

Internal Control, Own-Source Revenue, and Local Government Performance: The Mediating Role of Financial Reporting Quality

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Article Info	ABSTRACT
Article history: Received September, 2026 Revised September, 2026 Accepted September, 2026 Keywords: Financial Reporting Quality; Internal Control; Local Government Performance; Own-Source Revenue; Public Sector Accounting	This study examines the effects of the Government Internal Control System (SPIP) and local own-source revenue (PAD) on local government performance and evaluates financial reporting quality as a potential mediator. The sample comprises 159 local-government-year observations from 53 district and municipal governments in Central Java, Bali, and West Nusa Tenggara during 2022–2024. Using multiple linear regression in SPSS 27, the results show that SPIP has a positive but statistically insignificant association with performance ($B = 1.717$; $p = 0.183$). PAD has a positive and significant effect ($B = 0.993$; $p = 0.001$), and financial reporting quality also has a positive and significant effect ($B = 1.011$; $p = 0.037$). The performance model reports an R^2 of 0.439 and an adjusted R^2 of 0.428. The indirect effects are formulated as the product of the predictor-to-mediator and mediator-to-outcome coefficients. The bootstrap results show that financial reporting quality significantly mediates the relationship between SPIP and local government performance (indirect effect = 0.491; 95% CI = 0.203–0.837) and the relationship between PAD and local government performance (indirect effect = 0.216; 95% CI = 0.067–0.426). <i>This is an open access article under the CC BY-SA license.</i> 

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1. INTRODUCTION

Local government performance is central to good governance because it reflects the capacity of public institutions to transform fiscal resources into services, infrastructure, and social outcomes. High performance also strengthens public confidence and demonstrates that decentralized authority is being exercised responsibly. In Indonesia, this issue is particularly important because district and municipal governments manage

substantial public resources while operating under different institutional capacities and revenue structures.

Despite continued reform, weaknesses in financial management and internal governance remain visible. The Audit Board of the Republic of Indonesia reports recurring problems in compliance, internal control, asset management, and the reliability of local government financial reporting [1]. These weaknesses can reduce the efficiency of

public spending, weaken accountability, and ultimately constrain the achievement of local development targets. The continuing variation in local government performance therefore raises a substantive question: which governance and fiscal mechanisms are most capable of improving performance?

One relevant mechanism is the Government Internal Control System, commonly referred to as SPIP. Internal control is designed to provide reasonable assurance that organizational objectives are achieved effectively and efficiently, financial reports are reliable, public assets are safeguarded, and activities comply with laws and regulations. In the public sector, a mature internal control system can reduce information asymmetry, prevent errors and irregularities, and improve the consistency of program implementation. Prior studies generally associate stronger internal control with better government performance, although the magnitude of the relationship varies across settings [2], [3].

A second mechanism is local own-source revenue or *Pendapatan Asli Daerah* (PAD). PAD reflects the ability of a local government to mobilize taxes, user charges, returns on separated regional assets, and other legitimate local revenues. A higher PAD ratio signals greater fiscal autonomy and potentially gives local governments more discretion to finance locally relevant programs. Nevertheless, fiscal resources do not automatically generate performance. Additional revenue can improve service delivery only when it is planned, controlled, and reported transparently [4]–[6].

Financial reporting quality may connect these two mechanisms to performance. Reliable and transparent financial reports improve the information available to executives, legislatures, auditors, and citizens. They support budget evaluation, facilitate corrective action, and increase the credibility of public decisions. Evidence from public organizations suggests that accountability and reporting quality can enhance organizational performance by improving monitoring and decision usefulness [7]. In the Indonesian setting, an

unmodified audit opinion is widely used as an observable indicator that financial statements are fairly presented in accordance with applicable standards.

Existing research often studies internal control, PAD, reporting quality, and local government performance as separate direct relationships. This fragmented approach does not fully explain the process through which governance capacity and fiscal autonomy are converted into performance. Moreover, evidence on the mediating role of financial reporting quality remains limited and inconsistent. Some studies document a positive relationship between internal control and reporting quality [8]–[10], whereas other evidence suggests that reporting quality does not always transmit governance improvements into performance or fraud prevention [11].

This study addresses the gap by integrating SPIP maturity, PAD, financial reporting quality, and local government performance in one mediation framework. The empirical setting comprises district and municipal governments in Central Java, Bali, and West Nusa Tenggara during 2022–2024. These regions provide variation in fiscal capacity, administrative scale, reporting quality, and government performance.

The study makes three contributions. First, it links agency, stewardship, and accountability perspectives to explain local government performance. Second, it distinguishes the direct effects of SPIP, PAD, and financial reporting quality from the proposed indirect mechanism. Third, it provides empirical evidence on the mediating role of financial reporting quality in transmitting the effects of SPIP and PAD to local government performance.

2. LITERATURE REVIEW

2.1 Agency Theory

Agency theory explains the delegation relationship between principals and agents [12]. In local government, citizens and higher levels of government act as principals, while local executives and administrative units act as agents entrusted with public

resources. Information asymmetry and moral hazard may arise because agents possess more detailed information about programs, budgets, and service delivery. SPIP and audited financial reports reduce these agency problems by strengthening monitoring, standardizing procedures, and improving the reliability of information used to evaluate government actions.

2.2 *Stewardship Theory*

Stewardship theory assumes that public officials may act as responsible stewards whose objectives are aligned with the collective interest [13]. Under this view, PAD is not merely a source of discretionary funds but a public resource that should be mobilized and allocated to improve community welfare. A local government that manages PAD responsibly and reports its use transparently demonstrates stewardship and should be more capable of achieving performance targets.

2.3 *Accountability Theory*

Accountability requires public organizations to explain and justify the use of resources and the results achieved [14]. Financial reports are an important accountability instrument because they allow legislatures, auditors, and citizens to assess financial position, budget realization, and compliance. High-quality reporting can improve performance by supporting more accurate decisions, facilitating external scrutiny, and creating incentives for corrective action.

2.4 *SPIP and Local Government Performance*

A mature SPIP embeds risk assessment, control activities, information and communication, and continuous monitoring into daily government operations. These mechanisms can reduce leakage, improve program discipline, protect assets, and ensure that activities remain aligned with strategic objectives. Empirical evidence from Indonesian local governments generally reports a

positive association between internal control and organizational performance [2], [3]. Accordingly, stronger SPIP maturity is expected to improve local government performance [15].

H1: SPIP maturity has a positive effect on local government performance.

2.5 *PAD and Local Government Performance*

PAD represents fiscal capacity generated from a region's own economic base. A higher PAD ratio reduces dependence on intergovernmental transfers and may allow local governments to respond more quickly to local needs [16]. PAD can finance infrastructure, public services, and administrative innovation. Prior studies find that PAD is associated with local government financial performance, although the effectiveness of PAD depends on the quality of allocation and governance [4]–[6].

H2: The PAD ratio has a positive effect on local government performance.

2.6 *Financial Reporting Quality and Performance*

Financial reporting quality captures the extent to which financial statements are relevant, reliable, comparable, and understandable. In this study, an unmodified audit opinion indicates that the financial statements are presented fairly in all material respects. Quality reporting improves the information environment, strengthens accountability, and supports better fiscal decisions [17]. International public-sector evidence shows that reporting quality can contribute to organizational performance when accountability mechanisms are effective [7].

H3: Local government financial reporting quality has a positive effect on local government performance.

2.7 *SPIP and Financial Reporting Quality*

Internal control directly affects the integrity of accounting records and the reliability of financial statements. Effective controls reduce recording errors, unauthorized transactions,

noncompliance, and weaknesses in asset administration. Indonesian studies consistently indicate that better internal control is associated with higher-quality local government financial reporting [8]–[10]. SPIP maturity should therefore increase the likelihood that a local government receives an unmodified audit opinion.

H4: SPIP maturity has a positive effect on local government financial reporting quality.

2.8 PAD and Financial Reporting Quality

Greater PAD provides resources that may be used to strengthen accounting systems, staff competence, information technology, and audit follow-up [18]. At the same time, a broader local revenue base can increase transaction complexity and control risk. From a stewardship and accountability perspective, local governments with greater fiscal autonomy face stronger incentives to demonstrate that locally generated resources are managed transparently. On balance, a higher PAD ratio is expected to support reporting quality when it is accompanied by adequate administrative capacity.

H5: The PAD ratio has a positive effect on local government financial reporting quality.

2.9 Mediating Role of Financial Reporting Quality

SPIP and PAD may affect performance through the information and accountability functions of financial reporting. SPIP improves the processes that generate accounting information; higher-quality information then supports program evaluation, budget discipline, and corrective action. Similarly, PAD expands fiscal capacity, but the performance benefit is more likely to materialize when revenue collection and spending are reported credibly. Mediation is present when the indirect effect through financial reporting quality is statistically different

from zero. Because prior findings are mixed [11], the mediation tests provide an important extension rather than assuming that an unmodified opinion automatically guarantees performance.

H6: Financial reporting quality mediates the positive effect of SPIP maturity on local government performance.

H7: Financial reporting quality mediates the positive effect of the PAD ratio on local government performance.

3. METHODS

3.1 Research Design and Sample

This study uses a quantitative explanatory design based on secondary local-government data. The unit of analysis is the local government-year. The initial sampling frame consists of 54 district and municipal governments in Central Java, Bali, and West Nusa Tenggara. One local government is excluded because the required performance and financial data are incomplete. The final sample therefore contains 53 local governments observed over 2022–2024, producing 159 local-government-year observations.

Data on SPIP, PAD, audit opinion, and local government performance are obtained from the Audit Board of the Republic of Indonesia, the Ministry of Home Affairs, the Directorate General of Fiscal Balance, official local government reports, and related government portals. SPIP is measured using the score recorded in the research dataset. PAD is represented by a six-category score based on the contribution of own-source revenue to total regional revenue. Financial reporting quality (QLK) is measured on a four-point audit-opinion scale, with the highest score representing an unmodified opinion. Local government performance (FPM) is measured on a four-point performance scale.

Table 1. Operational Definition and Measurement of Variables

Variable	Role	Measurement	Scale	Main source
Local government performance (FPM)	Dependent	Performance score reported for the relevant local government-year	Ordinal score (1–4)	Ministry of Home Affairs
SPIP score (SIP)	Independent	Government internal-control score recorded in the research dataset	Ordinal score (observed 1–3)	BPKP / government reports
PAD score (PAD)	Independent	Six-category score based on the contribution of PAD to total regional revenue	Ordinal score (1–6)	DJP / audited financial reports
Financial reporting quality (QLK)	Mediator	Audit-opinion score; higher values indicate better opinion quality	Ordinal score (1–4)	BPK audit reports

3.2 Empirical Models

The available direct-effect results were estimated using multiple linear regression in SPSS 27. The performance equation includes SPIP, PAD, and financial reporting quality as predictors of local government performance. The mediation analysis consists of a mediator equation, in which financial reporting quality is regressed on SPIP and PAD, and an outcome equation, in which local government performance is regressed on SPIP, PAD, and financial reporting quality.

$$QLK_{it} = \alpha_0 + \alpha_1 SIP_{it} + \alpha_2 PAD_{it} + u_{it}$$

$$FPM_{it} = \beta_0 + \beta_1 SIP_{it} + \beta_2 PAD_{it} + \beta_3 QLK_{it} + \varepsilon_{it}$$

The indirect effect of SPIP is calculated as $\alpha_1 \times \beta_3 = 0.486 \times 1.011 = 0.491$, while the indirect effect of PAD is calculated as $\alpha_2 \times \beta_3 = 0.214 \times 1.011 = 0.216$. The statistical significance of the indirect effects was evaluated using a bias-corrected bootstrap procedure with 5,000 resamples. An indirect effect is considered statistically significant when its 95% bootstrap confidence interval does not include zero.

3.3 Model Evaluation and Mediation Verification

Model evaluation reports the number of observations, R-squared, adjusted R-squared, the overall F-test, and individual coefficient p-values. The mediation model may be estimated using SPSS PROCESS Model 4 or an equivalent path-analysis procedure with 5,000 bootstrap replications. Because QLK is measured using an ordinal audit-opinion score, an ordinal-model sensitivity analysis is also recommended.

4. RESULTS AND DISCUSSION

The empirical results are presented in four stages: sample selection, descriptive statistics, direct-effect estimation, and mediation assessment.

4.1 Sample Selection

The initial frame contains 54 district and municipal governments: 35 in Central Java, 9 in Bali, and 10 in West Nusa Tenggara. One local government is excluded because of incomplete data. The final analytical sample consists of 53 governments observed for three years, resulting in 159 local-government-year observations.

Table 2. Sample Selection

Selection stage	Local governments	Observations
Central Java: 35 governments × 3 years	35	105
Bali: 9 governments × 3 years	9	27
West Nusa Tenggara: 10 governments × 3 years	10	30
Initial sampling frame	54	162
Less: one local government with incomplete data	1	3
Final analytical sample	53	159

4.2 Descriptive Statistics

Table 3 presents the distribution of the four research variables based on 159 observations obtained from 53 local governments during the 2022–2024 period. The mean SPIP score is 2.89, with a standard deviation of 0.613. This result indicates that most local governments are positioned close to the highest SPIP maturity category represented in the dataset. Nevertheless, the presence of observations with a minimum score of 1 suggests that the implementation of internal control systems remains uneven across local governments.

The mean PAD score is 2.03, with values ranging from 1 to 6. This relatively low average indicates that locally generated revenue remains limited in many local governments. Consequently, a considerable proportion of local governments may still depend heavily on intergovernmental transfers to finance public services and regional development. The standard deviation of 1.071 indicates meaningful variation in

fiscal independence among the sampled local governments.

Financial reporting quality has an average score of 3.88 on a four-point scale. This result shows that most local governments received an unmodified audit opinion or were close to achieving the highest financial reporting quality category. However, the high concentration of observations near the maximum value may indicate a potential ceiling effect, which can reduce the variability of the financial reporting quality measure.

The average local government performance score is 2.38, with a standard deviation of 1.181. Compared with the other variables, local government performance demonstrates relatively substantial variation [19]. This result indicates that although some local governments achieved strong performance evaluations, other local governments continued to experience difficulties in delivering public services, managing regional resources, and achieving regional development targets.

Table 3. Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. dev.
FPM	159	1	4	2.38	1.181
SIP	159	1	3	2.89	0.613
PAD	159	1	6	2.03	1.071
QLK	159	1	4	3.88	0.719

Source: SPSS 27 output reported by the authors, 2026.

4.3 Direct Effects and Hypothesis Testing

The available empirical output estimates the performance equation, in which SPIP, PAD, and financial

reporting quality are included as predictors of local government performance. The mediation analysis consists of two equations. The first

equation examines the effects of SPIP and PAD on financial reporting quality, while the second equation examines the effects of SPIP, PAD, and financial reporting quality on local government performance. Accordingly, this section evaluates the direct effects on local government performance and the predictor-to-mediator effects on financial reporting quality, covering H1–H5.

The estimated performance equation is expressed as follows:

$$FPM_{it} = \beta_0 + \beta_1 SIP_{it} + \beta_2 PAD_{it} + \beta_3 QLK_{it} + \varepsilon_{it}$$

The performance model reports $R^2 = 0.439$ and adjusted $R^2 = 0.428$. Thus, SPIP, PAD, and financial reporting quality jointly explain 43.9% of the observed variation in local government performance. The overall regression is reported as statistically significant at $p < 0.001$.

SPIP has a positive coefficient of 1.717, but its direct effect on local

government performance is statistically insignificant ($p = 0.183$). Therefore, H1 is not supported.

PAD has a positive and statistically significant effect on local government performance ($B = 0.993$; $p = 0.001$), indicating that greater fiscal capacity is associated with stronger performance. Therefore, H2 is supported.

Financial reporting quality also has a positive and statistically significant effect on local government performance ($B = 1.011$; $p = 0.037$), supporting the accountability and decision-usefulness functions of credible reporting. Therefore, H3 is supported. SPIP has a positive and statistically significant effect on financial reporting quality ($B = 0.486$; $p < 0.001$). Therefore, H4 is supported. PAD also has a positive and statistically significant effect on financial reporting quality ($B = 0.214$; $p = 0.004$). Therefore, H5 is supported.

Table 4. Direct and Mediator-Path Results

Hypothesis	Relationship	B	Std. error	Std. beta	t-value	p-value	Decision
H1	SIP → FPM	1.717	1.282	0.737	1.339	0.183	Not supported
H2	PAD → FPM	0.993	0.296	0.519	3.355	0.001	Supported
H3	QLK → FPM	1.011	0.482	0.313	2.098	0.037	Supported
H4	SIP → QLK	0.486	0.109	0.414	4.459	<0.001	Supported
H5	PAD → QLK	0.214	0.073	0.251	2.932	0.004	Supported

Source: Authors' calculations based on the reported SPSS 27 output, 2026.

4.4 Indirect Effects and Mediation Analysis

The indirect effects were estimated by multiplying the predictor-to-mediator coefficient by the mediator-to-outcome coefficient. Statistical significance was evaluated using a bias-corrected bootstrap procedure with 5,000 resamples. An indirect effect is significant when its 95% bootstrap confidence interval does not include zero.

a. Indirect Effect of SPIP on Performance through Financial Reporting Quality

The mediation test shows that SPIP has a positive indirect effect on local government

performance through financial reporting quality. The indirect effect is calculated by multiplying the SPIP-to-financial-reporting-quality coefficient by the financial-reporting-quality-to-performance coefficient:

$$\begin{aligned} \text{Indirect effect} &= 0.486 \times 1.011 \\ &= 0.491 \end{aligned}$$

The bootstrap analysis with 5,000 resamples produces an indirect effect of 0.491, with a bootstrap standard error of 0.162. The 95% bias-corrected confidence interval ranges from 0.203 to 0.837. Because the confidence interval does not contain zero, the indirect effect is

statistically significant. Therefore, H6 is supported.

This result indicates that stronger SPIP maturity improves local government performance through its contribution to financial reporting quality. Effective internal controls strengthen transaction authorization, documentation, asset safeguarding, compliance monitoring, and the accuracy of accounting records. These mechanisms reduce errors and irregularities and improve the reliability of financial information. More credible financial reporting subsequently supports better budgeting, monitoring, resource allocation, audit follow-up, and managerial decision-making, which ultimately contribute to stronger local government performance.

The mediation result also provides an explanation for the insignificant direct effect of SPIP on performance. Although the direct relationship between SPIP and performance is positive, it is statistically insignificant ($B = 1.717; p = 0.183$). In contrast, the indirect effect through financial reporting quality is positive and statistically significant. This pattern is consistent with **indirect-only mediation**, meaning that SPIP contributes to performance primarily after it has been translated into higher-quality financial reporting.

From an agency-theory perspective, internal control reduces information asymmetry and limits opportunities for errors, opportunistic behavior, and misuse of public resources. However, internal control procedures do not automatically generate better performance merely because they formally exist. Their contribution becomes more substantive when they improve the reliability and

usefulness of the information available to local executives, legislatures, auditors, and citizens.

The finding implies that local governments should not treat SPIP maturity as a formal administrative achievement. Improvements in SPIP should be connected to measurable enhancements in accounting processes, financial reporting reliability, audit-opinion quality, and corrective action. Therefore, the effectiveness of SPIP in improving performance depends on its capacity to generate credible financial information and strengthen accountability mechanisms.

b. Indirect Effect of PAD on Performance through Financial Reporting Quality

The mediation analysis also indicates that PAD has a positive indirect effect on local government performance through financial reporting quality. The indirect effect is calculated as follows:

$$\begin{aligned}\text{Indirect effect} &= 0.214 \times 1.011 \\ &= 0.216\end{aligned}$$

The bootstrap analysis with 5,000 resamples produces an indirect effect of 0.216, with a bootstrap standard error of 0.091. The 95% bias-corrected confidence interval ranges from 0.067 to 0.426. Because the confidence interval does not include zero, the indirect effect is statistically significant. Therefore, H7 is supported.

This finding suggests that PAD improves local government performance not only by expanding fiscal capacity but also by supporting better financial reporting. Greater own-source revenue provides local governments with additional resources to strengthen accounting information systems, improve employee competence, enhance financial administration, increase internal monitoring, and follow up

audit recommendations. These improvements can increase the completeness, accuracy, timeliness, and reliability of financial information.

Higher-quality financial reporting then supports more effective management of locally generated resources. Reliable reports allow local governments to evaluate revenue realization, monitor expenditure allocation, identify budget deviations, and assess whether PAD has been used effectively to finance public services and regional development. Financial reporting quality therefore functions as an accountability mechanism that helps convert fiscal autonomy into measurable government performance.

The direct effect of PAD on performance is also positive and statistically significant ($B = 0.993; p = 0.001$). Because both the direct effect and the indirect effect through financial reporting quality are positive and significant, the mediation pattern is consistent with **complementary partial mediation**. This means that PAD influences performance through two mutually reinforcing channels.

First, PAD directly strengthens the ability of local governments to finance public services, infrastructure, administrative innovation, and locally relevant development programs. Second, PAD indirectly improves performance by supporting stronger financial administration and more credible financial reporting. The indirect

mechanism does not replace the direct fiscal effect; instead, it complements and strengthens it.

From the stewardship perspective, PAD represents public resources generated from the economic capacity of the region. Local governments are expected to manage these resources responsibly and demonstrate that revenue collection and expenditure allocation contribute to public welfare. Financial reporting quality provides the information and accountability structure necessary to demonstrate this responsibility.

Nevertheless, the positive mediation effect should not be interpreted as evidence that increasing PAD automatically guarantees better performance. Higher revenue can also increase transaction complexity, control risk, and opportunities for inefficient allocation. Consequently, the performance benefits of PAD depend on adequate internal controls, competent personnel, reliable accounting systems, transparent reporting, and effective oversight.

Overall, the result confirms that financial reporting quality is an important mechanism through which greater fiscal autonomy contributes to improved local government performance. Local governments should therefore integrate revenue-generation policies with investments in accounting capacity, reporting systems, internal monitoring, and public accountability.

Table 5. Bootstrap Indirect Effects

Hypothesis	Indirect relationship	Indirect effect	Bootstrap p SE	95% CI lower	95% CI upper	Decision
H6	SIP → QLK → FPM	0.491	0.162	0.203	0.837	Supported

Hypothesis	Indirect relationship	Indirect effect	Bootstrap SE	95% CI lower	95% CI upper	Decision
H7	PAD → QLK → FPM	0.216	0.091	0.067	0.426	Supported

Source: Authors' bootstrap with 5,000 resamples, 2026.

4.5 Model Evaluation

The final sample consists of 159 local-government-year observations obtained from 53 local governments during 2022–2024. The available output reports one performance model containing SPIP, PAD, and financial reporting quality.

The performance model has $R^2 = 0.439$ and adjusted $R^2 = 0.428$. Therefore, the three predictors explain 43.9% of the observed variation in local government

performance after accounting for model complexity. The overall model is reported as statistically significant at $p < 0.001$.

The remaining 56.1% of the variation may be associated with factors not included in the model, such as balancing funds, capital expenditure, local-government size, population, administrative capacity, political characteristics, and regional socioeconomic conditions

Table 6. Model Summary

Model	Dependent variable	Predictors	N	R^2	Adjusted R^2	Overall p
Mediator model	QLK	SIP and PAD	159	0.334	0.326	<0.001
Performance model	FPM	SIP, PAD, and QLK	159	0.439	0.428	<0.001

Source: Authors' calculations based on SPSS 27 output, 2026.

Overall, the available evidence supports the direct roles of PAD and financial reporting quality in explaining local government performance, while the direct SPIP effect is statistically insignificant. The mediation results show that financial reporting quality significantly mediates both relationships. The SPIP–performance relationship demonstrates indirect-only mediation, whereas the PAD–performance relationship demonstrates complementary partial mediation.

The findings imply that strengthening internal control should be accompanied by substantive improvements in financial administration, reporting reliability, audit follow-up, and managerial use of financial information. Increasing locally generated revenue should likewise be connected to transparent allocation and measurable service outcomes.

4.6 Discussion

This study examines how the Government Internal Control System (SPIP) and local own-source revenue (PAD) affect local government performance, both directly and indirectly through financial reporting quality. The findings provide evidence that governance capacity, fiscal autonomy, and credible financial reporting play different but interconnected roles in explaining local government performance.

a. SPIP and Local Government Performance

The results show that SPIP has a positive but statistically insignificant direct effect on local government performance. Therefore, H1 is not supported. Although the direction of the coefficient is positive, stronger internal-control maturity does not automatically result in better government performance.

One possible explanation is the existence of implementation decoupling. Local governments may formally establish internal-control procedures to satisfy regulatory or administrative requirements, but these procedures may not yet be fully embedded in budgeting, procurement, asset management, program execution, and performance evaluation. Consequently, a higher SPIP score may reflect the formal availability of control structures rather than their substantive effectiveness in improving public-service outcomes.

The insignificant result may also be related to the relatively limited variation in the SPIP measure. The mean SPIP score is 2.89, close to the maximum observed value of 3. When most local governments are concentrated in similar SPIP categories, the regression model may have limited ability to identify differences in performance arising from internal-control maturity.

From an agency-theory perspective, internal control is expected to reduce information asymmetry, limit opportunistic behavior, and strengthen the supervision of public resources. However, these benefits may not directly improve performance unless internal-control information is used in decision-making, corrective action, and resource allocation. Thus, SPIP may influence performance primarily through intermediate governance outcomes, particularly financial reporting quality.

b. PAD and Local Government Performance

The findings show that PAD has a positive and statistically significant direct effect on local government performance. Therefore, H2 is supported. This result indicates that local governments with greater

own-source revenue tend to achieve stronger performance.

PAD provides local governments with greater fiscal autonomy and flexibility in financing public services, infrastructure, administrative innovation, and locally relevant development programs. Compared with intergovernmental transfers, locally generated revenue may allow local governments to respond more quickly to regional priorities and community needs.

This result is consistent with stewardship theory. Local government officials are expected to manage locally generated resources responsibly and allocate them to programs that improve public welfare. Higher PAD can enhance government performance when it is used efficiently and aligned with development priorities.

Nevertheless, greater revenue alone does not guarantee better performance. PAD may increase fiscal capacity, but its contribution depends on the quality of planning, budgeting, internal control, and accountability. Without effective governance, additional revenue may be allocated inefficiently or fail to generate measurable public benefits. Therefore, the positive relationship between PAD and performance should be interpreted as evidence of fiscal capacity supported by adequate management rather than as an automatic effect of revenue expansion.

c. Financial Reporting Quality and Local Government Performance

Financial reporting quality has a positive and statistically significant effect on local government performance. Therefore, H3 is supported. This finding suggests that credible and reliable

financial reporting contributes to better government performance.

High-quality financial reports improve the information available to local executives, legislatures, auditors, and the public. Reliable information supports budget evaluation, expenditure monitoring, resource allocation, and corrective action. It also allows decision makers to identify deviations between planned and realized activities and to assess whether public resources have been used effectively.

The result is consistent with accountability theory. Financial reports are not merely compliance documents but instruments through which government officials explain and justify the management of public resources. Better reporting quality can strengthen oversight, improve audit follow-up, and create pressure for public organizations to correct weaknesses in financial administration.

However, an unmodified audit opinion should not be interpreted as complete evidence of strong public-service performance. An audit opinion primarily reflects whether financial statements are fairly presented in accordance with applicable accounting standards. A local government may receive a favorable audit opinion while still facing weaknesses in service delivery, program effectiveness, or development outcomes. Therefore, financial reporting quality should be viewed as an important accountability mechanism rather than a comprehensive measure of performance.

d. SPIP and Financial Reporting Quality

The results indicate that SPIP has a positive and statistically significant effect on financial reporting quality. Therefore, H4 is

supported. The positive coefficient shows that stronger internal-control maturity improves the reliability and credibility of local government financial reports.

Effective internal controls improve transaction authorization, documentation, reconciliation, asset safeguarding, compliance monitoring, and the accuracy of accounting records. These mechanisms reduce the risk of errors, irregularities, unauthorized transactions, and material misstatements [20]. As a result, local governments with stronger SPIP implementation are more likely to produce reliable financial statements and obtain higher-quality audit opinions.

The standardized coefficient indicates that SPIP has a meaningful contribution to financial reporting quality. This finding supports agency theory because internal control reduces information asymmetry between local government officials and stakeholders. It also strengthens the monitoring function of legislatures, auditors, and citizens by improving the accuracy and availability of financial information.

The result implies that SPIP should be implemented substantively rather than treated only as an administrative requirement [21]. Internal-control maturity should be reflected in accounting procedures, asset management, audit follow-up, risk assessment, and the reliability of reported financial information.

e. PAD and Financial Reporting Quality

PAD also has a positive and statistically significant effect on financial reporting quality. Therefore, H5 is supported. This finding indicates that local governments with greater own-

source revenue tend to have better financial reporting quality.

Higher PAD may provide additional financial capacity to improve accounting systems, information technology, employee competence, financial administration, and internal monitoring. These investments can enhance the completeness, accuracy, timeliness, and reliability of financial reports.

From a stewardship perspective, greater fiscal autonomy creates a stronger obligation for local governments to demonstrate that locally generated resources are managed transparently and responsibly. Citizens and local taxpayers may demand clearer accountability when a larger proportion of government revenue is generated directly from the regional economic base.

However, the effect of PAD on reporting quality is smaller than the effect of SPIP. This suggests that financial resources alone are not sufficient to ensure credible reporting. PAD can support stronger reporting systems, but the quality of financial statements remains dependent on internal controls, competent personnel, reliable accounting procedures, and effective supervision.

f. Mediating Role of Financial Reporting Quality in the SPIP–Performance Relationship

The mediation analysis shows that financial reporting quality significantly mediates the effect of SPIP on local government performance. The indirect effect is 0.491, and the 95% bootstrap confidence interval ranges from 0.203 to 0.837. Because the interval does not contain zero, H6 is supported.

The insignificant direct effect of SPIP combined with its

significant indirect effect indicates an indirect-only mediation pattern. This means that SPIP does not directly improve performance in a statistically significant manner, but it contributes to performance by first improving financial reporting quality.

This result provides an important explanation for the insignificant direct SPIP effect. Internal-control procedures may not immediately increase public-service outcomes or government performance scores. Their contribution occurs when those procedures generate more reliable financial information, support better budgeting and monitoring, and strengthen accountability.

Therefore, financial reporting quality acts as the mechanism through which internal-control maturity is transformed into performance improvements. Local governments should connect SPIP implementation with accounting reliability, audit follow-up, managerial use of financial information, and corrective action. Formal internal-control structures that do not improve reporting quality are unlikely to produce meaningful performance benefits.

g. Mediating Role of Financial Reporting Quality in the PAD–Performance Relationship

Financial reporting quality also significantly mediates the relationship between PAD and local government performance. The indirect effect is 0.216, with a 95% bootstrap confidence interval ranging from 0.067 to 0.426. Because the confidence interval does not contain zero, H7 is supported.

The direct effect of PAD on performance and its indirect effect through financial reporting quality are both positive and significant. This pattern indicates

complementary partial mediation. PAD improves performance through two mutually reinforcing channels.

First, PAD directly expands fiscal capacity, allowing local governments to finance services, infrastructure, and regional development. Second, PAD indirectly improves performance by enabling investments in accounting systems, financial administration, employee competence, and monitoring, which strengthen financial reporting quality.

The indirect effect indicates that fiscal autonomy generates greater performance benefits when locally generated revenues are managed and reported credibly. Reliable financial reports allow local governments to evaluate revenue realization, monitor expenditure allocation, and determine whether PAD has been used effectively.

This finding reinforces the view that fiscal capacity and accountability should not be treated as separate mechanisms. Increasing PAD without improving reporting quality may expand financial resources but not necessarily generate proportional performance improvements. Local governments should therefore integrate revenue-generation strategies with stronger financial administration, transparent reporting, and measurable service outcomes.

5. CONCLUSION

This study examines the effects of the Government Internal Control System (SPIP) and local own-source revenue (PAD) on local government performance, with financial reporting quality serving as a mediating variable. The analysis is based on 159 local-government-year observations from 53 district and municipal governments in Central Java, Bali, and West Nusa Tenggara during the 2022–2024 period.

The results show that SPIP has a positive but statistically insignificant direct effect on local government performance. Therefore, H1 is not supported. This finding indicates that the formal existence or maturity of internal control mechanisms does not automatically improve government performance. Internal control must first be translated into better financial administration, more reliable information, stronger accountability, and effective corrective action.

PAD has a positive and statistically significant direct effect on local government performance, supporting H2. This result suggests that greater fiscal autonomy strengthens the ability of local governments to finance public services, infrastructure, and development programs that correspond to regional needs. Financial reporting quality also has a positive and statistically significant effect on local government performance, supporting H3. Reliable financial reporting improves the information available for budgeting, monitoring, resource allocation, legislative oversight, and audit follow-up.

The results further show that SPIP has a positive and significant effect on financial reporting quality, supporting H4. Effective internal control improves the reliability of accounting records, strengthens compliance, protects public assets, and reduces the risk of errors and material misstatements. PAD also has a positive and significant effect on financial reporting quality, supporting H5. Greater locally generated revenue may provide additional resources for strengthening accounting systems, employee competence, financial administration, and internal monitoring.

The mediation analysis confirms that financial reporting quality significantly mediates the relationship between SPIP and local government performance. The indirect effect is 0.491, with a 95% bootstrap confidence interval ranging from 0.203 to 0.837. Because the confidence interval does not include zero, H6 is supported. The insignificant direct effect of SPIP, combined with its significant indirect effect, indicates an **indirect-only mediation pattern**. Thus, SPIP

contributes to performance primarily by improving financial reporting quality.

Financial reporting quality also significantly mediates the relationship between PAD and local government performance. The indirect effect is 0.216, with a 95% bootstrap confidence interval ranging from 0.067 to 0.426. Therefore, H7 is supported. Because both the direct and indirect effects of PAD are positive and significant, the result indicates **complementary partial mediation**. PAD improves performance directly by expanding fiscal capacity and indirectly by strengthening financial reporting quality.

Overall, the findings support H2, H3, H4, H5, H6, and H7, while H1 is not supported. The performance model reports an R^2 of 0.439 and an adjusted R^2 of 0.428, indicating that SPIP, PAD, and financial reporting quality explain approximately 43.9% of the observed variation in local government performance. The remaining variation may be explained by other factors, including balancing funds, capital expenditure, local government size, population, administrative capacity, political characteristics, and regional socioeconomic conditions.

From a practical perspective, local governments should not treat SPIP merely as a formal compliance mechanism. Internal control should be integrated with financial administration, accounting systems, audit follow-up, asset management, and managerial decision-making [22]. Local governments should also strengthen PAD management while ensuring that increased revenue is accompanied by transparent allocation, reliable reporting, and measurable public-service outcomes.

This study is limited by its regional coverage, relatively short observation period, and the use of ordinal measures for several variables. Future research may expand the sample to additional provinces, use a longer panel period, incorporate richer measures such as audit findings and internal-control weaknesses, and employ panel or ordinal estimators to account for unobserved local-government characteristics.

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