

Strengthening Financial Performance of Local Governments through Internal Supervision and Accountability

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ABSTRACT

This study investigates the influence of the Government Internal Supervisory Apparatus (APIP) and the Government Agency Performance Accountability System (SAKIP) on the financial performance of local governments in Indonesia. Financial performance is measured through indicators of independence and sustainability, reflecting regional capacity in managing fiscal resources effectively. Using panel data from 2019–2021 with 1,623 observations across provincial, district, and city governments, multiple linear regression analysis was conducted. The results indicate that APIP significantly enhances financial performance through stronger internal control and accountability mechanisms. SAKIP also contributes positively by fostering transparent and result-oriented management. Both variables collectively strengthen fiscal independence and sustainability, confirming that internal supervision and accountability are crucial for sustainable local financial governance.

Keywords: APIP; SAKIP; Financial; Performance; Financial Independence; Financial Flexibility

Memperkuat Kinerja Keuangan Pemerintah Daerah Melalui Pengawasan Internal dan Akuntabilitas

ABSTRAK

Penelitian ini meneliti pengaruh Aparat Pengawasan Intern Pemerintah (APIP) dan Sistem Akuntabilitas Kinerja Instansi Pemerintah (SAKIP) terhadap kinerja keuangan pemerintah daerah di Indonesia. Kinerja keuangan diukur melalui indikator kemandirian dan keberlanjutan yang mencerminkan kapasitas daerah dalam mengelola sumber daya fiskal secara efektif. Menggunakan data panel tahun 2019–2021 dengan 1.623 observasi dari pemerintah provinsi, kabupaten, dan kota, analisis dilakukan menggunakan regresi linier berganda. Hasil penelitian menunjukkan bahwa APIP berperan signifikan dalam meningkatkan kinerja keuangan melalui penguatan pengendalian internal dan mekanisme akuntabilitas. SAKIP juga berkontribusi positif dengan mendorong manajemen kinerja yang transparan dan berorientasi hasil. Kedua variabel tersebut bersama-sama memperkuat kemandirian dan keberlanjutan fiskal, menegaskan bahwa pengawasan internal dan akuntabilitas merupakan kunci tata kelola keuangan daerah yang berkelanjutan.

Kata Kunci: APIP; SAKIP; Kinerja Keuangan; Kemandirian Keuangan; Fleksibilitas Keuangan

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INTRODUCTION

The financial performance of local governments is one of the main indicators used to assess the effectiveness of public financial management and the quality of governance in Indonesia. This performance reflects the ability of regional governments to manage financial resources effectively to meet development and public service needs (Lestari et al., 2019; Sumiyana et al., 2023). According to data from the Directorate General of Treasury, Ministry of Finance (DJPB Kemenkeu), financial performance varies significantly across regions. Previous studies Aliwardi (2023); Jatmiko et al. (2020) and Mustaufiq et al. (2024) have shown that financial performance is influenced by the quality of internal supervision and performance accountability systems, particularly through the Government Internal Supervisory Apparatus (APIP) and the Government Agency Performance Accountability System (SAKIP). However, several studies still reveal gaps in simultaneously measuring the effects of APIP and SAKIP on local government financial performance, both in terms of data coverage and analytical approach (Amirya, 2024; Dewi et al., 2021). This study aims to address these gaps by examining the simultaneous role of APIP and SAKIP in improving the financial performance of local governments in Indonesia using nationally representative panel data.

National regulations, such as Minister of Home Affairs Regulation No. 64 of 2020 and Minister of Administrative and Bureaucratic Reform Regulation No. 53 of 2014, emphasize that APIP holds a strategic responsibility for internal oversight to ensure financial and performance accountability within local government institutions. Meanwhile, SAKIP functions as a system that integrates performance reporting with strategic planning and institutional evaluation as mandated by the same regulations [8]. Field observations show disparities in APIP capabilities across regions, particularly regarding human resource competence, audit technology infrastructure, and compliance with SAKIP implementation (Aliwardi, 2023; Mustaufiq et al., 2024; Yudianto & Ningsih, 2023). Studies Muhdsan & Usman (2024); Suharyanto et al. (2018) and Wulandari et al. (2024) indicate that improving APIP capability and SAKIP effectiveness has a significant positive impact on regional financial performance.

In this study, APIP capability is measured based on the BPKP standard, covering human resource competence, audit technology, and internal audit standards. SAKIP effectiveness is assessed through the integration of performance reporting, achievement of targets, and follow-up evaluations in accordance with Ministry of Administrative Reform regulations. These dimensions are analyzed because disparities in APIP capability and SAKIP implementation often hinder internal supervision and performance accountability, as reflected in challenges of government auditing and the effects of internal control on local financial reporting quality (Muhdsan & Usman, 2024). Therefore, evaluation based on national standards is essential to identify the determinants of optimal financial performance. The research gap addressed in this study lies in the limited number of studies that analyze both variables comprehensively at the national level. For instance, Mailoor et al. (2017) only examined the partial effect of APIP on good governance in a limited region without integrating SAKIP, while Wulandari et al. (2024) analyzed APIP and the Government Internal Control System (SPIP) in

relation to performance accountability without directly linking them to financial performance. This study contributes to filling that gap by developing a holistic measurement framework based on the synergy between internal supervision and accountability Suharyanto et al. (2018), providing a new theoretical model of local financial governance, and offering practical recommendations to enhance APIP and SAKIP competence to reduce regional disparities (Sutaryo et al., 2023).

This research employs a quantitative approach using panel data regression based on datasets from Indonesian local governments covering the 2019–2021 period. Prior findings indicate that higher APIP capability contributes to more effective financial oversight, which in turn improves regional financial performance (Amirya, 2024; Mustaufiq et al., 2024). Additionally, SAKIP effectiveness significantly enhances governance and transparency in financial performance reporting (Mailoor et al., 2017). A broader empirical study Indahyanti et al. (2024) supports these findings, validating the positive influence of APIP and SAKIP using nationally aggregated data.

The novelty of this study lies in its simultaneous testing of APIP capability and SAKIP effectiveness as primary predictors of local government financial performance on a national scale, employing panel data regression with 1,623 observations from 2019–2021 to provide representative temporal analysis across Indonesia. This approach differs from Mailoor et al. (2017), which empirically tested APIP and internal control in a single district without integrating SAKIP or assessing national financial performance, and from Wulandari et al. (2024), which examined APIP and SPIP concerning performance accountability without addressing financial outcomes. Furthermore, it expands upon Gowon et al. (2021), which only explored performance measurement and SAKIP implementation in Jambi Province without involving APIP or broader financial performance analysis. Thus, this study fills existing empirical gaps in regional or partial analyses, contributes theoretical advancements through the APIP-SAKIP synergy model for accountability and supervision, and offers practical policy recommendations to strengthen local financial governance capacity.

The Supervision Theory proposed by Henri Fayol (1841) asserts that control is a fundamental managerial function that ensures all organizational activities and processes align with established plans and standards. Supervision acts as a corrective mechanism to detect deviations and maintain operational efficiency, forming the foundation for effective financial management in public sector organizations (Lestari et al., 2019; Sumiyana et al., 2023). In the context of local government financial performance, supervision serves as a preventive and corrective tool to guarantee that financial policies are implemented in accordance with regulations, targets, and fiscal discipline. Fayol's principle of *control and coordination* is particularly relevant for government entities, as it emphasizes the need for structured oversight systems to achieve transparency and accountability (Aliwardi, 2023; Jatmiko et al., 2020).

In this research, Supervision Theory provides the conceptual basis for understanding how the Government Internal Supervisory Apparatus (APIP) functions as an internal control mechanism to maintain the integrity of financial management and ensure goal alignment within local governments. Effective supervision reduces irregularities, enhances compliance, and supports sustainable

fiscal management. Previous studies have confirmed that strong supervisory structures positively influence financial performance by minimizing administrative inefficiency and misuse of resources (Amirya, 2024; Mustaufiq et al., 2024). Therefore, the theory underpins the assumption that the presence of an effective internal control body such as APIP contributes directly to the enhancement of local financial performance in Indonesia.

Agency Theory, introduced by Jensen and Meckling (1976), explains the contractual relationship between the *principal* (the resource owner) and the *agent* (the manager or implementer). In public sector contexts, citizens act as principals who entrust public resources to local governments (agents), which are responsible for managing them efficiently, transparently, and accountably (Dewi et al., 2021; Sutaryo et al., 2023). However, this relationship is often characterized by information asymmetry and goal divergence, leading to potential agency problems such as inefficiency, moral hazard, and misuse of public funds (Yudiyanto & Ningsih, 2023).

Within this study, Agency Theory provides the analytical framework for examining how APIP and SAKIP function as mechanisms to reduce agency conflicts. APIP minimizes asymmetry by ensuring that financial management adheres to accountability principles, while SAKIP enhances information transparency through performance-based reporting. These mechanisms align agents' actions with the interests of principals, thereby improving trust and fiscal performance (Mailoor et al., 2017; Suharyanto et al., 2018). Empirical evidence supports this relationship, showing that institutionalized accountability systems reduce opportunistic behavior and promote the efficient use of public resources (Muhdsan & Usman, 2024; Wulandari et al., 2024). Thus, Agency Theory reinforces the argument that both APIP and SAKIP serve as complementary instruments to mitigate agency risks and improve financial outcomes at the local government level.

The role of the Government Internal Supervisory Apparatus (APIP) is central to strengthening local government financial performance. APIP serves as the internal oversight body that ensures the effectiveness and accountability of regional financial management through the implementation of internal control and compliance mechanisms (Aliwardi, 2023; Dewi et al., 2021; Jatmiko et al., 2020). Through continuous auditing and monitoring, APIP identifies potential irregularities early and optimizes budget utilization efficiently and transparently (Amirya, 2024; Suharyanto et al., 2018; Sumiyana et al., 2023).

Supervision Theory emphasizes that internal control is essential for preventing fraud and improving the overall performance of public organizations. In this context, APIP functions as a vital instrument for achieving good governance and sound public financial management (Afronisa & Erawati, 2024; Kantohe & Sumual, 2024; Leksana & Suharto, 2019). From the perspective of Agency Theory, APIP reduces information asymmetry and goal conflicts between the principal (citizens) and the agent (local governments), ensuring that resources are managed in alignment with public mandates (Gowon et al., 2021).

Empirical studies indicate that the effectiveness of APIP is positively correlated with the quality of financial reporting and fiscal accountability (Afronisa & Erawati, 2024; Wardhani et al., 2017). Effective APIP operations

promote transparency, reduce budget inefficiency, and increase public trust in local government financial management (Bandiyono, 2020; Engkus et al., 2019; Muhtar et al., 2020). Therefore, within this research framework, APIP is considered a structural determinant of fiscal performance improvement.

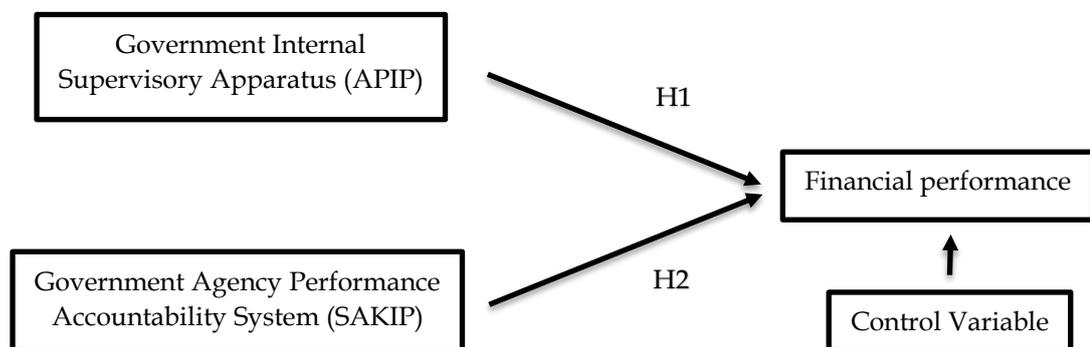
H₁: The role of APIP has a significant positive effect on the financial performance of local governments in Indonesia.

The Government Agency Performance Accountability System (SAKIP) facilitates measurable performance monitoring and evaluation, thereby enhancing the financial performance of local governments (Mulyati et al., 2022). Through structured performance management, SAKIP enables efficient budget utilization and improves both accountability and transparency in public financial management (Engkus et al., 2019; Muhtar et al., 2020). From the perspective of Supervision Theory, SAKIP functions as an internal control mechanism that strengthens financial oversight, minimizes risk of deviation, and reinforces budget discipline (Sutaryo et al., 2023). The system also complements APIP's auditing functions, enabling a continuous feedback loop between performance reporting and financial outcomes (Handayani et al., 2025).

Moreover, SAKIP supports the development of a compliance-oriented culture and fosters participatory budgeting processes (Wulandari et al., 2024). In Agency Theory, SAKIP addresses the principal-agent problem between the central government (principal) and local governments (agents) by providing structured, evidence-based performance reports that reduce information asymmetry and enhance accountability. As a result, SAKIP not only functions as a reporting tool but also as a strategic management instrument for achieving performance-based governance and fiscal efficiency (Kantohe & Sumual, 2024).

Empirical studies confirm that effective SAKIP implementation has a significant positive effect on local financial performance by promoting budget efficiency, accuracy in performance reporting, and adherence to fiscal discipline. Accordingly, this study posits the following hypothesis:

H₂: The role of SAKIP has a significant positive effect on the financial performance of local governments in Indonesia.



Picture 1. Conceptual Framework

Source: Research Data, 2025

The conceptual framework illustrates how the Government Internal Supervisory Apparatus (APIP) and the Government Agency Performance

Accountability System (SAKIP) influence the financial performance of government institutions. In this framework, APIP and SAKIP serve as two independent variables that are assumed to play a critical role in improving public financial management. APIP functions as an internal control mechanism that ensures efficiency and compliance with established regulations, while SAKIP operates as an accountability system that guarantees the allocation of public funds toward measurable and responsible outcomes. Together, these mechanisms aim to enhance transparency, efficiency, and effectiveness in budget management, thereby supporting better financial performance within public institutions.

Within this framework, the role of APIP is positioned as an organizational control mechanism responsible for detecting irregularities, assessing risks, and promoting performance improvement through internal audits and policy recommendations. The existence of APIP is expected to minimize budget misuse and encourage the implementation of programs that are efficient and goal-oriented. Conversely, SAKIP functions as a management tool designed to ensure that every government-funded activity produces clear and measurable outputs. Through systematic performance reporting and evaluation, government agencies are encouraged to plan budgets based on real performance targets rather than administrative routines. When effectively implemented, both systems create an organizational environment that is accountable, transparent, and responsive to public financial responsibilities.

RESEARCH METHODS

This study employs a purposive sampling technique, in which samples are deliberately selected based on specific characteristics relevant to the research objectives. The dataset comprises 548 local governments in Indonesia, including provinces, districts, and cities, covering the period from 2019 to 2021. However, six municipalities within the Special Capital Region of Jakarta (DKI Jakarta) were excluded from the sample because they do not operate as independent reporting entities but are integrated parts of the DKI Jakarta Provincial Government's consolidated reporting entity. In addition, one local government (South Halmahera Regency) was also excluded due to the unavailability of financial performance data during the observation period. Consequently, the final sample consists of 541 local governments.

Given that the study uses panel data over a three-year period, the total number of observations analyzed amounts to 1,623. All data utilized in this research were obtained from official government sources, including: data on the Government Internal Supervisory Apparatus (APIP) from the Financial and Development Supervisory Agency (BPKP); data on the Government Agency Performance Accountability System (SAKIP) from the Ministry of Administrative and Bureaucratic Reform (KemenPAN-RB); and financial performance data from the Directorate General of Treasury, Ministry of Finance of the Republic of Indonesia (DJPB, MoF).

To address the research objectives and test the proposed hypotheses, this study employs the following empirical model:

$$\text{KinKeu}_{it} = \beta_0 + \beta_1\text{APIP}_{it} + \beta_2\text{SAKIP}_{it} + \beta_3\text{Insizetotal}_{it} + \varepsilon_{it} \dots \dots \dots (1)$$

Financial performance ($KinKeu_{it}$) is measured using indicators of financial independence and financial flexibility, which reflect the capacity of local governments to finance operational and investment activities without excessive reliance on central government transfers, as well as their ability to adjust to changes in budget allocations and fiscal conditions. The variable $APIP_{it}$ represents the capability of the Government Internal Supervisory Apparatus (APIP), assessed on a five-level scale developed by the Financial and Development Supervisory Agency (BPKP). At Level 1, APIP has not yet established a clear supervisory structure and internal control remains highly limited. At Level 2, a more organized structure has emerged, though risk management effectiveness remains weak. At Level 3, internal supervision is carried out more systematically but still relies heavily on individual auditors and lacks full integration across all organizational units. At Level 4, internal control becomes effective, well-documented, and periodically evaluated. Finally, Level 5 signifies an optimal supervisory function, where APIP operates with an integrated system supported by information technology, enabling continuous and automated internal monitoring throughout local government sectors.

The variable $SAKIP_{it}$ refers to the Government Agency Performance Accountability System (SAKIP) score, which represents the level of accountability and performance quality of local governments. The score is measured on a scale from 0 to 6, where 6 indicates excellent performance characterized by strong accountability, optimal achievement of performance targets, and comprehensive documentation. A score of 5 reflects very good performance with effective implementation and measurable outcomes, while 4 represents good performance with consistent progress toward strategic objectives. A score of 3 indicates adequate performance with moderate achievement of goals, 2 suggests less satisfactory performance, 1 denotes poor performance, and 0 represents very poor performance with minimal accountability or unreported results.

Meanwhile, the control variable $InSizetotal_{it}$ captures the total size of local government assets, measured as the natural logarithm of total assets, including current assets, investments, and fixed assets such as infrastructure, buildings, and public facilities. This variable reflects the overall fiscal capacity and available resources that enable local governments to carry out their administrative responsibilities and respond effectively to economic challenges.

Table 1. Operationalization of Variables

| Variable Name | Operational Definition | Data Source |
|---------------------------|--|---|
| KinKeu _{it} | Measured using indicators of Financial Independence and Financial Flexibility, which describe the ability of local governments to finance regional activities without relying on central government funds. | Directorate General of Treasury, Ministry of Finance of the Republic of Indonesia (DJPB-MoF RI) |
| APIP _{it} | Represents the capability level of the Government Internal Supervisory Apparatus (APIP), measured using a scale ranging from Level 1 to Level 5. | Financial and Development Supervisory Agency (BPKP) |
| SAKIP _{it} | Measured using a score ranging from 0 to 6, indicating the level of performance accountability of local governments. | Ministry of Administrative and Bureaucratic Reform (KemenPAN-RB) |
| Insizetotal _{it} | Refers to the size of local government, measured using the natural logarithm (LN) of total assets owned by the local government. | Ministry of Home Affairs (KEMENDAGRI) |

Source: Research Data, 2025

RESULTS AND DISCUSSION

A summary of the descriptive statistics for all variables used in this study is presented in **Table 2**.

Table 2. Descriptive Statistics of Variables

| Variabel | Mean | Std. Dev. | Min | Max |
|----------------------------|-------|-----------|-------|-------|
| Kmndriankeu _{it} | 13.60 | 11.90 | 0.08 | 87.27 |
| Flksbltaskeu _{it} | 2.25 | 0.71 | 0.79 | 8.94 |
| Apip _{it} | 2.42 | 0.63 | 1 | 3 |
| Sakip _{it} | 1.79 | 1.53 | 0 | 6 |
| Insizetotal _{it} | 28.75 | 0.77 | 24.64 | 33.93 |

Source: Research Data, 2025

The descriptive statistical summary of the variables used in this study is presented in Table 2. The variable Kmndriankeu_{it} shows an average value of 13.60 with a relatively high standard deviation of 11.90, indicating significant variation among local governments in their ability to finance operational and investment activities independently without relying on central government transfers. The minimum value of 0.08 suggests that some regions remain highly dependent on central funds, whereas the maximum value of 87.27 demonstrates that certain local governments have achieved a strong level of financial independence. The Flksbltaskeu_{it} variable, representing financial flexibility, has an average of 2.25 with a standard deviation of 0.71, suggesting that financial flexibility levels across regions are relatively uniform. However, the maximum value of 8.94 indicates that a few regions possess much higher fiscal adaptability compared to others.

Meanwhile, the $Apip_{it}$ variable, which reflects the capability level of the Government Internal Supervisory Apparatus (APIP), records an average score of 2.42 with a relatively low standard deviation of 0.63. This implies that most local governments in the sample demonstrate a fairly good level of internal audit capability on a scale of 1 to 5. However, it is noteworthy that throughout the observation period, no local government achieved the highest capability level of 5, indicating that the overall maturity of internal supervision in local governments still has room for improvement. The $Sakip_{it}$ variable, which measures the degree of performance accountability of local governments, has a lower average value of 1.79, with substantial variation as indicated by a standard deviation of 1.53 and a maximum value of 6. This finding highlights notable disparities in performance accountability among local governments. The $Insizetotal_{it}$ variable, representing local government size based on total assets, has an average value of 28.75 with a relatively small standard deviation of 0.77. The asset range from 24.64 to 33.93 indicates that most local governments in the sample have relatively comparable asset capacities.

Table 3. Correlation Analysis of Variables

| Variable | Kmndriankeu _{it} | Flksbltaskeu _{it} | Apip _{it} | Sakip _{it} | Insizetotal _{it} |
|----------------------------|---------------------------|----------------------------|--------------------|---------------------|---------------------------|
| Kmndriankeu _{it} | 1.000 | | | | |
| Flksbltaskeu _{it} | -0.155*** | 1.000 | | | |
| Apip _{it} | 0.297*** | -0.253*** | 1.000 | | |
| Sakip _{it} | 0.372*** | -0.146*** | 0.235*** | 1.000 | |
| Insizetotal _{it} | 0.684*** | 0.038 | 0.228*** | 0.310*** | 1.000 |
| | 0.000 | 0.118 | 0.000 | 0.000 | |

Number of Observations = 1,623

***, **, * = Significant at 1%, 5%, and 10% levels respectively.

Source: Research Data, 2025

The correlation analysis results, as presented in Table 3, are based on a total of 1,623 observations. The findings reveal that the variable $Kmndriankeu_{it}$ (financial independence) exhibits a significant positive correlation with $Apip_{it}$ (0.297), $Sakip_{it}$ (0.372), and $Insizetotal_{it}$ (0.684) at the 1% significance level. This indicates that the financial independence of local governments is strongly associated with higher internal audit capability, better performance accountability, and greater asset capacity. In other words, financially independent regions tend to possess stronger internal oversight mechanisms, higher accountability in performance management, and a larger resource base.

Conversely, the $Flksbltaskeu_{it}$ (financial flexibility) variable shows a significant negative correlation with $Kmndriankeu_{it}$ (-0.155), $Apip_{it}$ (-0.253), and $Sakip_{it}$ (-0.146), also significant at the 1% level. This suggests that regional financial flexibility tends to decrease as financial independence, internal supervision capability, and accountability improve, possibly reflecting the trade-off between flexibility and fiscal discipline. Meanwhile, the correlation between $Flksbltaskeu_{it}$ and $Insizetotal_{it}$ (0.038) is positive but statistically insignificant ($p > 0.05$), indicating that the relationship between financial flexibility and asset size is weak or inconsistent.

Overall, the strong positive correlation between $Kmndriankeu_{it}$ and $Insizetotal_{it}$ emphasizes the crucial role of asset capacity in supporting local financial independence. The significant relationships among other variables also highlight the complex interconnections between financial performance, internal supervision, and accountability within local government governance. These findings underscore the importance of strengthening the synergy among these dimensions to enhance the effectiveness and sustainability of regional financial management and governance.

Table 4. Hypothesis Testing Results

| KinKeu _{it} = β ₀ + β ₁ APIP _{it} + β ₂ SAKIP _{it} + β ₃ Insizetotal _{it} + ε _{it}1 | | | |
|--|---------------|---------------------------|----------------------------|
| Variable | Expected Sign | Kmndriankeu _{it} | Flksbltaskeu _{it} |
| Cons | | -182.4 | 0.463 |
| | | 0.000 | 0.606 |
| Apip _{it} | H1 : (+) | 1.089*** | -0.126*** |
| | | 0.000 | 0.000 |
| Sakip _{it} | H2 : (+) | 1.510*** | -0.057*** |
| | | 0.000 | 0.000 |
| Insizetotal _{it} | (+/-) | 6.630*** | 0.076** |
| | | 0.000 | 0.016 |
| Prov > F | | 0.000 | 0.000 |
| Adj R-Square | | 0.500 | 0.080 |
| Obs | | 1.623 | 1.623 |

Explanation of the operationalization of variables in table 1

***, **, * = Significant at 1%, 5%, and 10% levels respectively

Source: Research Data, 2025

The hypothesis testing summarized in Table 4 examines two regression models designed to analyze the determinants of local government financial performance, namely $Kmndriankeu_{it}$ (financial independence) and $Flksbltaskeu_{it}$ (financial flexibility). Both models incorporate three key independent variables: APIP capability ($Apip_{it}$), performance accountability ($Sakip_{it}$), and total asset size ($Insizetotal_{it}$). The results reveal that all models are statistically significant at the 1% level ($Prob > F = 0.000$), indicating their overall explanatory power and robustness in capturing the relationship between internal audit capability, accountability mechanisms, and fiscal outcomes in local governments.

For the $Kmndriankeu_{it}$ model, all independent variables show a positive and statistically significant effect at the 1% level, with coefficients of 1.089 for $Apip_{it}$, 1.510 for $Sakip_{it}$, and 6.630 for $Insizetotal_{it}$. These findings suggest that improvements in APIP capability, enhanced performance accountability, and greater asset capacity each contribute to strengthening the financial independence of local governments. Among these, $Sakip_{it}$ exhibits the largest coefficient, underscoring that accountability in performance management plays a pivotal role in enabling regions to manage their finances autonomously and efficiently. The Adjusted R² value of 0.500 indicates that 50% of the variation in financial independence can be explained by the model's three independent variables.

In contrast, the $Flksbltaskeu_{it}$ model shows that $Apip_{it}$ (-0.126) and $Sakip_{it}$ (-0.057) have negative and significant effects at the 1% level, suggesting that stronger internal audit oversight and accountability systems tend to reduce financial flexibility—likely due to stricter compliance and budgetary control

processes. Conversely, $Insizetotal_{it}$ has a positive and significant effect (0.076, $p < 0.05$), indicating that larger asset capacity provides local governments with a modest increase in flexibility to manage fiscal resources. The Adjusted R^2 of 0.080 implies that 8% of the variation in financial flexibility can be explained by the model. Overall, these results highlight a key trade-off: while stronger internal control and accountability mechanisms foster greater financial independence, they may also impose constraints on fiscal flexibility.

The capability of the Government Internal Supervisory Apparatus (APIP) plays a crucial role in strengthening the financial governance of local governments, particularly in enhancing both financial independence and flexibility. The findings of this study demonstrate that an increase in APIP capability significantly and positively influences regional financial independence. This result is consistent with Supervision Theory proposed by Henri Fayol (1841), which emphasizes that effective supervision ensures control, discipline, and coordination within organizations, leading to improved efficiency and goal attainment. In this context, a highly capable APIP can detect irregularities and prevent inefficiencies in budget management, thereby optimizing the use of local resources. Strengthened internal oversight not only promotes transparency and accountability but also builds external stakeholder trust, including from investors and development partners, thus expanding access to alternative revenue sources beyond central government transfers. These results are consistent with Aliwardi, (2023) and Engkus et al. (2019), who emphasized APIP's role in preventing financial irregularities and reinforcing fiscal autonomy through effective supervision, as well as Mustaufiq et al. (2024), which highlighted how APIP's oversight mitigates the misuse of authority, improving efficiency and fiscal capacity. From an Agency Theory perspective (Jensen & Meckling, 1976), a competent APIP acts as a monitoring mechanism that reduces information asymmetry between principals (the public and central government) and agents (local administrators). By minimizing opportunistic behavior, APIP enhances fiscal discipline and strengthens local financial independence.

In contrast, the influence of APIP capability on financial flexibility shows a negative and significant relationship. This suggests that as APIP capacity improves, the level of internal control becomes more stringent and comprehensive, which, while strengthening integrity and compliance, may restrict administrative agility. Enhanced supervisory rigor often results in longer verification processes and additional documentation requirements, which can slow down urgent fiscal decision-making—such as reallocating funds for emergency responses or development acceleration. This trade-off reflects a structural dilemma in public governance: stronger oversight mechanisms, although essential for accountability and efficiency, may constrain the adaptability of local governments to respond swiftly to dynamic economic conditions. These findings align with Amirya (2024) and Handayani et al. (2025), who noted that internal audit strictness can delay fiscal responsiveness, thereby reducing operational flexibility. Theoretically, this negative association illustrates the tension within Agency Theory, wherein tighter control mechanisms reduce discretionary authority and flexibility in decision-making, thereby limiting the adaptive capacity of local managers under complex and time-sensitive fiscal environments.

The Government Agency Performance Accountability System (SAKIP) serves as a key instrument for measuring and improving local government performance, directly influencing fiscal dynamics. The results of this study indicate that the SAKIP variable exerts a significant and positive effect on financial independence. This relationship reinforces Fayol's Supervision Theory, which posits that structured oversight supported by clear performance indicators enhances efficiency, discipline, and goal-oriented management. Through performance-based budgeting and accountability mechanisms, a strong SAKIP implementation drives efficiency and strategic resource allocation by compelling local governments to focus on measurable outputs and outcomes. Furthermore, well-implemented SAKIP systems enhance the credibility of local governments before central authorities and financial institutions, facilitating access to fiscal incentives and reducing dependency on central transfers. These findings are in line with Gowon et al. (2021) and Pujiastuti et al. (2025), who observed that performance-based accountability systems enhance budget efficiency and transparency, as well as Yudiyanto & Ningsih (2023), who noted the integration of risk management as a driver of sustainable fiscal responsibility. Within the Agency Theory framework, SAKIP functions as a formal monitoring mechanism that aligns agent behavior (local officials) with the objectives of principals (citizens and the central government), thereby reinforcing fiscal discipline and accountability.

However, the influence of SAKIP on financial flexibility is negative and significant. This indicates that strict performance accountability requirements may limit local governments' ability to adjust budget allocations in response to unexpected circumstances. The procedural demands of SAKIP – such as detailed reporting, verification, and performance audits – tend to delay financial decisions and reduce adaptive capacity. Consequently, regions may adopt more conservative fiscal behavior to safeguard their performance scores, even at the cost of agility. This trade-off reflects the inherent tension between accountability and adaptability in public sector management. The finding is consistent with Afronisa & Erawati (2024) and Sofyani et al. (2020), who argued that rigid accountability systems often prioritize compliance over responsiveness, particularly in resource-constrained regions. Theoretically, this outcome demonstrates how Supervision Theory and Agency Theory intersect: while supervision enhances control and accountability, excessive oversight may suppress managerial discretion, creating a governance paradox between maintaining integrity and ensuring flexibility in fiscal management.

CONCLUSION

This study concludes that the capability of internal government auditors and the effectiveness of the government performance accountability system simultaneously have a significant and positive influence on improving the financial performance of local governments in Indonesia, as reflected in the indicators of financial independence and flexibility. Strengthening internal supervision and accountability mechanisms serves as a key driver for enhancing transparency, efficiency, and fiscal responsibility in public financial management. However, the study also highlights that stronger control and accountability measures may limit managerial flexibility, indicating the need for balanced

governance policies that harmonize internal control with financial autonomy to ensure fiscal sustainability and responsiveness.

Despite its contributions, this study has several limitations related to methodological scope and data coverage. The analysis was limited to a three-year observation period (2019–2021), which may have been affected by the COVID-19 pandemic, and financial performance was measured only through two indicators— independence and flexibility— thus not capturing other dimensions such as efficiency or liquidity. The model included a limited control variable and relied solely on secondary data from official sources without triangulation. Future research should extend the data period to include pre- and post-pandemic observations, develop a more comprehensive composite index of financial performance, incorporate additional control, mediation, and moderation variables to capture regional heterogeneity, and validate secondary data through primary surveys or audit-based verification. Such improvements would enhance the robustness, generalizability, and policy relevance of future studies on public financial governance.

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