

# Ethical Climate as a Moderator in the Influence of Internal Control Effectiveness on Treasury Performance among Local Government Units

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## ABSTRACT

Local government units (LGUs) are entrusted with managing public funds and resources efficiently, transparently, and in accordance with regulations. Effective treasury operations depend on strong internal control systems, which are formally mandated in public institutions to enhance financial discipline, cash management, and organizational performance, but variations in implementation and ethical context may influence how these controls translate into actual performance outcomes. Supported by Agency Theory, Stewardship Theory, and Ethical Climate Theory, this study investigated the influence of internal control effectiveness on local treasury performance among LGUs in Misamis Oriental. It also determined whether the ethical climate had a significant moderating effect on the relationship between these variables. A quantitative design with moderation analysis was employed with 120 respondents across the selected 24 LGUs. Quantitative data were gathered using structured surveys, while key informant interviews (KII) were conducted to gather qualitative information. Descriptive statistics, non-parametric tests, and both simple linear and multiple regression were employed to analyze the data. The findings showed that the internal control effectiveness had a significant influence on local treasury performance. Furthermore, among the dimensions of internal control effectiveness, the control environment and monitoring strongly predict performance, highlighting the importance of leadership tone, integrity, and accountability, as well as continuous oversight of treasury operations. Moreover, no significant differences in internal control effectiveness or local treasury performance were observed when respondents were grouped by age, sex, or years of service, since public service requires integrity and adherence to standardized governance systems rather than demographic attributes. Finally, ethical climate did not significantly moderate the influence of internal control effectiveness on local treasury performance, but it did have a significant positive direct effect on such performance, as a positive ethical environment independently reinforces responsible behavior and performance, even when formal control systems are already in place in the LGUs. Qualitative findings identified implementation challenges, including resource constraints, weak ethical leadership & political influence, insufficient training, and resistance to change. The study further implies that treasury performance may be strengthened by institutionalizing ethical oversight structures, feedback mechanisms, embedding ethics in evaluation systems, investing in continuous training, and adopting digitalization and periodic internal audit review.

**Keywords:** Ethical Culture, Financial Stewardship, Public Financial Management, Public Sector Accountability, Internal Control System, Public Governance, Financial Transparency

## INTRODUCTION

Public service begins with a simple but powerful idea: public office is a public trust. Local government units (LGUs) demonstrate this trust by gathering, safeguarding, and allocating public funds to community needs. The local treasury office is responsible for collecting taxes, fees, and other revenue, and for ensuring that the money is deposited, documented, and reported legally (Bureau of Local Government Finance [BLGF], 2019). When treasury operations are effective, citizens see roads repaired, water systems maintained, and public services sustained. Thus, sound financial management promotes local development and public trust (Ansa, 2013, as cited in Erricoa et al., 2023).

Governments everywhere acknowledge that ethical behavior, accountability, and transparency are critical to providing high-quality public services. The World Bank (2023) states that responsible management of public funds prevents misuse and improves services. Similarly, integrity is emphasized as a cornerstone of public financial management by the Chartered Institute of Public Finance and Accountancy (CIPFA, 2022). According to Farazmand et al. (2022), the likelihood of corruption and poor management rises when oversight is inadequate and transparency decreases. These global insights are very important for the Philippines, where LGUs work within detailed legal and audit frameworks.

The Local Government Code of 1991 (Republic Act No. 7160), Commission on Audit (COA) circulars, and public-sector internal control standards require accurate, reliable financial reporting, timely deposits, proper documentation, and accountability for unauthorized spending. The Anti-Graft and Corrupt Practices Act (Republic Act No. 3019) and the Code of Conduct and Ethical Standards for Public Officials (Republic Act No. 6713) both serve to further strengthen ethical standards. At first glance, the system seems both thorough and rigorous.

Nonetheless, persistent COA findings, such as unreconciled accounts, unliquidated cash advances, missing records, and delayed deposits, suggest that compliance gaps may still exist. Court cases involving finance and treasury officials demonstrate that control failures can result in administrative sanctions, including civil and criminal liability.

Internal control systems do provide formal safeguards (COSO, 2013, as cited in Pkatey, 2024), but they do not work alone. Research on organizational behavior indicates that employees' conduct is shaped by the ethical climate of their workplace, defined as their collective perception of what is right or wrong (Victor & Cullen, 1987, 1988, as cited in Newman et al., 2020). Over time, small lapses may become normalized if they are accepted (Mendoza et al., 2025). People use Bandura's concept of moral disengagement to explain how they make excuses for bad behavior, especially when there is little oversight (Bandura, 1999, as cited in Newman et al., 2020).

Although international studies link internal controls and ethical climate to organizational performance (Abdou et al., 2024; Bashaija, 2022; Mahadeen et al., 2016), limited empirical research examines how these factors interact within Philippine LGU treasury offices. This gap is particularly relevant in provinces like Misamis Oriental, where LGUs operate under the same laws yet differ in fiscal capacity and governance performance (National Competitiveness Council, 2023).

Thus, this study seeks to examine how local treasury performance is influenced by the internal control effectiveness and how this relationship is moderated by the ethical climate. By focusing on city and municipal treasury offices in Misamis Oriental, the study examines how workplace ethics and structural systems interact to influence accountability and financial governance in local governments.

## METHODOLOGY

This study employed a quantitative research design with moderation analysis to examine the relationships among internal control effectiveness, ethical climate, and local treasury performance in selected local government units (LGUs) of Misamis Oriental. The study aimed to measure perceptions quantitatively, test hypothesized relationships, and determine whether the effectiveness of internal control significantly influences local treasury performance. Moderation analysis was utilized to assess whether ethical climate alters or conditions the strength of this relationship.

The study was conducted in the 22 municipalities and 2 component cities of Misamis Oriental, excluding Cagayan de Oro City due to its political and fiscal independence as a highly urbanized city. Although these LGUs operate under uniform national laws and audit regulations, they vary in income classification and fiscal capacity, making the province an appropriate setting for examining differences in treasury performance within the same regulatory environment.

The respondents consisted of 120 treasury-involved personnel, with five (5) respondents selected from each of the twenty-four (24) LGUs requested. These individuals hold key financial positions or designations directly

engaged in fiscal management. Their responsibilities include revenue collection, fund custody, disbursement processing, obligation control, financial recording, and compliance with audit requirements. Random selection within identified treasury-related positions ensured appropriate representation of finance personnel and enhanced data reliability, consistent with the principle that sampling strategies must align with the study's purpose (Etikan & Bala, 2017).

Data were gathered using a structured questionnaire composed of four sections: respondent profile, internal control effectiveness, ethical climate, and local treasury performance. These variables were measured using adapted instruments based on the COSO framework (OCC ICQ), IWPQ (Koopmans et al., 2012), and Ethical Climate Index (Arnaud, 2010), respectively. All items were measured using a four-point Likert scale. The instrument underwent expert validation by three experts in public financial management and was pilot-tested with 30 LGU personnel apart from the study's respondents. Reliability testing yielded strong internal consistency (Cronbach's alpha ranging from .92 to .95).

Prior to data collection, the study followed established ethical guidelines in participant treatment, research conduct, and data management, and all required approvals were obtained. Participation was entirely voluntary, confidentiality was strictly observed, and no physical risks were anticipated. Further, data were analyzed using SPSS. Descriptive statistics summarized respondent profiles and variable levels. Multiple regression analysis determined the influence of internal control effectiveness on local treasury performance, while moderation analysis tested the interaction effect between internal control effectiveness and ethical climate.

This methodological approach provided a systematic and statistically grounded basis for explaining how structural internal controls and ethical climate jointly influence treasury performance in LGUs.

## RESULTS AND DISCUSSION

This section presents the study's findings on the influence of internal control effectiveness on local treasury performance and the moderating role of ethical climate in selected local government units (LGUs) in Misamis Oriental.

### Profile of the Treasury-involved Personnel

The respondents to the survey are professionals involved in the Treasury who hold key financial positions in their LGUs. The majority are in middle adulthood, meaning many are in the developed stage of their professional tenure and may have broad organizational exposure, which can help them build deeper institutional knowledge, professional competence, and work experience. Erikson's Psychosocial Theory (1963, as cited in Cherry, 2023) asserts that individuals in this life stage demonstrate generativity and are motivated to make substantial contributions to society and to lead institutions with responsibility. Stewardship Theory (Davis et al., 1997, as cited in Ceschi et al., 2017; Schillemans & Bjurstrøm, 2019) says that public officials are naturally motivated to do what is best for the organization and the people they serve. This developmental orientation is especially important for people who manage public funds. Additionally, the group is predominantly female, indicating strong involvement in administrative and financial management tasks, and they play a major role in upholding financial accountability and governance in governmental organizations. Furthermore, their years in service span from early-career to veteran stages, with many falling into the developing stage of their careers, where workers are still honing their institutional knowledge and skills while already having hands-on experience with government financial procedures. Overall, the profile shows experienced public finance professionals tasked with protecting public funds, implementing internal controls, and maintaining accountability, which enhances the validity and comprehensiveness of the study's findings.

### Perception of Internal Control Effectiveness

The very high level of internal control effectiveness ( $M = 3.51$ ) shown in Table 1 shows that LGUs are governed by a strong legal and regulatory framework, based on the Local Government Code of 1991, which requires accountability, proper fund management, and measurable treasury outputs.

**Table 1** Summary Result of Internal Control Effectiveness

Dimension	Mean	SD	Description
1. Control Environment	3.59	0.55	Very High
2. Risk Assessment	3.45	0.59	Very High
3. Control Activities	3.55	0.56	Very High
4. Information and Communication Systems	3.45	0.62	Very High
5. Monitoring	3.49	0.58	Very High
<b>Overall</b>	<b>3.51</b>	<b>0.58</b>	<b>Very High</b>

The Seal of Good Local Governance Act of 2019, the Government Auditing Code of the Philippines, and Commission on Audit regulations all support this by institutionalizing uniform, compliance-driven internal control systems throughout LGUs (Public Expenditure and Financial Accountability or PEFA, 2022). The Control Environment obtained the highest mean score among the components, signifying that strong leadership integrity, accountability frameworks, duty awareness, feedback mechanisms, and audit responsiveness guide how to do the job. Monitoring, on the other hand, had the lowest mean, implying that while internal controls exist, the continuous review of transactions, follow-up of audit findings, and timely corrective actions may be more difficult to sustain due to practical constraints such as resource constraints, workload, and weak segregation of duties, all of which affect monitoring capacity (Talla et al., 2025; DBM, 2023). These findings confirm that internal controls in local governments are highly institutionalized and serve as structured governance mechanisms to ensure consistent, accountable, and reliable treasury performance.

### Perception of Local Treasury Performance

Table 2 shows a Very Good rating (M = 3.58) for local treasury performance due to the structured and regulated nature of financial management in LGUs.

**Table 2** Summary Result of Local Treasury Performance

Dimension	Mean	SD	Description
1. Revenue Generation and Collection Efficiency	3.51	0.56	Very Good
2. Disbursement Timeliness and Fund Management	3.56	0.55	Very Good
3. Compliance and Reporting	3.64	0.48	Very Good
4. Service Delivery to Stakeholders	3.57	0.51	Very Good
5. Internal Operational Efficiency	3.63	0.50	Very Good
<b>Overall</b>	<b>3.58</b>	<b>0.52</b>	<b>Very Good</b>

The Bureau of Local Government Finance Local Treasury Operations Manual (2019), which offers explicit guidelines on revenue collection, fund custody, and financial reporting, is a significant factor in the high rating as characterized by its established rules, standard procedures, and accountability frameworks. Compliance and Reporting had the highest mean among the dimensions because these tasks are strictly enforced, regularly reviewed, and directly subject to audit requirements. On the other hand, Revenue Generation and Collection Efficiency had the lowest mean, even though it was still very good. This is somehow more sensitive to operational and contextual issues like political interference and weak leadership support, which can lead to inconsistent enforcement of collection policies, informal considerations, and failure to follow up on delinquent accounts. This underscores the significance of leadership integrity and the "tone at the top" in facilitating effective financial management (COSO, 2013, as cited in Pkatey, 2024; Brown & Treviño, 2006, as cited in Bedi et al., 2024). The findings indicate that treasury systems are structurally strong and compliance-driven, yet performance may still differ based on local governance conditions.

### Perception of Ethical Climate

In Table 3, the overall ethical climate was rated Very Positive ( $M = 3.44$ ), indicating that they generally believe their offices have a strong culture of integrity, accountability, and sound decision-making. This positive assessment can be attributed to the nature of treasury functions in local governments, where employees are entrusted with public funds and are expected to maintain high ethical standards, as reinforced by the Republic Act No. 6713 or the Code of Conduct and Ethical Standards for Public Officials and Employees.

**Table 3** Summary Result of Ethical Climate

Dimension	Mean	SD	Description
1. Collective Moral Sensitivity	3.29	0.68	Very Positive
2. Collective Moral Judgment	3.44	0.56	Very Positive
3. Collective Moral Motivation	3.50	0.56	Very Positive
4. Collective Moral Character	3.55	0.52	Very Positive
<b>Overall</b>	<b>3.44</b>	<b>0.59</b>	<b>Very Positive</b>

Collective Moral Character had the highest mean of the dimensions, indicating that integrity, fairness, and a commitment to public trust are consistently practiced and embedded in daily activities. On the other hand, Collective Moral Sensitivity had the lowest mean, suggesting that people may not always recognize ethical issues early on. This dimension shows the ability to spot problems such as unusual transactions or bypassed steps (Arnaud, 2010, as cited in Loke et al., 2019). In routine settings, these problems may be less likely to be noticed because of normal practices or close working relationships, which can lead to "organizational moral disengagement" (Fida et al., 2025). In general, the results show that even though people have strong internalized ethical values, it is still important to raise ethical awareness and identify problems early to help treasury performance stay accountable.

### Significant Difference in Internal Control Effectiveness as influenced by Profile

**Table 4** Test of significant difference in internal control effectiveness when grouped based on profile

Profile	Category	Mean Rank	Test Statistic	p-value	Decision	Interpretation
Age	18-40 years old	57.18	-1.128	0.260	Do not reject $H_{01a}$	Not Significant
	41-65 years old	63.50				
Sex	Male	59.25	-0.304	0.761	Do not reject $H_{01b}$	Not Significant
	Female	61.08				
Years in Service	1-3 years	62.68	3.170	0.530	Do not reject $H_{01d}$	Not Significant
	4-9 years	55.66				
	10-19 years	67.89				
	20-29 years	63.03				
	30 years and above	67.17				

Table 4 shows no significant differences in internal control effectiveness by age, sex, or years of service ( $p > 0.05$ ), indicating consistent implementation across respondents. Young ones rely on strict adherence to procedures, whereas the "once young" use practical judgment; however, both achieve similar effectiveness because they work within the same structured system of standardized procedures, legal requirements, and accountability mechanisms that ensure consistent control implementation (Schneid et al., 2016). Quinal and Dupa (2024) discovered that sex does not affect workplace outcomes when roles and expectations are clearly defined. Similarly, male and female LGU employees adhere to the same procedures and accountability frameworks. Employees, whether newly hired or long-tenured, receive early training and continue to work within the same structured system of policies, procedures, and verification processes, resulting in consistent application of internal controls regardless of tenure (Gregorio, 2025; Ashbaugh-Skaife et al., 2007, cited in Hua et al., 2022).

The findings suggest that the effectiveness of internal controls in local governments is system-driven and consistent across all personnel.

### Significant Difference in Local Treasury Performance as influenced by Profile

Table 5 shows no significant differences in how well local treasuries do when they are grouped by age, sex, or years of service ( $p > 0.05$ ).

**Table 5** Test of significant difference in local treasury performance when grouped based on profile

Profile	Category	Mean Rank	Test Statistic	p-value	Decision	Interpretation
Age	18-40 years old	60.57	-0.025	0.980	Do not reject H02a	Not Significant
	41-65 years old	60.44				
Sex	Male	55.99	-1.141	0.254	Do not reject H02b	Not Significant
	Female	62.59				
Years in Service	1-3 years	65.41	2.972	0.562	Do not reject H02d	Not Significant
	4-9 years	56.72				
	10-19 years	70.32				
	20-29 years	60.44				
	30 years and above	60.43				

No significant differences in local treasury performance were found when personnel were grouped by age, sex, and years of service ( $p > 0.05$ ). Young ones depend on structured workflows and guidance, while the “once young” rely on familiarity and routine; however, both groups achieve similar outcomes due to the same system (Cotingjo et al., 2025). When it comes to sex, roles are based on professional duties and following rules, not on sex, because males and females follow the same procedures and performance standards (Enero et al., 2024). Ng and Feldman (2013, as cited in Castaño et al., 2024) say that tenure does not always affect performance in structured environments where they are required to follow the same workflows, documentation requirements, and accountability systems, regardless of years of service. The findings indicate that local treasury performance is driven by consistent execution of financial processes and adherence to compliance and established procedures, allowing for uniform results across personnel regardless of individual differences.

### Significant Influence of Internal Control Effectiveness on Local Treasury Performance

The simple linear regression reveals that internal control effectiveness significantly influences local treasury performance, explaining approximately 63.7% of its variance ( $R^2 = 0.637$ ), and the model is statistically significant ( $F = 206.832$ ,  $p < 0.001$ ), as shown in Table 6.

**Table 6** Model 1 Test on the Significant Influence of Internal Control Effectiveness on Local Treasury Performance

Predictor	Unstandardized Coefficients (B)	Standardized Coefficients ( $\beta$ )	t-value	p-value	Decision	Interpretation
(Constant)	1.006	-----	5.579	<0.001	----	-----
Internal Control Effectiveness	0.735	0.798	14.382	<0.001	Reject H <sub>03</sub>	Significant

**Model Summary:**

$R^2=0.637$ ;  $Adjusted R^2=0.634$ ;  $F\text{-value}=206.832$ ;  $p\text{-value} < 0.001$ ;  $Interpretation = Significant$

Improvements in internal control systems significantly enhance local treasury outcomes, as indicated by the strong positive standardized coefficient ( $\beta = 0.798$ ,  $p < 0.001$ ). This result is consistent with global evidence that strong internal controls enhance transparency and accountability (Raudhatinur et al., 2023; Ongonge, 2024), as well as organizational performance and financial discipline in public institutions (Priantono & Vidiyastutik,

2022; Gyimah et al., 2024; Razzouki, 2024). Given that audit observations in the Philippines often result from control failures, the findings highlight how crucial structured control mechanisms are for maintaining credible and efficient local treasury operations.

**Table 7** Model 2 Test on the Significant Influence of the Dimensions of Internal Control Effectiveness on Local Treasury Performance

Predictors	Unstandardized Coefficients (B)	Standardized Coefficients ( $\beta$ )	t-value	p-value	Interpretation
(Constant)	0.810	-----	4.627	<0.001	-----
Control Environment	0.377	0.437	5.405	<0.001	Significant
Risk Assessment	0.106	0.134	1.560	0.122	Not Significant
Control Activities	0.151	0.180	1.811	0.073	Not Significant
Information and Communication Systems	-0.139	-0.181	-1.813	0.073	Not Significant
Monitoring	0.286	0.379	4.678	<0.001	Significant

**Model Summary:**  
 $R^2=0.696$ ;  $Adjusted R^2=0.682$  ;  $F-value=52.101$ ;  $p-value <0.001$ ;  $Interpretation = Significant$

These results lend support to global frameworks for public financial management that highlight oversight mechanisms and governance foundations as key determinants of fiscal performance (PEFA, 2022). Strong control environments and effective monitoring are linked to better revenue management and financial accountability, consistent with research conducted in Tanzania and Uganda (Eton et al., 2022; Hyera et al., 2025). The findings provide empirical evidence that enhancing local treasury performance in local government units necessitates strong governance integrity and continuous oversight mechanisms.

**Moderating Effect of Ethical Climate on the Influence of Internal Control Effectiveness on Local Treasury Performance**

In Table 8, the moderation analysis demonstrates that both internal control effectiveness (ICE) and ethical climate (EC) are significant independent predictors of local treasury performance ( $p < 0.001$ ); however, their interaction is not significant ( $p = 0.702$ ), suggesting that ethical climate does not moderate the relationship.

**Table 8** Moderation Analysis of Ethical Climate in the Influence of Internal Control Effectiveness on Local Treasury Performance

Variables	B	SE	z	p-value	Decision	Interpretation
Constant	0.543	0.050	10.77	<0.001	---	---
Internal Control Effectiveness (ICE)	0.543	0.050	10.77	<0.001	---	Significant
Ethical Climate (EC)	0.287	0.049	5.856	<0.001	---	Significant
ICE x EC	0.041	0.107	0.382	0.702	---	Not significant
Interaction Effect				>0.05	Do not reject $H_{04}$	Not Significant

**Note:** Ethical climate is treated as a single composite moderating variable since it is not categorical.

The non-significant moderating effect suggests that ethical climate has no effect on the relationship between internal control effectiveness and local treasury performance, as internal controls consistently influence performance regardless of ethical variations. This implies that internal control systems in LGUs are institutionalized and compliance-driven, founded on government directives from the Commission on Audit (COA), Department of Budget and Management (DBM), and Bureau of Local Government Finance (BLGF), among others, and executed via standardized procedures, audit mandates, and regulatory supervision that guarantee consistent performance results. According to Agency Theory, formal control systems guide and align employee actions through monitoring and accountability mechanisms (Jensen & Meckling, 1976, as cited in

Zogning, 2017; Ceschi et al., 2017). Ethical climate affects how employees see and deal with ethical problems (Newman et al., 2017; Arnaud, 2010, as cited in Loke et al., 2019), which is in line with Ethical Climate Theory (Victor & Cullen, 1988, as cited in Loke et al., 2019). However, it does not alter (strengthen nor weaken) how internal controls work because they are formal, rule-based systems. In the context of local government units (LGUs), internal control (structural) and ethical climate (behavioral) function as independent yet parallel factors influencing performance. Stewardship Theory supports this idea by saying that employees can act in the best interest of the organization by sharing values (Davis et al., 1997, as cited in Madison et al., 2016). This means that ethical climate can directly improve performance without changing the role of internal controls (Davis et al., 1997, as cited in Schillemans & Bjurström, 2019). In general, the effectiveness of internal controls is a stable structural factor that affects performance, while the ethical climate is a separate, non-interactive predictor.

### Implementation Challenges of Internal Controls and Ethical Climate

As shown in Table 9, following Virginia Braun and Victoria Clarke (2006, 2024), a thematic analysis of ten key informant responses identified five major challenges: resource constraints, weak ethical leadership and political interference, weak segregation of duties and structural deficiencies, insufficient training and capacity development, and resistance to change.

**Table 9** Implementation Challenges of Effective Internal Controls & Ethical Climate

Theme	Description	Number of Responses
1. Resource Constraints	Lack of manpower, limited budget, and outdated systems	4
2. Weak Ethical Leadership & Political Interference	Tolerance of wrongdoing and political influence	4
3. Weak Segregation of Duties and Structural Deficiencies	Structural deficiencies and lack of Internal Audit Services (IAS)	4
4. Insufficient Training and Capacity Development	Lack of ethics training and professional development	4
5. Resistance to Change	Bureaucracy, innovation resistance	3

These themes, distinct from the preceding variable dimensions, were obtained from key informant interviews and reveal operational and contextual challenges not reflected in the survey's high ratings of internal control effectiveness and ethical climate. Earlier research shows that insufficient resources hinder control implementation (Talla et al., 2025), and unclear segregation of duties increases risk-taking (DBM, 2023). Furthermore, weak leadership and political interference undermine the "tone at the top" highlighted by COSO (2013, as cited in Pkatey, 2024) and ethical leadership (Brown & Treviño, 2006, as cited in Bedi et al., 2024). These findings show that practical and behavioral constraints continue to affect implementation, even with strong formal systems in place. This shows that LGUs need stronger leadership commitment, institutional support, and continuous capacity-building to maintain strong internal controls and ethical governance.

## CONCLUSION

This study investigated the influence of internal control effectiveness on local treasury performance and the moderating effect of ethical climate within local government units in Misamis Oriental. The findings indicate that internal control effectiveness is a strong and significant predictor of treasury performance, particularly through control environment and monitoring, emphasizing the importance of leadership integrity, accountability, and consistent oversight. Ethical climate has a direct positive effect on performance, but it does not alter the relationship. This means that internal controls function as stable, institutionalized governance mechanisms, regardless of ethical or demographic variations. However, qualitative findings reveal persistent challenges, including resource constraints, political interference, weak ethical leadership, weak segregation of duties, structural deficiencies, insufficient training and capacity development, and resistance to change, which may impede optimal implementation. Overall, the study suggests that improving local treasury performance necessitates not only strong internal control systems but also increased institutional support through ethical

oversight structures, feedback mechanisms, ongoing capacity development, and adaptive governance reforms to ensure long-term, accountable, and effective public financial management.

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