

The Impact of Supervision of Government Internal Control Apparatus (Apip) on the Financial Performance of Local Governments in Indonesia

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Abstract. The financial performance of an organization, be it public or private, is a critical indicator for evaluating its sustainability. This study aims to investigate the extent to which the capacity of the Government Internal Supervisory Apparatus (APIP) affects the financial performance of local governments in Indonesia. The analysis uses data from 542 local governments, including provinces, districts, and cities, employing a purposive sampling method with a final sample of 2,710 observations. The results show that APIP considerably influences financial performance, specifically in the areas of fiscal independence, financial flexibility, and service solvency. The implications of this research emphasize the necessity of enhancing APIP's capabilities to encourage improved governance, particularly in local financial management. Nonetheless, this study is constrained by its dependence on secondary data and the variability present in regional data, which may limit the generalizability of the results. Therefore, future research should explore wider datasets and incorporate additional variables to provide a more comprehensive understanding of APIP's role in regional financial performance.

Keywords: Internal control, financial performance, local government, fiscal independence, financial flexibility, service solvency.

1. Introduction

Since the implementation of regional autonomy in Indonesia in 1999, there has been a significant shift in the management of government from the central government to local governments, including in the management of regional finances [1] & [2]. This autonomy aims to enhance the independence and accountability of local governments in managing their financial resources. The main objective is to improve regional autonomy, transparency, and accountability in financial management [3]. However, in practice, decentralization faces several challenges, such as a high dependency on transfer funds from the central government. This reliance contradicts the initial purpose of decentralization, which is to enhance regional financial independence [4], & [5].

The primary focus of this research is to assess how effective the Internal Government Supervisory Apparatus (APIP) is in improving regional financial performance. This research question is backed by existing literature. Previous studies have highlighted key challenges in regional financial management, including low Original Regional Revenue (PAD) and a high dependence on transfer funds from the central government [6]. For example, a study on the regional financial condition of Enrekang Regency reveals that although the local government can effectively manage its budget in the short term, it indicates the need for enhanced financial management effectiveness and internal oversight to enable the local government to become more self-reliant and sustainable in the long term.

The supervision of regional finances by the Government Internal Supervisory Apparatus (APIP) is crucial in ensuring transparency and accountability in the use of regional budgets. APIP plays a vital role in guaranteeing transparency, accountability, and efficiency in regional financial management [7]. It is hoped that effective oversight by APIP will enhance the financial performance of regional governments by minimizing the risks of corruption, inefficiency, and budget waste [8]. Therefore, this study aims to assess the effectiveness of internal control in improving regional financial performance in three key indicators: fiscal independence, financial flexibility, and service solvency.

The success of achieving performance can be measured by the efficiency and effectiveness of a program and financial performance should be aligned with the goals and objectives of the government's strategic plan and with indicators in compliance with applicable laws and regulations [9]. A study by reference [10] states that to evaluate the quality of regional financial governance performance, it is essential to measure the Regional Financial Management Index (IPKD). This study assesses the financial performance of regional governments based on one of the IPKD measurement dimensions: regional financial conditions. Several indicators are used for this measurement, including fiscal independence, financial flexibility, and service solvency. Performance measurement using various indicators is also supported by Indonesian Government Regulation No. 71 of 2010 on Government Accounting Standards, specifically in the Accrual-Based Government Accounting Standards (PSAP No. 04, Notes to Financial Statements). Clause 31a states, "Performance typically cannot be fully expressed using only one indicator." [11].

Several previous studies have shown the importance of good financial conditions for local governments to provide adequate public services [12] & [13]. Research emphasized in reference [14] underscores the significance of training and certification for internal auditors, alongside the use of information technology in auditing processes, to enhance the precision and efficiency of oversight. Moreover, it has been identified that factors such as top management support, organizational culture, and human resources quality significantly impact the effectiveness of internal controls [15]. [16] underscores the significance of transparency and professional support in regional financial management. Research conducted in the Makassar City Government indicates that an effective internal control system, competent personnel, and internal supervision

positively impact the accountability and performance of regional financial managers [17]. Research in reference [7] also indicates that APIP capabilities significantly impact the performance of regional financial management. These capabilities include variables such as human resource management, APIP roles and services, professional practices, management accountability and performance, organizational culture, and governance structure. A recent study by reference [18] emphasizes that enhancing APIP capabilities and combating corruption are essential components in achieving the SDGs, particularly SDG 11, which focuses on the sustainable development of cities and human settlements

This study shows that its results differ from those of earlier research. Earlier studies have emphasized the importance of the internal audit agency (APIP) and a strong financial position for local governments to provide quality public services. However, there remains a lack of research on the specific effects of APIP oversight on various aspects of regional financial performance, such as fiscal independence, financial flexibility, and service solvency. Therefore, this research aims to fill this gap by analyzing the influence of APIP oversight on the financial performance of regional governments in Indonesia.

Using data from 2017 to 2021 with a total of 2,710 observations from provincial, regency, and city governments, it was generally found that APIP had an impact on efforts to improve the financial performance of regional governments in Indonesia. Based on this, the findings and contributions of this research can be summarized as follows. First, regarding local government fiscal financing, this research indicates that APIP oversight positively impacts fiscal financing. An effective APIP enhances local governments' ability to manage budgets more independently and increase locally-generated revenue (PAD). These findings contribute to previous research on the role of APIP in fiscal independence, such as studies in [14], [15], [17], and [18]. They argue that increasing the role of APIP is critical to achieving greater fiscal independence for local governments in Indonesia. The findings of this research suggest that local governments must enhance the capability and effectiveness of their APIP to reduce dependence on central transfer funds and strengthen fiscal independence. Secondly, regarding financial flexibility, this research indicates that APIP control negatively impacts financial accounting. Close supervision by APIP can restrict local governments' ability to adjust budgets and expenditures according to changing needs. The findings of this research contribute to providing further explanation to previous research that analyzed the impact of APIP controls on financial results, such as those carried out by [7], [19], and [20]. They emphasize the need to balance regulatory compliance and uncertainty in budget management to ensure that oversight does not hinder efficiency and accountability. Third, regarding service solvency, this research shows that APIP control has a negative effect on service solvency. An excessive focus on compliance and audits can reduce budget allocations for direct community services. These findings provide additional explanation to previous research analyzing the impact of APIP controls on service solvency, including references [18], [19], and [21]. It is important for local governments to ensure that APIP monitoring does not reduce budget allocations for essential public services.

The implications of the results of this research indicate that strengthening APIP capabilities is very important to increase the fiscal independence of local governments. Regional governments with effective APIP will be better able to manage their financial resources independently and reduce dependence on central transfer funds. Therefore, both central and regional governments must invest in developing APIP competencies through training, certification and improving information technology infrastructure to support audit and supervision processes. Additionally, this research underscores the importance of balancing regulatory compliance and flexibility in budget management. Local governments must ensure that APIP oversight does not impede their ability to adjust budgets according to changing needs, which is important for maintaining efficiency and accountability in budget management. This research also shows that an excessive focus on compliance and auditing can reduce budget allocations for direct community services. Therefore, local governments need to ensure that monitoring by APIP does not reduce budget allocations for important public services. Local governments need to develop policies that ensure that financial oversight does not reduce their ability to provide quality public services.

Although this research provides valuable insight into the impact of APIP supervision on the financial performance of local governments in Indonesia, it still has several limitations. First, this analysis relies on secondary data originating from local government financial reports and APIP audits, which only cover the period 2017 to 2021 due to the unavailability of the latest data for 2022 to 2023. Therefore, this analysis does not include the latest information that can provide insight comprehensive regarding trends in local government financial performance. Second, this research only utilizes three of the six indicators stipulated in Ministry of Home Affairs Regulation (Permendagri) 19 of 2020 concerning Regional Financial Management Index, namely fiscal independence, financial flexibility and service solvency. And the last, all data in this study was processed exclusively using STATA 14.2.

2. Literature Review and Hypothesis

2.1 Internal Control Theory

The internal control theory proposed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) holds important relevance for this study. It is comprised of five fundamental components: control environment, risk assessment, control activities, information and communication, and monitoring. The COSO framework is instrumental in evaluating the effectiveness of APIP internal controls in attaining strong financial performance. This framework emphasizes the necessity of providing adequate assurance to fulfill operational, reporting, and compliance objectives [22].

2.2 Agency Theory

This theory explains the relationship between principals (local government) and agents (society), as well as the challenges that arise when their interests differ. In the context of local government, this theory helps in understanding how internal controls

implemented by APIP can mitigate institutional problems through increasing transparency and accountability. Agency theory offers a valuable framework for analyzing government stakeholder relationships and the role of internal controls in addressing agency problems [23].

2.3 Public Finance Theory

This theory pertains to government management of its financial resources. In the context of this study, public finance theory can be applied to analyze how regional financial management might be affected by effective internal controls, particularly concerning fiscal independence and financial sustainability. Public finance theory explores governmental approaches to managing financial resources to achieve public policy objectives, emphasizing efficiency, equity, and stability in fiscal operations [24].

2.4 Good Governance Theory

This theory underlines the importance of effective governance in public administration. Strong internal control is an important element in good governance. Through implementing these principles, local governments can improve their overall financial performance. Good governance is essential for sustainable development, ensuring efficient and fair use of public resources [25].

2.5 The Influence of the Government Internal Supervisory Apparatus (APIP) on the Financial Performance of Regional Governments in Indonesia

Regional financial management plays a crucial role in a region's development. Achieving targeted levels of regional financial performance requires not only competent human resources but also an effective and efficient internal monitoring mechanism. APIP plays a critical role in ensuring transparency and accountability in regional financial management. Strong internal controls by APIP can enhance accountability and enhance the financial performance of local governments. Effective internal controls provide a framework that assists local governments in managing financial risks, protecting assets, and ensuring compliance with regulations and policies. The research cited in reference [26] indicates that the performance measurement process can enhance accountability and improve the performance of public institutions. In the study of management performance in the public sector, its significance lies in how effective management provides information and improves decision-making processes while improving public services [27]. According to reference [8], regional financial conditions refer to the capability of regional governments to meet their obligations, prepare for unforeseen events, and efficiently exercise their financial rights. The research conducted by reference [6] assesses regional financial conditions by measuring short-term solvency, budget solvency, fiscal effort, financial autonomy, and service-level solvency. In the context of internal control, this research aims to examine how APIP internal control can improve regional financial performance through increasing transparency, accountability and risk management.

Numerous previous studies have examined regional financial management; however, none have specifically analyzed the impact of APIP supervision on different aspects of regional financial performance. Several investigations indicate that, despite the presence of supervision, transparency and accountability remain major challenges within regional financial management. This research aims to explore how internal control implemented by APIP can enhance regional financial performance by promoting transparency, accountability, and risk management. To support the development of this research hypothesis, it is essential to incorporate recent studies that are relevant to this topic. For instance, a study conducted by [28] demonstrates that using information technology in the audit process can improve the efficiency and accuracy of supervision.

H1. Government Internal Supervisory Apparatus (APIP) Influences the Financial Performance of Regional Governments in Indonesia.

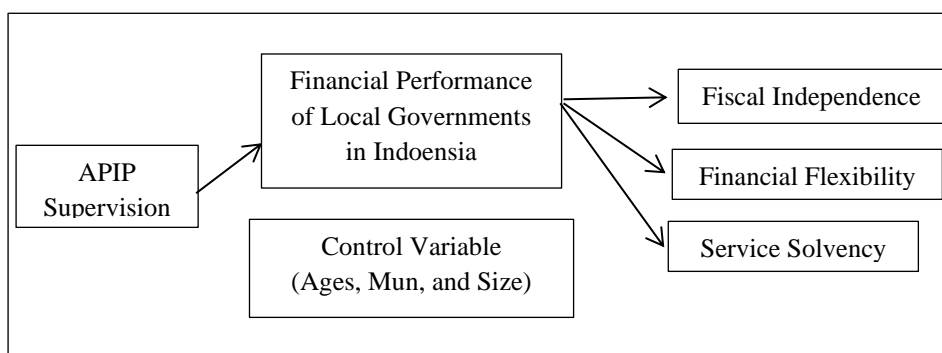


Figure 1. Conceptual Framework

3. Research Methods

3.1 Data

The sample in this research was determined using the purposive sampling method for data collection. Purposive sampling is a technique employed to select data sources based on specific criteria or considerations [29]. In this study, data from 548 regional governments including provincial, district, and city governments in Indonesia were used, covering the period from 2017 to 2021. However, the six districts and cities within the Special Capital Region (DKI) Jakarta Province were excluded from the sample, because they are part of the DKI Jakarta Province reporting agency. Consequently, the final sample comprised 542 observations, which represents 98.90% of the total regional governments in Indonesia. Considering the observation period from 2017 to 2021, the overall final sample consisted of 2,710 observations. All data for this research were obtained from various Indonesian government agencies: Fiscal Independence, Service Solvency, and SIZE data from the Financial Audit Agency (BPK); Financial Flexibility data from the Ministry of National Development Planning/National Development Planning Agency (BAPPENAS); Apparatus Government Internal Supervision (APIP) data from the Financial and Development

Supervisory Agency (BPKP); and Regional Characteristics data, such as AGES and MUN, from the Ministry of Home Affairs.

3.2 Empirical Model and Operational Variables

In order to address research questions and evaluate hypotheses, the empirical model used in this study is as follows:

$$\text{KinKeu}_{it} = \beta_0 + \beta_1 \text{APIP}_{it} + \beta_2 \text{AGES}_{it} + \beta_3 \text{MUN}_{it} + \beta_4 \text{SIZE}_{it} + \varepsilon_{it} \dots \dots \dots (1)$$

The main variables in this research are Financial Performance and APIP. *KinKeu_{it}* is a metric used to indicate a region's ability to effectively and efficiently implement financial regulations to maintain desired public services. Financial performance serves as a measure to ensure that regions can properly adhere to financial regulations while maintaining the desired level of service. In this research, financial performance is assessed using three indicators: fiscal independence, financial flexibility, and service solvency. *FiskalMan_{it}* refers to the capacity of a regional government to fund its public expenditures using its local original income (PAD), without depending on transfers from the central government or foreign sources. This is measured by dividing the total Regional Original Income by the Total Income. *FleksKeu_{it}* is a measure of a local government's ability to adjust its expenditures in response to changes in economic or fiscal conditions. It is calculated by subtracting Special Allocation Funds (DAK) from Total Revenue, and then dividing the result by the sum of Total Liabilities and Employee Expenditures. *ServSolv_{it}* is a condition where local governments can provide and maintain the quality of public services needed and desired by the community, measured by Total Fixed Assets divided by the Population.

APIP_{it} is a capability variable for the Government Internal Supervisory Apparatus (APIP), measured on a scale of five levels, from 1 to 5. Level 1 is termed Initial, level 2 as Infrastructure, level 3 as Integrated, level 4 as Managed, and level 5 as Optimizing [30]. At level 1, APIP's capabilities show a lack of established monitoring practices, relying heavily on individual performance. As a result, APIP at this level cannot ensure compliance with regulations, negatively impacting regional financial performance. At level 2, APIP is characterized by regular audits and some infrastructure that meets standards. At this stage, APIP begins to improve regional financial performance by promoting transparency and accountability in budget usage, thus enhancing the efficiency and effectiveness of public financial management. At level 3, APIP features uniform and standard internal audit practices, as well as consultation on governance, risk management, and internal control. This enables the assessment of the efficiency, effectiveness, and economy of programs or activities. At this level, APIP enhances regional financial performance by ensuring efficient, effective, and economical budget use, as well as strengthening financial governance. Structured internal audits help optimize resources, reduce waste, and increase accountability in public financial management. At level 4, APIP is characterized by an internal audit unit that has integrated all organizational information to improve governance and risk management. The results provide comprehensive assurance on governance, risk management, and

internal control. At this level, APIP significantly improves local government financial performance by providing a holistic view that strengthens transparency, accountability, and integrity in budget usage. Information integration aids local governments in making better decisions, reducing financial risks, and ensuring more effective and efficient resource allocation. At level 5, APIP is characterized by an internal audit unit that continuously learns from both internal and external sources for ongoing improvement, positioning APIP as an agent of change. At this level, APIP significantly enhances local government financial performance by implementing best practices and innovations in financial management. By continuously learning and adapting, APIP ensures that financial governance is consistently updated and improved, leading to increased efficiency, effectiveness, and transparency in the use of public budgets.

The control variables in this study are $AGES_{it}$, MUN_{it} , and $SIZE_{it}$. $AGES_{it}$ represents the age of the regional government from 2017 to 2021, measured by the number of years since the regional government's establishment up to 2021. MUN_{it} is a variable representing the status of the local government, measured using a categorical scale: "0" if the local government is a Regency, "1" if it is a City, and "2" if it is a Province. $SIZE_{it}$ represents the size of the regional government from 2017 to 2021, measured by the natural logarithm (Ln) of the total value of the regional government's assets.

Table 1. Operational variables and data sources

Variables	Operational Variables	Data Sources
FiskalMan _{it}	The capacity of a regional government to fund its public expenditures using its own Original Regional Income (PAD), without depending on transfers from the central government or foreign entities, is assessed by calculating the ratio of total Original Regional Income to total income.	Financial Audit Agency (BPK)
FleksKeu _{it}	The capacity of local governments to modify their expenditures in reaction to fluctuations in economic or fiscal conditions is evaluated by deducting Special Allocation Funds from Total Revenue. This result is then divided by the sum of Total Liabilities and Personnel Expenditures.	Ministry of National Development Planning/National Development Planning Agency (BAPPENAS).
ServSolv _{it}	The capability of local governments to provide and uphold the standard of public services that the community needs and desires is evaluated by calculating the ratio of Total Fixed Assets to Total Population.	Financial Audit Agency (BPK)
APIP _{it}	Capability of Government Internal Supervisory Apparatus (APIP).	Financial and Development Audit Agency (BPKP)

AGES _{it}	The age of regional governments between 2017 and 2021 is calculated based on the number of years that have elapsed since their establishment, extending to the years in question, 2017 to 2021.	Ministry of Internal Affairs
MUN _{it}	The status of local governments is measured using categorical variables. Local governments with the status of a Regency are marked with "0", those with the status of a City are marked with "1", and those with the status of a Province are marked with "2".	Ministry of Internal Affairs
SIZE _{it}	The total wealth of the Regional Government is quantified by the natural logarithm (Ln) from the years 2017 to 2021.	Financial Audit Agency (BPK)

Data Source: Processed by Researchers (2024).

4. Results and Discussion

4.1 Descriptive Statistics

A complete explanation of the descriptive statistics of the variables in this research can be seen in table 2 below:

Table 2. Description of statistical variables

<i>Variables</i>	<i>Obs</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>Min</i>	<i>Max</i>
FiskalMan _{it}	2.710	13.22	11.74	0.08	87.27
FleksKeu _{it}	2.710	2.37	0.78	0.79	10.15
ServSol _{it} *	2.710	12.07	14.72	0.28	185.24
APIP _{it}	2.710	2.12	0.63	1	3
AGES _{it}	2.710	42.18	24.01	3	71
MUN _{it}	2.710	0.30	0.58	0	2
SIZE _{it} **	2.710	5,109.26	22,376.06	585.55	544,504.58

Information:

Number of Observations = 2,710

*) In millions of rupiah

***) In billions of rupiah

FiskalMan_{it} represents a variable that indicates regional fiscal independence, which is assessed as the percentage of total Regional Original Income (PAD) relative to total Regional Income. FleksKeu_{it} denotes a financial variable that evaluates the capacity of local governments to modify their expenditures in response to fluctuations in economic or fiscal conditions. This variable is derived by deducting Special Allocation Funds (DAK) from Total Revenue and subsequently dividing the outcome by the aggregate of Total Liabilities and Employee Expenditures. ServSol_{it} pertains to the capability of local governments to provide and maintain the quality of public services that the community requires and expects. This is measured by dividing Total Fixed Assets by Total Population. APIP_{it} evaluates the competencies of Government Internal

Audit Officials on a scale ranging from 1 to 5. $AGES_{it}$ signifies a variable that represents the age of regional governments from 2017 to 2021, calculated by counting the number of years since their establishment up to 2021. MUN_{it} is a variable representing the status of local governments, measured categorically: "0" if the local government is a Regency, "1" if it is a City, and "2" if it is a Province. $SIZE_{it}$ refers to a variable that characterizes the size of regional governments during the 2017-2021 period, as determined by the natural logarithm (Ln) of the total value of regional government assets.

Data Source: Processed by Researchers (2024).

Table 2 presents the results of descriptive statistics, showing that the $FiskalMan_{it}$ variable has a mean of 13.34. This value is still below 50, indicating that, on average, the regional governments in the sample of this study have not yet been able to cover their expenses using Regional Original Income (PAD). The $fleksKeu_{it}$ value of 2.36 indicates that the average level of financial flexibility of local governments in this research sample indicates a slow level of financial resource mobilization. $ServSolv_{it}$ has an average value of 12.07, suggesting that the average ability of local governments to meet long-term obligations through the quality of public services provided is relatively low.

$APIP_{it}$ shows an average value of 2.11, indicating that most local governments have a medium level of internal supervision, or are at level 2. This means that the audit process is conducted regularly, some of the infrastructure meets standards, and it is supported by adequate HR competency qualifications. Meanwhile, control variables such as $AGES_{it}$, MUN_{it} , and $SIZE_{it}$ show an average of 42.18, 0.30, and 5,109.26, respectively. This shows that on average the regional governments in this study have been around for a long time, have district regional government status, and have quite large total assets. Furthermore, the results of the correlation analysis between each variable are presented in table 3 below:

Table 3. Variable correlation analysis

<i>Variables</i>	<i>FiskalMan_{it}</i>	<i>FleksKeu_{it}</i>	<i>ServSolv_{it}</i>	<i>APIP_{it}</i>	<i>Ages_{it}</i>	<i>Mun_{it}</i>	<i>Size_{it}</i>
FiskalMan _{it}	1.000						
FleksKeu _{it}	-0.182*** (0.000)	1.000					
ServSolv _{it}	-0.335*** (0.000)	0.391*** (0.000)	1.000				
APIP _{it}	0.263*** (0.000)	-0.225*** (0.000)	-0.184*** (0.000)	1.000			
AGES _{it}	0.360*** (0.000)	-0.337*** (0.000)	-0.439*** (0.000)	0.197*** (0.000)	1.000		
MUN _{it}	0.627*** (0.000)	-0.092*** (0.000)	-0.180*** (0.000)	0.180*** (0.000)	0.087*** (0.000)	1.000	
SIZE _{it}	0.717*** (0.000)	-0.021 (0.267)	-0.162*** (0.000)	0.193*** (0.000)	0.387*** (0.000)	0.474*** (0.000)	1.000***

Number of observations = 2,710

Explanation of variable operationalization in table 2.

***, **, * = significant P-value 1%, 5%, 10%

Data Source: Processed by Researchers (2024).

In Table 3, the results of the correlation analysis between variables show that all the main variables used in this research are correlated with each other. Therefore, it can be said that these variables can be used to test the next hypothesis. This shows that there is a relationship between APIP and variables measuring regional government financial performance. Meanwhile, among the control variables used, regional government size has no correlation with the financial flexibility variable.

4.2 Hypothesis Testing

The hypothesis testing in this research employs the multiple linear regression method using the STATA-14.2 software. The results of the test are displayed in Table 4 below:

Table 4. Hypothesis testing results

<i>Variables</i>	<i>Expected Sign</i>	<i>FiskalMan_{it}</i>	<i>FleksKeu_{it}</i>	<i>ServSolv_{it}</i>
1	2	3	4	5
_Cons		-203.807*** (0.000)	-3.307*** (0.006)	13.353*** (0.000)
APIP _{it}	H : (+/-)	1.457*** (0.000)	-0.186*** (0.000)	-0.111*** (0.000)
AGES _{it}	(+/-)	0.063*** (0.000)	-0.012*** (0.000)	-0.015*** (0.000)
MUN _{it}	(+/-)	7.677*** (0.000)	-0.187*** (0.000)	-0.256*** (0.000)
SIZE _{it}	(+)	7.281*** (0.000)	0.231*** (0.000)	0.123*** (0.000)
Prob > chi2 / Prob > F		(0.000)	(0.000)	(0.000)
Pseudo R2 / Adj R-Squared		0.643	0.172	0.228

Number of observations = 2,710

Explanation of variable operationalization in table 2.

***, **, * = significant P-value 1%, 5%, 10%

Data Source: Processed by Researchers (2024).

In general, the test results show that the three financial performance indicators each have an R-Square value of 0.643, 0.172, and 0.228. This means that the research model is able to contribute 64 percent, 17 percent and 23 percent of the variation in efforts to improve regional government financial performance in Indonesia, with a significance level (F-statistic value) of 1 percent. Table 4 shows that the role of APIP has an impact on the Financial Performance of Regional Governments in Indonesia. Each indicator shows a coefficient of 1.457, -0.186, -0.111 with a significance level of 1 percent. This means that the data used in this research supports H1.

The findings of this research show that APIP supervision has different impacts on various aspects of Regional Government Financial Performance in Indonesia. APIP supervision has a positive effect on fiscal financial management, but has a negative impact on financial flexibility and service solvency. In addition, all control variables have a significant impact on these three aspects, with the influence being positive or negative depending on the aspect studied. This shows that apart from APIP's capabilities, factors such as the age of regional governments, their status, and the size of regional governments also play an important role in the financial performance of regional governments in Indonesia.

The first finding generally confirms previous research conducted by [1] entitled "Assessing the Financial Condition of Regional Governments in Indonesia: Exploration" which shows that regional governments with effective internal supervision demonstrate greater fiscal independence. Research conducted by reference [2] also indicates that effective APIP oversight enhances fiscal independence by improving financial management, increasing local revenue, and reducing reliance on central transfers. Furthermore, research conducted by reference [5] indicates that local governments with strong internal oversight are more effective at managing budgets and reducing their reliance on transfer funds from the central government. It was also noted that effective internal control boosts the efficiency and effectiveness of regional financial management, safeguards officials from allegations of fraud, and enhances the use of financial resources for improved public services. Additionally, strong internal control can better allocate local government finances, leading to improved community services and a reduction in the reliance on local taxes [19]. Additionally, reference by [31] found that addressing audit recommendations positively affected fiscal management, reflecting the commitment of local governments to addressing audit findings and enhancing public trust. Masdar in reference [16] found that transparency and support from BPKP improved adherence to audit recommendations, indicating that APIP supervision can enhance regional financial accountability. Quality Assurance results at BPKP West Papua indicate that the support of regional heads for the role of the inspectorate helps improve financial performance [7]. The article "Analysis of Regional Financial Conditions in the Regional Government of Enrekang Regency, South Sulawesi Province, Indonesia" indicates that the financial condition of the Enrekang regional government is relatively strong in terms of budget solvency and financial alignment. The research reveals that effective financial management contributes to stable and relatively profitable financial conditions. This shows that strong supervision, such as that carried out by APIP, can help local governments achieve fiscal independence [6]. In addition, the "Draft Guidelines for Improving APIP Self-Capability" underlines that an effective APIP must be at level 2 (Infrastructure) to

3 (Integrated) in accordance with the Internal Audit Capability Model (IA-CM) developed by The Institute of Internal Auditors (IIA). This research shows that APIP's internal supervision improves regional financial governance, increasing efficiency, effectiveness, accountability and transparency. Therefore, the hypothesis that APIP affects the fiscal independence of local governments is strongly supported.

The second finding also corroborates earlier research conducted by [12], which indicated that stringent supervision often leads to suboptimal resource allocation and restricts local governments' ability to respond swiftly and effectively to changing economic conditions. Additionally, according to the Technical Guidelines for Improving the Capacity of Government Internal Oversight Apparatus Independently (Self Improvement) [30], the low capability level of APIIP further supports the finding that supervision is ineffective in ensuring that governance processes comply with regulations and in preventing. This, in turn, restricts financial equity among regional governments. Research conducted in Ghana indicates that, despite efforts to enhance the internal control system, financial performance does not always improve as anticipated. This suggests that stringent internal controls may sometimes constrain operational efficiency [32]. Other literature also highlights that while control systems can enhance efficiency and reporting, overly stringent controls may hinder an organization's ability to adapt to rapid changes in the external environment [17]. Therefore, this research makes a valuable contribution to how strict APIP monitoring can adversely impact local government financial misconduct, which in turn impacts their capacity to respond effectively to economic changes. Overall, these findings support the hypothesis that the implementation of supervision and internal control must be balanced to ensure efficiency without reducing effectiveness.

The last, according to reference by [30], a low APIP capability (Level 1) signifies numerous areas needing improvement in operational efficiency and effectiveness. A study by reference [32] found that while internal control systems positively contribute to overall financial performance, excessively rigid implementation of these controls can impede an institution's ability to adapt to changing external conditions and operational needs. This can reduce the efficiency and effectiveness of public services. Research conducted by Alam in his article, "The Influence of Internal Control Systems, Apparatus Competence, and Internal Supervision on the Accountability and Performance of Makassar City Government Financial Managers," supports these findings. Alam noted that while internal control can enhance accountability and financial performance, overly stringent supervision can restrict managerial and operational efficiency, potentially negatively affecting public service communication [17]. Furthermore, study by reference [6] found in his research that APIP supervision had a significant negative impact on service solvency. This study evaluates service solvency using various ratios, showing that tight monitoring by APIP can reduce resource efficiency for long-term public services. Excessive supervision often causes resource allocation to be suboptimal, and ultimately reduces the quality of public services that can be provided by local governments. Therefore, while supervision by APIP is crucial for good financial governance, it must be balanced with enhanced capabilities to avoid diminishing the efficiency of public services. Without sufficient capabilities, strict monitoring could negatively affect long-term service solvency and reduce service efficiency. Overall, these findings support the hypothesis that stringent

monitoring by APIP, without an increase in capabilities, can adversely impact the efficiency and solvency of public services.

5. Conclusion

This research aims to examine the influence of supervision by the Government Internal Audit Apparatus (APIP) on the financial performance of local governments in Indonesia. These findings show that APIP plays an important role in ensuring financial management is transparent, accountable and compliant with regulations. Effective supervision by APIP not only increases fiscal independence and financial flexibility but also strengthens the solvency of local government services. APIP's role is very important in increasing transparency and accountability in regional financial management. Through strict supervision, APIP helps prevent budget irregularities and ensures that public funds are used properly, thereby increasing public trust in local government and encouraging citizen participation in decision making. In addition, APIP helps local governments identify and manage financial risks, enabling them to proactively address potential problems such as decreasing revenues or increasing debt. Effective risk management promotes long-term financial stability and sustainability of public services. In addition, APIP oversight supports sustainable regional development by ensuring development projects are managed efficiently and effectively, helping local governments achieve broader development goals such as improving infrastructure, health services, and education, which have a positive impact on people's quality of life.

The findings of this study have significant implications for policymakers. Both central and regional governments should enhance the role and capabilities of APIP through initiatives such as training and certification, as well as by increasing the use of information technology in the auditing process. Additionally, policies should be developed to strike a balance between supervision and flexibility in financial management, allowing local governments to adapt to evolving financial needs and conditions.

This research has limitations in terms of data coverage and variables used. It relies on local government financial reports, which are limited to certain periods and only cover a few key indicators of financial performance. Future research should expand the scope of the data and include additional relevant variables to provide a more comprehensive understanding of the role of APIP in local government financial management.

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