that while the application of good governance principles enhances risk management practices, improvements in financial performance are more strongly influenced by other factors such as leadership, organizational culture, and human resource competence. The study concludes that integrating GG and RM with broader organizational strategies is essential for strengthening financial performance in local governments.

Keywords : Good Governance; Risk Management; Financial Performance; Local Government

1. Introduction

The financial performance of local governments plays a strategic role in achieving development goals and enhancing the quality of public services at the regional level, including in Bontang City Government. As mandated by Act No. 23 of 2014 on Regional Government, Article 300 paragraph (2), the Regional Budget (APBD) must be managed in an orderly manner, in compliance with laws and regulations, and in an efficient, economical, effective, transparent, and accountable way, while taking into account principles of fairness, propriety, and benefits for society. This emphasizes that the APBD is not merely a budgeting document, but also a key instrument in local governance that must be managed based on the principles of good governance.

Nevertheless, in practice, various obstacles hinder the optimization of local financial performance, such as low budget absorption, potential deviation, and frequent changes in national policy. The significant deviation between budget plans and realizations indicates that

planning has not been fully effective or that program implementation faces significant challenges. Such deviations reflect the extent to which local governments achieve efficiency and effectiveness in financial management. A large deviation suggests inaccurate planning, suboptimal implementation, or weak oversight functions (Mardiasmo, 2009).

According to (Shiyammurti & Rachman, 2015) performance is an illustration of the degree to which an organization achieves its goals, vision, and mission as set forth in its strategic planning. Performance measurement is a process of evaluating progress toward predetermined objectives, including the efficiency of resource used in producing quality outputs, comparing results with planning, and assessing the effectiveness in order to reach the goals. The success of a public organization cannot be measured solely from financial perspective. Surplus or deficit in financial reports cannot serve as the only benchmark, given that local governments are not profit-oriented; instead, their success should also be measured through overall organizational performance (Irvan, 2020).

According from 2022 to 2024 data, Bontang City Government experienced deviations between budget and realization indicating financial management risks that must be addressed promptly.

Table 1. Bontang City Financial Performance Year 2022 to 2024

No.	Year	Budget	Target	Realization	Deviation
1.	2020	1.556.121.460.870	100,00	93,12	6,88
2.	2021	1.549.715.333.138	100,00	87,76	12,24
3.	2022	1.656.441.252.306	100,00	72,65	27,35
4.	2023	2.532.272.667.551	100,00	87,37	12,63
5.	2024	3.360.998.808.720	100,00	87,40	12,60

Source : Bagian Administrasi Pembangunan Setda Kota Bontang, 2025

Bontang City Government is still facing the challenge where the budget realization has not been achieved optimally in accordance with the targets that have been set. According to financial performance report from 2022 to 2024, deviations between budget and realizations reached above 10%. This reflects potential risks that could hinder the ability to achieve regional development targets. Some factors that could contribute to this inability are incomprehensive planning, delays in procurement, insufficient integration of risk management in budgeting, and weak coordination among stakeholders.

These discrepancies between planned and realized budgets represent strategic risks for local government agencies as they hinder efficiency and effectiveness in public financial management. (Perwitasari et al., 2022) stated that deviations from planned budgets reflect weak performance-based planning, ultimately reducing government accountability to the public. Large budget discrepancies indicate suboptimal financial management, whether from overspending or revenue that does not reach the target. This situation causes a shortage in fundings for priority programs, disrupt operational activities, and weakening institution ability to reach their long-term goals. (Budi Susilo & Trisulo, 2025) classified the accuracy level of Fund Withdrawal Plan (Rencana Penarikan Dana (RPD)) according to the size of deviation between budget and realization, where deviation more than 15% is categorized as medium to low accuracy. This fact highlights the importance of public needs-based budget planning, because budget absorption that is too low or too high from initial plan shows a disharmony between planning and implementation. Furthermore, a high budget deviation could potentially

undermine stakeholder trust, including donors and the general publics, also give a negative image for the government organization.

Given this situation, strengthening financial governance based on Good Governance (GG) principles and integrating risk management into local government practices have become urgent priorities, in order to achieve a transparent, accountable, and result-focused financial management. This is in line with Presidential Regulation No. 39 of 2023 on National Development Risk Management (Manajemen Risiko Pembangunan Nasional (MRPN)), which emphasizes the importance of incorporating risk management into public financial administration. Through this approach, it is expected that local financial management will not only support sustainable development but also generate tangible benefits for the community and enhance public trust in government performance.

2. Literature Review

Agency Theory

Agency theory explains the relationship between a principal (the delegator of authority) and an agent (the one who carries out delegated tasks), in which the agent acts on behalf of the principal, but their interests are not always aligned. This concept was formally introduced by Michael C. Jensen and William H. Meckling, who describe it as a contractual relationship in which the principal delegates authority to the agent to perform certain tasks (Jensen & Meckling, 1976). Other scholars, such as (Mitnick, 1973), (Safri & Iswandir, 1979), (Mccubbins et al., 1987), (Lupia, 2001), (Kurniawansyah et al., 2018), (Rahayu & Fadli, 2021) and (Ardini, 2022) further expanded agency theory as an analytical framework for examining control systems, particularly in budgeting formulation and implementation processes.

Stakeholder Theory

Stakeholder theory emphasizes the importance of considering the interests of all parties involved in or affected by organizational activities, not merely focusing on shareholders. Introduced by R. Edward Freeman in his book *Strategic Management: A Stakeholder Approach* (1984), this theory has since become an important foundation of governance and management studies. Stakeholders include individuals or groups who can influence or are influenced by organizational goals—such as the community, employees, government, business partners, and other parties. Therefore, management is obliged to be able to identify, understand, and respond to stakeholder expectations, since organizational survival depends heavily on these relationships (Freeman & McVea, 1984). Along as its development, stakeholder theory is frequently used as a theoretical framework for Corporate Social Responsibility (CSR), corporate management, and sustainability report studies. (Freeman, 2004) in his article titled *Stakeholder Theory and "The Corporate Objective Revisited"*, emphasized that involving stakeholders in decision-making strengthens organizational legitimacy and promotes sustainable performance. Similarly, (Ackermann & Eden, 2011) in *Strategic Management of Stakeholders: Theory and Practice*, stated the strategic importance of mapping and managing stakeholder relationships as determinants of long-term organizational success.

Risk Theory

Risk theory provides a framework for understanding how organizations identify, assess, manage, and respond to uncertainties that could hinder goal achievement. In the public sector, it highlights the need for systematic approaches to address financial, operational, legal, and strategic risks that could appear during government programs implementation. Enterprise Risk Management (ERM), particularly the COSO ERM framework, is widely applied and consists of eight components, including risk evaluation, mitigation strategies, and internal control

mechanisms. Risk theory underlies the view that public sector organization need to act proactively in anticipating potential risks as an integral in GG.

Recent studies had applied this theory in regional government context and public institution. For example, (Lestari & Mayangsari, 2023) examine the implementation of RM in district government and discover that COSO ERM contributed positively to budget efficiency. Research by (Indrijantoro & Irwansyah, 2023) reported that stronger risk management reduced budget deviations and project failures. Risk theory thus underscores that risk management is not just an administrative requirement but a crucial mechanism for accountability and performance enhancement in public sector.

In this study, risk management is positioned as a mediating variable between Good Governance (GG) and financial performance. A solid governance framework provided by GG would help RM acts as implementing mechanism to identify and minimalize potential obstacles to reach financials target. Previous findings (Dila Nugraha & Novianty, 2022), suggest that RM significantly mediates the relationship between GG and financial outcomes in local government. Therefore, risk theory not only explain the importance of uncertainties management but also strengthen relationship between GG and the successful achievement of organizational performance.

Financial Performance of Local Government Agencies

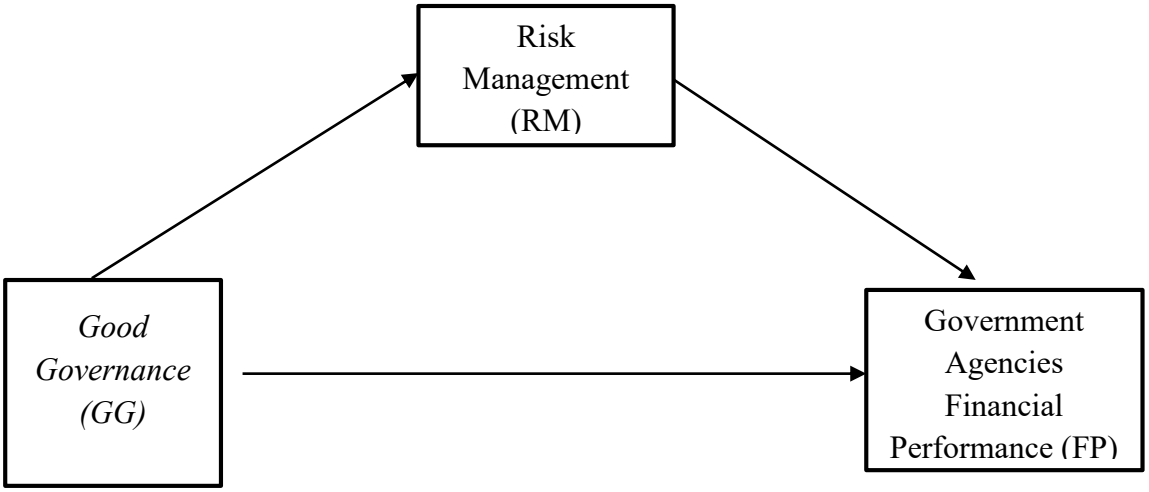
Financial performance is an indicator that reflects the effectiveness and efficiency of local government financial management in supporting administrative functions. Within the framework of regional autonomy, financial performance reflects the ability of government to manage revenue, expenditure, and financing transparently and accountably. In general, financial performance is often measured by indicators such as budget realization rates, growth of locally generated revenue, expenditure-to-income ratios, and audit opinions by the Audit Board of Indonesia (BPK). This evaluation is intended to ensure that government agencies are able to utilize public resources optimally for public welfare and minimalize overspending and budget deviation.

Research has studied financial performance aspect from different perspective. (Rantepulung et al., 2023) found that public accountability and budgeting quality positively influence financial performance, while (Khusnul Khuluq et al., 2024) showed that integrated financial information systems support a better financial performance. Similarly, (Suwanda, 2020) emphasized that integrating risk management into financial planning improves budgeting effectiveness in local government.

In summary, prior studies highlight that government agencies financial performance does not only affect by technical aspect such as reporting system and budget planning but also very dependent to governance quality, transparency level, and the readiness of government agencies to face financial and operational risks. Therefore, the effort to evaluate and increase public sector financial performance should includes a comprehensive approach, institutional aspect, human resource competence, and comprehensive internal control policies. In this context, study about the influence of Good Governance implementation and Risk Management on financial performance becomes very relevant, especially for Bontang City Government.

Research Methods

Based on the description above, the research model can be designed as follows:



Picture 1 : Research Model

Hypothesis

Based on background of the study and research model above, the research hypothesis can be formulated as follows:

H1: Good Governance has a positive and significant influence on the financial performance of government agencies.

H2: Good Governance has a positive and significant influence on the risk management of government agencies

H3: Risk management has a positive and significant influence on the financial performance of government agencies

H4: Risk management mediated the relationship between Good Governance and Government Agencies Financial Performance.

3. Research Methodology

Research Design and Population

This study employs a quantitative approach with descriptive and explanatory methods to describe and explain the relationships among the variables inspected. The research population consisted of all 31 local government agencies (Organisasi Perangkat Daerah/OPD) in Bontang City. Given the relatively small population, a census (saturated sampling) method was applied, meaning that all agencies were included as research samples. Secondary data were collected from financial reports, performance reports, and evaluation results from the Financial and Development Supervisory Agency (BPKP) and the Regional Inspectorate of Bontang City. A Likert scale was used to measure the data, while hypothesis testing was conducted using Structural Equation Modeling (SEM) with the WarpPLS 3.0 application.

Variables and Operational Definitions

The study involves three key variables: Good Governance (GG), Risk Management (RM), and Government Financial Performance (FP).

Operational Definition

1) Independent Variable (X)
   Good Governance
   Operational Definition
   Good Governance (GG) refers to the implementation of governance principles in the public sector, particularly local government, encompassing transparency, accountability, responsibility, independence, and fairness.
   Measurement:
   GG was measured through evaluation scores from the Government Agency Performance Accountability System (SAKIP), covering planning quality, tiered and continuous performance measurement, performance reporting, and internal accountability evaluation by the Inspectorate. The higher GG score, the better the governance implemented in the government agencies.
2) Mediation Variable (Z)
   Risk Management (RM)
   Operational Definition
   Risk Management is defined as a systematic process of identifying, analyzing, assessing, controlling, and monitoring risks that may affect the achievement of organizational goals
   Measurement:
   RM was measured through evaluation scores provided by the Regional Inspectorate, based on official guidelines and indicators, including planning evaluation, leadership capability, risk management policy, human resources, partnerships, risk management processes, risk handling activities, and outcomes.
3) Dependent Variable (Y)
   Government Financial Performance (FP)
   Operational Definition
   Financial performance reflects the degree of effectiveness and efficiency in local government financial management.
   Measurement:
   Financial performance was measured quantitatively through budget realization ratios, comparing planned and actual expenditures for each agency especially comparison between budget realization with budget planning (budget realization ratio) for each government agencies.

4. Results and Discussion

Data Analysis Process

This study employed a quantitative approach using Structural Equation Modelling (SEM) with WarpPLS 3.0 software. This method was chosen based on the ability of SEM to analyse clausal relationship between latent variables simultaneously and to test instruments validity and reliability comprehensively. The analysis was carried out in three stages: (1) outer model analysis to test validity and reliability, (2) inner model analysis to examine the structural relationships among latent variables, and (3) model fit assessment.

Outer Model Analysis

The outer model aims to evaluate whether the indicators accurately and reliably measure the latent variables. The results are depicted on the tables bellow:

Validity Test on Outer Model

Table 2: Validity Test on Outer Model

	GG	FP	RM	SE	P Value
GG	(1.000)	0.000	-0.000	0.065	<0.001
FP	-0.000	(1.000)	0.000	0.127	<0.001
RM	0.000	0.000	(1.000)	0.028	<0.001

The results of the validity test showed that all indicators had loading values greater than 0.7 and p-values < 0.001, indicating that the constructs were valid.

Table 3 : AVE Score Results

	GG	FP	RM
R-Squared		0.055	0.158
Composite Reliab.	1.000	1.000	1.000
Cronbach's Alpha	1.000	1.000	1.000
Avg. Var. Extrac.	**1.000**	**1.000**	**1.000**
Full Collin. VIF	1.185	1.011	1.194
Q-Squared		0.005	0.160

In addition, the Average Variance Extracted (AVE) values exceeded 0.5 for all constructs, meaning that more than 50% of the indicator variance was explained by their respective constructs.

Reliability Test

The result of Composite Reliability (CR) analysis are depicted as follows:

Table 4 : CR Analysis Result

	GG	FP	RM
R-Squared		0.055	0.158
Composite Reliab.	**1.000**	**1.000**	**1.000**
Cronbach's Alpha	1.000	1.000	1.000
Avg. Var. Extrac.	1.000	1.000	1.000
Full Collin. VIF	1.185	1.011	1.194
Q-Squared		0.005	0.160

CR Analysis Result on the table above showed that the value of every variables are 1 (one) which shows that every variables meet the criteria CR that is above 0,7, indicating that every variables are considered reliable.

Corelation Among Latent Variable Test

Table 5 : Corelation Among Latent Variable Test Result

Latent Variable Correlations

	GG	FP	RM
GG	(1.000)	-0.014	0.392
FP	-0.014	(1.000)	0.089
RM	0.392	0.089	(1.000)

Note: Square Roots of Average Variances Extracted (AVE's) Shown on Diagonal.

P Value For Correlation

	GG	FP	RM
GG	1.000	0.861	<0.001
FP	0.861	1.000	0.273
RM	<0.001	0.273	1.000

Table 5 shows that the score of AVE's quadrant for every latent variable is higher than corelation among latent variable score with other variables, indicating that the indicators have a good discriminant validity. The latent variables are shown with the value inside parentheses (1.000).

According to the analysis results, it can be concluded that discriminant validity test meets the criteria, shown by each construct loading score that are higher than their own indicators compared to indicators on other construct. It is emphasized with the result of corelation among latent variables test that showed the root value of AVE is higher that corelation between variables.

Thus, the constructs in this study fulfilled the requirements of convergent validity, discriminant validity, and reliability.

Inner Model Analysis

The inner model assesses the direct, indirect, and mediating effects among the variables. Based from the test, the results were:

Direct Significant Test (Direct Effect)

Table 6 : Direct Significant Test (Direct Effect)

Path Coefficients

	GG	FP	RM
GG			
FP	-0.211		0.120
RM	0.397		

P Value

	GG	FP	RM
GG			
FP	0.150		0.139
RM	<0.001		

According to table 6 above, it can be seen that:

- RM has a positive influence to FP with coefficient value 0,129 but not significant because P Value, 0,139, is higher than 0,05. (Rejecting H3)
- GG has a positive influence to RM with coefficient value 0,397 and significant because P Value is lesser than 0,05. (Accepting H2)
- GG has a negative influence to FP with coefficient value -0,211 but not significant because P Value, 0,150, is higher than 0,05. (Rejecting H1)

Indirect Effect Test

Table 7 : Indirect Effect Test
P Values of Indirect Effects for Paths With 2 Segments

	GG	FP	RM
GG			
FP	0.135		
RM			

From the table above, it can be seen that, the P Value for Indirect Effects is 0,135. This value shown that RM could not mediate GG to FP because the P Value is higher than 0,05 (>0,05), thereby rejecting H4.

R-Square Test

R-Square test is Used to calculate the degree of variation between the independent variable and the dependent variable (Hasibuan et al., 2023). The R^2 value for RM was 0.158, while the R^2 for FP was only 0.055. Values below 0.25 are considered weak, suggesting that GG and RM explained only a small portion of the variance in FP.

According to the criteria by (Hair et al., 2013), an R^2 value below 0.25 is categorized as weak, indicating that this model has a low explanatory power for KKPD. This suggests the possibility of other variables that may have a more dominant influence on KKPD, which are not included in this research model.

- The Good Governance (GG) variable has a positive effect on Risk Management (MR) with a path coefficient of 0.397 and a P-value < 0.05, thus hypothesis H2 is accepted.
- The GG variable does not have a significant effect on KKPD (β = -0.211; P = 0.150), so H1 is rejected.
- The MR variable does not have a significant effect on KKPD (β = 0.120; P = 0.139), so H3 is also rejected.
- The indirect effect test shows that MR does not mediate the relationship between GG and KKPD (P = 0.135), so H4 is rejected.

These results indicate that there is only one significant path of influence, namely from GG to MR. The direct and indirect effects on KKPD are not statistically proven.

Discussion

Based on the research findings, Good Governance (GG) has a positive influence on Risk Management (MR), which aligns with the theory that implementing good corporate governance can enhance an organization's risk management. However, the lack of influence from GG and MR on Regional Apparatus Performance Effectiveness (KKPD) suggests that KKPD may be more affected by other factors such as leadership, organizational culture, or job satisfaction, which were not included in this research model. The results show that Good Governance (GG) has a positive and significant effect on Risk Management (MR) (β = 0.397; P < 0.05).

This research aligns with Agency Theory and the concept of enterprise risk management, which state that the implementation of Good Governance (GG) principles—such as transparency, accountability, and responsibility—can strengthen risk management within an organization. In

the context of this study, organizations that apply GG tend to have better control and oversight systems, enabling them to identify and manage risks more systematically. These findings are consistent with previous studies by (Pradana & Rikumahu, 2014) and (Gollu & Utami, 2024), which show that Good Corporate Governance (GCG) has a positive correlation with enhancing managerial capabilities in risk management.
However, the influence of GCG on organizational performance is not statistically significant (β = -0.211; P = 0.150), and the relationship between Risk Management (MR) and Regional Apparatus Performance (KKPD) is also not significant (β = 0.120; P = 0.139). Furthermore, MR fails to mediate the effect of GG on the Financial Performance of Regional Apparatus (KKPD), as indicated by the indirect effect P-value of 0.135 (> 0.05). This means that the three main hypotheses directly or indirectly related to performance (H1, H3, and H4) are rejected.
These findings are quite intriguing and suggest that although GG and MR are implemented, they do not necessarily lead to a direct improvement in organizational performance.

This phenomenon can be explained through the contingency theory approach, which states that the effectiveness of managerial influence is highly dependent on the internal and external context of the organization. The low R-squared value for performance (R^2 = 0.055) indicates that Good Governance (GG) and Risk Management (MR) explain only a very small portion of the variance in the Financial Performance of Regional Apparatus (KKPD), and may even be considered irrelevant. This suggests the presence of other variables—such as organizational culture, transformational leadership, or employee motivation—that may play a more dominant role in influencing performance

From a practical standpoint, this implies that the implementation of Good Governance (GG) and risk management may not be effective in influencing the Financial Performance of Regional Apparatus (KKPD) unless accompanied by strategies to enhance human resource capabilities, technology, and organizational communication. The model fit also shows partial results; this test was conducted to determine whether the model aligns with the research data. Only the Average Path Coefficient (APC) value (0.243; P < 0.001) is significant, while the Average R Squared (ARS) value (0.107; P = 0.130) is not significant, reinforcing the argument that the model is not yet optimal for comprehensively explaining performance.

In an academic context, these findings highlight the need to expand the theoretical model by incorporating additional intervening or moderating variables. For instance, based on literature such as (Vitriana et al., 2021), performance is strongly influenced by a balance between financial aspects, customer orientation, internal business processes, and learning—elements not covered in the current model.

5. Conclusion

Conclusion

This study aims to evaluate the influence of Good Governance (GG) on Risk Management (RM) and the Financial Performance of Regional Apparatus (FPR), as well as to examine whether RM serves as a mediating variable in this relationship. Based on data analysis using WarpPLS 3.0, it was found that GG has a positive and significant effect on RM (β = 0.397; P < 0.05), thus hypothesis H2 is accepted. However, GG does not show a significant effect on FPR (β = -0.211; P = 0.150), nor does RM significantly affect FPR (β = 0.120; P = 0.139). Furthermore, mediation effect testing indicates that RM does not act as a mediator in the

relationship between GG and FPR (P = 0.135), leading to the rejection of hypotheses H1, H3, and H4.

These findings suggest that while sound governance practices contribute to improved risk management, they do not directly translate into enhanced financial performance. Theoretically, this underscores the non-linear and potentially indirect nature of the relationship among GG, RM, and FPR. It also points to the influence of contextual factors such as organizational culture, leadership style, and individual motivation, which may moderate or mediate these dynamics.

From a practical standpoint, the results highlight the need for regional agencies to adopt a more holistic approach—one that integrates governance and risk management frameworks with strategic human resource development. Strengthening organizational capabilities and employee engagement may be critical to realizing performance gains.

The study's primary limitation lies in the low explanatory power of the model for FPR (R^2 = 0.055), indicating that other unobserved variables may play a significant role. Additionally, the cross-sectional design restricts the ability to capture temporal shifts and long-term causal relationships, suggesting that future research should consider longitudinal approaches to better understand the evolving interplay between governance, risk, and performance

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