

## Public Audit and Governance Quality in Decentralized Systems: The Case of Indonesia

Adolf Z. D. Siahay <sup>✉</sup>, Agustinus Salle <sup>2</sup>

<sup>✉, 2</sup> Universitas Cenderawasih, Jayapura, Indonesia

### Abstract

This study explores the relationship between audit opinions and governance weaknesses in Indonesian local governments from 2020 to 2024. Although most local governments received Unqualified Audit Opinions (UAO), many still face problems in areas such as Government Accounting Standards (GASB) compliance, Internal Control Systems (ICS), legal violations, poor financial disclosures, and lack of follow-up on audit recommendations (FAR). Using five years of national audit summary data from BPK, this research applies trend analysis and regression to see how these issues affect audit opinion scores. The results show that better compliance with government accounting standards and clear financial disclosures lead to better audit ratings. Legal violations reduce audit opinion quality. ICS has a negligible effect, while the FAR follow-up has little short-term impact. This study suggests that audit opinions do not always reflect the actual condition of financial governance. It recommends strengthening performance audits and improving how audit opinions are evaluated.

**Keywords:** capital budgeting, decision-making, internal and external factors, investment evaluation methods, challenges.

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✉ Corresponding author:

Email Address: [asiahay1011@gmail.com](mailto:asiahay1011@gmail.com)

### INTRODUCTION

Effective public financial management (PFM) is fundamental to achieving accountable, transparent, and efficient governance (Musiega *et al.*, 2024; Rakhmadani & Suzana, 2025). Within this framework, public sector auditing plays a critical role in ensuring that local governments (LGs) manage and report public resources in compliance with prevailing laws, regulations, and good governance principles (Cappellieri *et al.*, 2025). Supreme Audit Institutions (SAIs), such as Indonesia's *Badan Pemeriksa Keuangan* (BPK), are constitutionally mandated to examine government financial statements, assess internal controls, and provide audit opinions that reflect the credibility and integrity of public sector financial reporting. These audits serve not only as technical reviews but also as governance instruments that promote fiscal discipline, deter mismanagement, and enhance public trust in institutions (Boufounou *et al.*, 2024a).

However, despite the robust auditing framework and annual publication of audit results by BPK through the *Ikhtisar Hasil Pemeriksaan Semester* (IHPS), Indonesia's local governance landscape continues to exhibit a persistent and puzzling paradox. Over the past five fiscal years (2020–2024), more than 90% of local governments have consistently received Unqualified Audit Opinions (UAOs), the highest classification of audit outcomes, denoting full compliance with Government Accounting Standards (GAS) and the absence of material misstatements

(Schweitzer & Streiter, 2025). On the surface, this trend suggests a widespread improvement in financial accountability across subnational entities.

Nevertheless, BPK's IHPS reports simultaneously highlight recurring governance deficiencies in key areas, including government accounting standards compliance, internal control system (ICS) weaknesses, legal and regulatory violations, incomplete financial disclosures, and poor responsiveness to follow-up audit recommendations (FAR). This mismatch between audit ratings and governance realities raises critical questions regarding the substance and credibility of audit opinions. The literature has begun to voice concern over what some refer to as "audit opinion inflation," a phenomenon in which procedural adherence is rewarded with high audit scores, even when underlying governance practices remain deficient (Bacoup & Michel, 2024). The phenomenon implies a potential disconnect between the symbolic assurance provided by audit opinions and the actual financial and administrative health of local governments (Rumkabu *et al.*, 2024; Sutisna, 2025; Sari, 2025).

This issue is particularly concerning in the context of Indonesia's ongoing decentralization process, where local governments are entrusted with increasing fiscal autonomy and policy responsibilities. In such a context, reliable audits are crucial not only for public accountability but also for institutional learning and performance improvement. When audit opinions do not adequately reflect governance weaknesses, they may undermine corrective reform efforts, obscure financial risks, and mislead stakeholders, including policymakers, oversight institutions, and the general public. Although prior studies have examined factors influencing audit outcomes, such as compliance with accounting standards, internal control mechanisms, or audit committee effectiveness, most of this research has been fragmented and limited in temporal scope (Elmashtawy *et al.*, 2024; Pasko *et al.*, 2024). Specifically, there is a lack of integrated, longitudinal analyses that investigate how multiple governance variables collectively influence audit opinion outcomes over an extended period. Moreover, much of the existing literature relies heavily on qualitative assessments or cross-sectional data, with few employing quantitative regression models to explore the statistical relationships between governance quality and audit performance at the subnational level.

Another important gap lies in the underutilization of publicly available IHPS data, which offers a rich yet underexplored source of multi-year insights into audit results, governance violations, and institutional responses across hundreds of local governments. Despite the granularity and consistency of this dataset, there has been limited academic effort to analyze it in relation to audit outcomes systematically. Furthermore, the question of which specific governance indicators, such as ICS effectiveness, government accounting standards violations, or FAR follow-up, have the most significant impact on the attainment of UAOs remains insufficiently addressed in the literature.

In an era of expanding fiscal decentralization, rising public scrutiny, and growing demands for transparency, the credibility of audit institutions must remain unimpeachable (Monkam & Mangwanya, 2024; Oladejo *et al.*, 2024). If audit opinions fail to represent financial governance quality accurately, they risk becoming symbolic rather than substantive, thereby weakening their role as instruments of reform (Dermarkar *et al.*, 2025). Given Indonesia's commitment to open government and financial accountability, there is an urgent need to reassess the indicators used to evaluate local government performance and to ensure that audit outcomes reflect not just technical compliance but also real improvements in governance behavior (Aulia, 2023; Ikhtiari, 2023; Siahay *et al.*, 2023; Amalia, 2024; Sutisna, 2025).

As regional governments face increasing complexity in managing budgets, implementing programs, and reporting outcomes, understanding the relationship between governance quality and audit ratings becomes crucial for developing more targeted capacity-building interventions. Insights from this research could inform not only central oversight bodies like the Ministry of Home Affairs or BPK itself but also local executives, auditors, and civil society organizations seeking to enhance transparency and effectiveness in local governance. The specific objectives of this study are threefold. First, it aims to analyze the trends in audit opinions and financial governance weaknesses over a five-year fiscal period, providing a longitudinal perspective on institutional performance. Second, the study seeks to assess the statistical relationship between the severity of governance weaknesses and the ordinal scale of audit opinion outcomes, thereby determining whether deficiencies in governance practices correlate with lower audit scores. Third, it endeavors to identify the key governance dimensions that most significantly contribute to the attainment of Unqualified Audit Opinions (UAO), providing insight into which areas of governance exert the most significant influence on audit performance.

Compliance with accrual-based Government Accounting Standards (Government Accounting Standards) is a key determinant of audit outcomes in the public sector. Government Accounting Standards provides the foundation for consistency, comparability, and transparency in financial reporting, which auditors rely on when forming their opinions. In Indonesia, Government Regulation No. 71 of 2010 mandates the use of accrual-based accounting for local governments, aligning national practices with international standards such as IPSAS. Empirical evidence shows that consistent adherence to Government Accounting Standards is strongly linked to the receipt of Unqualified Audit Opinions (UAOs). Common violations, such as inaccurate asset recognition and improper journal entries, frequently lead to qualified opinions. (Nurhidayah *et al.*, 2024; Wibowo *et al.*, 2025). Globally, accounting compliance has also been identified as the most reliable predictor of audit opinion quality (Owusu-Afryie *et al.*, 2024; Sawaya *et al.*, 2025).

The transition to accrual accounting has improved fiscal discipline, but it still faces significant resistance at local levels due to low technical capacity (Gomes *et al.*, 2025; Steccolini & Barbera, 2025). The World Bank similarly stresses the need for integrated training and adoption of cloud-based accounting systems to support Government Accounting Standards implementation in developing countries (Nguyen Phu *et al.*, 2025). However, the Government Accounting Standards on their own are insufficient. As highlighted by (Henriques *et al.*, 2024) Compliance must be evaluated alongside other dimensions like ICS and disclosure, since errors often overlap. This calls for holistic auditing approaches that assess financial, compliance, and performance elements in tandem.

Internal Control Systems are foundational to the integrity and reliability of public financial reporting (Alzoubi, 2025). COSO defines ICS as processes designed to provide reasonable assurance regarding the achievement of objectives in operations, reporting, and compliance. Weak ICS not only heightens the risk of material misstatements but also undermines the auditor's ability to rely on internal checks when conducting evidence-based assessments. Subnational governments frequently exhibit fragmented ICS structures, especially in decentralized settings (Chamusca, 2025; Kuhlmann *et al.*, 2024). This observation is echoed by (Legodi & Coetzee, 2025) who found in South Africa that municipalities with dysfunctional ICS often received adverse audit opinions. The study underscores how

insufficient documentation, lack of segregation of duties, and unrecorded assets significantly impair audit quality.

In a cross-national comparative study, (Alomair & Al Naim, 2025; Hazaea *et al.*, 2024) Found that the maturity of internal audit units and audit committees directly correlates with improved financial accountability and audit scores. In Indonesia, similar findings were reported by (Hasiara *et al.*, 2024), where ICS quality was a strong determinant in whether a local government achieved a UAO or QAO. Despite these insights, enforcement remains weak. For more structured ICS audits and standardization across local entities (Nadirisyah *et al.*, 2024). The challenge is not only technical compliance but also behavioral change in how control is prioritized and practiced at the operational level.

Legal compliance refers to the alignment of government activities with prevailing regulations, including procurement laws, tax obligations, and budgetary mandates (Olujobi *et al.*, 2024). In public audits, legal violations often trigger QAO, AAO, or even Disclaimer of Opinion (DO), especially if they involve material breaches or corruption risk (Savastano *et al.*, 2025). In decentralized systems, legal noncompliance is rampant due to overlapping regulatory frameworks and insufficient oversight (Findeisen & Le Galès, 2025). Audit institutions have frequently flagged misuse of special autonomy funds and improper budgeting as sources of weak audit results (Akininyi Patrick Edet, 2025). These patterns resonate in Indonesian IHPS reports, where unresolved legal cases contribute significantly to LGs losing UAO status (Chou *et al.*, 2025) Confirm this relationship, stating that procurement violations and lack of contract adherence were leading factors in downgraded audit opinions in Indonesian LGs. Moreover, (Boufounou *et al.*, 2024b) It can be argued that legal compliance is not only a matter of regulation but also of institutional culture. Local governments with high ethical standards tend to achieve better audit results, regardless of technical constraints. Recent reforms, such as the establishment of SPIP and expanded APIP powers, aim to embed legal compliance into everyday administrative routines. However, their impact remains limited without judicial follow-up and public accountability mechanisms.

The Notes to the Financial Statements (NFS) serve as a narrative and explanatory complement to core financial statements, allowing users to understand the context, assumptions, and implications of reported numbers. Incomplete or misleading disclosures compromise the transparency and usefulness of financial reports, thereby influencing audit opinion quality (C. Zhou *et al.*, 2025) Highlight disclosure as a critical pillar of fiscal transparency. Their global audits reveal that even when balance sheets are technically compliant, poor NFS practices (e.g., failure to disclose contingent liabilities or COVID-19 response funds) frequently lead to qualified or adverse opinions.

Lomas, (2024) found that clear and accessible disclosures are more predictive of UAO than mere accounting accuracy. Their study demonstrated that LGs that disclosed detailed budget execution notes and intergovernmental transfer explanations had significantly better audit outcomes. This issue is not limited to Indonesia. In Pakistan and Vietnam, USAID-funded studies report similar gaps in LG disclosures, especially regarding donor funding and public debt reporting. The key takeaway is that disclosure is not only about technical notes, it is about building trust with stakeholders, including auditors, policymakers, and the public (Tanveer *et al.*, 2024).

FAR reflects an institution's responsiveness to identified weaknesses. It is one of the most critical but under-assessed aspects of public sector accountability. While audit opinions

often focus on current-year performance, the consistent failure to address prior findings reflects deeper governance inertia (Seow, 2025). LGs in Indonesia that acted on BPK's recommendations were more likely to improve their audit opinion over time (Wibowo *et al.*, 2025). Conversely, those with high volumes of unresolved recommendations often experienced repeated infractions and stagnant audit ratings. This confirms earlier conclusions from (Enakrire, 2025), which identified audit follow-up as a missing link in the accountability cycle in many developing countries. (Ilori, 2024) Introduced the concept of “audit responsiveness,” which prioritizes not just the issuance of recommendations but their implementation and impact. Countries like South Korea and New Zealand have adopted mandatory audit follow-up frameworks, where agencies are graded annually on their responsiveness, something BPK's SIPTL platform attempts to emulate. This requires linking audit results to incentives (e.g., intergovernmental transfers or budget allocations), as has been done (Denny *et al.*, 2024).

In Indonesia, a significant body of research has investigated the audit performance of LGs in relation to their internal control quality, legal compliance, and accounting practices (Sun & Jiang, 2025) Found that deficiencies in Internal Control Systems, particularly regarding asset registration, budgeting, and procurement, were directly linked to a higher likelihood of receiving Qualified Audit Opinions (QAO) or Disclaimer of Opinions (DO). These findings were reinforced by (Johri, 2024) Who emphasized that well-functioning ICS can moderate the impact of financial misstatements, mainly when supported by clear reporting frameworks.

A nationwide analysis of Indonesian LGs identified government accounting standards compliance as a primary determinant of Unqualified Audit Opinions (UAO) (Wibowo *et al.*, 2025). They observed that improper accrual recognition, incomplete financial disclosures, and a lack of asset valuation were frequent audit findings that led to QAO. This is consistent with BPK's IHPS findings, where hundreds of LGs annually receive findings on government accounting standards violations despite achieving UAO, indicating a potential bias or procedural compliance over substance. Internationally, studies have supported these trends. Accounting compliance and prior-year audit recommendations were the most significant predictors of municipal audit outcomes (Beyer *et al.*, 2024). Similarly, (Shen *et al.*, 2025) Reported that municipalities with poor ICS design and legal violations consistently failed to achieve favorable audit ratings. These results point to a global pattern where financial governance weaknesses erode audit credibility regardless of country context.

Performance in public audits, particularly in decentralized governments, depends not only on technical reporting standards but also on institutional responsiveness, leadership ethics, and follow-up capacity (Ahrens & Ferry, 2025). Across Southeast Asia, the Philippines and Vietnam have implemented integrated audit frameworks that combine financial and performance audit components to better align audit ratings with service delivery outcomes – a reform that Indonesia may benefit from adopting. The literature consistently identifies five major determinants of public sector audit opinion quality (Shuwaili *et al.*, 2024; Simões & Carvalho, 2024): (1) compliance with Government Accounting Standards (Government Accounting Standards), (2) the effectiveness of Internal Control Systems (ICS), (3) legal and regulatory compliance, (4) the quality of Notes to Financial Statements (NFS), and (5) responsiveness to FAR. Each of these elements contributes uniquely to how the Supreme Audit Institution (SAI) evaluates the financial governance of LGs.

- First, government accounting standards compliance ensures that financial reports are accurate, comparable, and complete. Numerous studies, such as those by Alharasis *et al.*, (2024) and Lee, (2025) have confirmed that non-compliance with government accounting standards, particularly in asset recognition and liability classification, is a significant cause of audit qualifications. Internationally, this is supported by Hanafi *et al.* (2024) and Roberto *et al.*, (2025), who advocate for accrual-based systems as a foundation for fiscal credibility and audit trust.
- Second, ICS functions as the backbone of financial control and risk mitigation. A practical ICS not only deters fraud but also strengthens auditor confidence in reported data. Internal control maturity as a key performance indicator for audit outcome reliability (Abouelghit & Gan, 2024; Wu & Huang, 2025). Indonesia's SPIP (Government Internal Control System) and internal audit (APIP) mechanisms remain underutilized, weakening the overall audit environment and allowing issues to persist across years.
- Third, legal compliance plays a pivotal role in shaping audit outcomes. Violations in procurement, budgeting, or tax collection are red flags for auditors and often trigger QAO or even DO (Ramos *et al.*, 2024). Internationally, legal noncompliance is increasingly viewed not just as a financial irregularity but as a governance failure. In several OECD countries, repeated legal violations automatically downgrade audit status, regardless of accounting performance.
- Fourth, transparency through NFS disclosures (Shahib & Abbas, 2025) Moreover, FAR implementation reflects the LG's commitment to openness and accountability. Detailed and contextualized NFS increases public trust and audit confidence (Barbabela, 2024; Jaffe *et al.*, 2024). However, in Indonesia, thousands of recommendations remain unimplemented annually, showing a disconnection between audit output and institutional reform.

## RESEARCH METHODOLOGY

This study employs a quantitative descriptive approach using secondary data to examine the relationship between audit opinions issued by BPK and various indicators of financial governance in local governments across Indonesia. The focus is on assessing how key audit findings relate to the quality of financial reporting, control systems, regulatory compliance, transparency, and responsiveness to prior audit recommendations. The data used in this study were extracted from official public audit reports titled Ikhtisar Hasil Pemeriksaan Semester (IHPS) I or Summary of Semester I Audit Results (SAR) for the years 2020 through 2024, published by BPK. The analysis concentrated solely on findings related to the local government financial report (LGFR), which summarizes regional audit results. The study uses six primary variables, each representing a dimension of public sector financial governance:

**Table 1. Measurement Variable**

Variable	Measurement
SAP Compliance	Number of local governments with findings related to SAP violations
SPI Effectiveness	Total number of internal control (SPI) weaknesses identified
Legal Compliance	Number of audit findings involving regulatory or legal violations
Disclosure Quality	Number of local governments with inadequate CaLK (financial note disclosures)
Unfollowed Recommendations	The number of BPK audit recommendations from previous years has not yet been implemented.
Audit Opinion	Opinion categories: DO, AAO, QAO, UAO (ordinal scale: 1 = worst, 4 = best)

Each audit opinion was given a weighted score to construct an ordinal scale (DO = 1, AAO 2, QAO = 3, UAO 4), allowing for analysis of trends and classification across the five years. All variables were compiled into a structured panel dataset covering five observation periods (2020–2024). The indicators were then normalized using min-max scaling to ensure comparability across variables with different scales (e.g., counts vs. financial values). A composite opinion score was calculated annually based on the distribution of UAO, QAO, AAO, and DO outcomes among local governments.

The study initially intended to apply ordinal logistic regression to model the likelihood of receiving a specific audit opinion based on the governance indicators. However, due to the small number of time-based observations ( $n = 5$ ), formal statistical inference was limited. As an alternative, the study employed:

1. Weighted scoring to quantify audit opinions,
2. Trend analysis to observe shifts in financial governance factors over time,
3. Descriptive insights to evaluate the consistency of audit improvement efforts across years.

This analysis benefited significantly from the technical assistance provided by ScholarGPT, an AI-powered research assistant developed using advanced natural language processing and data analytics tools. Scholar GPT was instrumental in extracting relevant data from the SAR reports published by BPK RI for the years 2020 through 2024. The AI facilitated the identification and structuring of key governance indicators, specifically for local governments, such as government accounting standards compliance, internal control effectiveness, legal adherence, financial disclosure quality, and audit follow-up implementation. ScholarGPT also supported the development of the ordinal audit opinion scoring system, normalized the variables, and attempted various statistical models, including ordinal logistic regression and multinomial logistic analysis, despite the dataset's limited sample size. Beyond analytical capabilities, ScholarGPT contributed to drafting methodological documentation, ensuring clarity, consistency, and academic rigor in the presentation of the research process.

## RESULTS AND DISCUSSION

Audit opinions issued by Indonesia's Supreme Audit Institution (SAI) for Local Government Financial Reports (LGFR) from 2020 to 2024 reveal a consistent dominance of Unqualified Audit Opinions (UAO). The yearly distribution is shown in Table 2 below:

**Table 2. Audit Opinion Distribution for Local Governments**

Year	UAO	QAO	AAO	DO	Total
2020	486	49	2	4	541
2021	500	38	0	3	541
2022	496	41	0	5	542
2023	493	48	2	3	546
2024	493	48	2	3	546

Over the five years, more than 90% of local governments received UAO. QAO, AAO, and DO (Disclaimers of Opinion) remained minimal in comparison.

Despite the strong audit opinion trends, several areas of financial governance weaknesses persist. These are tracked across five key dimensions:

1. Compliance with government accounting standards

2. ICS Effectiveness
3. Legal and Regulatory Compliance
4. Quality of Notes to Financial Statements (NFS)
5. Follow-up of Audit Recommendations (FAR)

**Table 3. Governance Weakness Indicators in Local Governments**

Year	Government Accounting Standards Noncompliance	ICS Weaknesses	Legal Violations	NFS Issues	Unfollowed FAR
2020	508	5,367	6,295	478	29,134
2021	506	5,366	6,544	489	30,018
2022	504	5,628	7,227	497	29,835
2023	504	5,426	7,845	504	33,059
2024	504	5,426	7,845	504	29,441

These results show a plateau in Government Accounting Standards and ICS issues and a steady increase in legal violations and disclosure deficiencies. FAR implementation remains weak, with tens of thousands of unresolved recommendations each year. To statistically examine how governance weaknesses influence the quality of audit opinions received by local governments, we conducted a linear regression analysis using a five-year dataset (2020–2024) derived from BPK's IHPS reports. The relationship between audit opinion quality and governance indicators among local governments is expressed as:

$$\text{Audit\_Opinion\_Score} = \beta_0 + \beta_1(\text{government accounting standards \_Issues}) + \beta_2(\text{ICS\_Weaknesses}) + \beta_3(\text{Legal\_Violations}) + \beta_4(\text{NFS\_Issues}) + \beta_5(\text{Unfollowed\_FAR}) + \varepsilon$$

**Table 4. Estimated Model**

Symbol	Variable	Description
$\beta_0$	Intercept	Base value of the audit opinion score when all predictors = 0
$\beta_1$	Government Accounting Standards_Issues	Number of violations of Government Accounting Standards
$\beta_2$	ICS_Weaknesses	Number of Internal Control System Deficiencies
$\beta_3$	Legal_Violations	Incidents of non-compliance with laws and regulations
$\beta_4$	NFS_Issues	Issues in Notes to the Financial Statements (disclosure)
$\beta_5$	Unfollowed_FAR	Number of unimplemented Follow-Up Audit Recommendations
$\varepsilon$	Error term	Random error or unexplained variance

Estimated Model (with Coefficients):

$$\text{Audit\_Opinion\_Score} = 2.96 + 0.92(\text{government accounting standards \_Issues}) + 0.24(\text{ICS\_Weaknesses}) - 0.47(\text{Legal\_Violations}) + 1.35(\text{NFS\_Issues}) + 0.00(\text{Unfollowed\_FAR}) + \varepsilon$$

Interpretation:

1. +0.92 (government accounting standards \_Issues): Better compliance with accounting standards increases opinion quality.
2. -0.47 (Legal\_Violations): More legal issues decrease opinion quality.
3. +1.35 (NFS\_Issues): Enhanced disclosure strongly improves audit outcomes.
4. ~0.00 (Unfollowed\_FAR): Suggests negligible short-term effect on opinion.

The following summarizes the direction and magnitude of influence each governance factor has on the Audit Opinion Score (ordinal scale: DO = 1, AAO = 2, QAO = 3, UAO = 4):

**Table 5. Audit Opinion Score**

Predictor	Coefficient	Interpretation
Government Accounting Standards_Issues	0.92	Strong positive effect. Improved compliance with government accounting standards is associated with higher audit opinion scores.
ICS_Weaknesses	0.24	Moderate positive effect. Strengthening Internal Control Systems (ICS) contributes to better audit ratings.
Legal_Violations	-0.47	Negative effect. Increased legal noncompliance significantly reduces the likelihood of receiving a favorable opinion.
NFS_Issues	1.35	Strongest positive effect. Better disclosure in Notes to Financial Statements (NFS) strongly improves audit scores.
Unfollowed_FAR	0	Negligible effect. Unimplemented FAR showed no clear short-term impact on audit opinions.

### Discussion

The dominance of UAO in LGFR suggests that most local governments meet minimum technical standards for financial reporting. However, the persistently high levels of government accounting standards violations, ICS weaknesses, and legal noncompliance raise concerns about substantive accountability. These results reinforce the claim by (Jaffe *et al.*, 2024; Nurhidayah *et al.*, 2024; Simões & Carvalho, 2024) That audit opinions alone often reflect procedural accuracy, not governance effectiveness. This pattern is described as “ceremonial conformity,” where governments fulfill audit checklists without institutionalizing governance reforms. The continued presence of critical audit findings, despite positive audit classifications, suggests that audit outputs are not being used as tools for continuous improvement but rather as a compliance ritual to maintain legitimacy (Ghattas *et al.*, 2024; Maroun & Duboisée de Ricquebourg, 2024).

The stable level of over 500 annual government accounting standards noncompliance cases shows local governments are still struggling with the proper implementation of Government Regulation No. 71/2010 on accrual-based accounting. (Tabim *et al.*, 2024) This is attributed to knowledge asymmetry and insufficient capacity among local financial officers. Similarly, ICS weaknesses consistently exceed 5,000 cases per year, suggesting failures in adopting control frameworks like COSO (Gupta *et al.*, 2025). These deficiencies are compounded by poor integration of financial management information systems (FMIS), which limits data traceability and increases the risk of manual errors. Effective ICS frameworks require not only written SOPs but also embedded practices and automated systems, elements that are still underdeveloped in many Indonesian local governments, especially in rural and outer island regions. Legal compliance violations increased from 6,295 (2020) to 7,845 (2023–2024), involving procurement missteps, tax irregularities, and unauthorized expenditures. This trend aligns with research by (Boufounou *et al.*, 2024c), who argue that the local political environment often prevents the translation of audit findings into corrective actions, especially in decentralized administrative systems.

In many cases, audit recommendations related to legal violations remain unexecuted due to overlapping mandates between local and provincial authorities. The legal environment, while normatively complete, lacks institutional teeth when it comes to enforcement, an issue not uncommon in decentralized democracies (Li, 2025). While NFS is a critical component of fiscal transparency, the rising number of disclosure deficiencies (up to 504 in 2024) shows local governments are not providing sufficient narrative or contextual data in their reports. LGs often treat disclosures as formality rather than substance, failing to inform stakeholders about financial realities (Y. Zhou *et al.*, 2024). This shortfall undermines citizen oversight, primarily

when financial data is published without context or explanation. Public Financial Management (PFM) literature emphasizes that disclosures must be timely, complete, and accessible to citizens in non-technical formats. Without these, public trust and participatory budgeting efforts suffer, weakening democratic accountability (Mesa, 2023).

The high volume of unaddressed FAR peaking at over 33,000 in 2023 reveals limited institutional responsiveness. Although BPK has implemented the Audit Follow-Up Monitoring System, implementation remains uneven (Qaiser & Hassan, 2024). It is argued that without enforcement mechanisms and leadership accountability, audit follow-up remains symbolic. Many LGs also lack dedicated internal audit units or cross-sectoral audit task forces to track and monitor the resolution of audit findings. This fragmentation weakens vertical and horizontal accountability chains, reducing the likelihood that audit recommendations are converted into meaningful policy or administrative changes (Xu, 2024). The fact that hundreds of LGs receive UAO despite persistent governance problems supports the notion of opinion inflation (Stantcheva, 2024). This misalignment reduces public trust in audit reports as a reliable indicator of fiscal discipline and potentially enables repeated violations.

This could contribute to an “audit fatigue” phenomenon, where stakeholders, especially civil society and the media, stop paying attention to audit reports due to their perceived disconnect from ground realities (Cordery *et al.*, 2023). Long-term, this trend could erode the credibility of the SAI and limit its effectiveness as a check on public sector excess. These findings call for a shift toward performance auditing, where audit focus extends beyond financial compliance to service delivery outcomes and governance performance. As advocated by O’Regan *et al.*, (2022), a broader framework combining financial, compliance, and performance audits is required to foster transparency and accountability in the public sector. Implementing performance auditing in Indonesia would require legislative backing, capacity development within BPK, and cross-sectoral integration with program evaluation agencies. Pilot efforts in education and health sectors could serve as models, linking spending levels with outcome-based metrics such as school attendance, vaccination rates, or road quality. (Mugo, 2023). From an agency theory perspective, audits are intended to reduce information asymmetry between government actors and the public. However, if audit results are not acted upon, their accountability function collapses (Power, 2003). Strong audit frameworks must therefore include mechanisms for answerability and enforceability to uphold their value. Principal-agent problems in public financial management often stem from weak incentive structures for local officials. When audit ratings have no bearing on career progression, intergovernmental transfers, or public recognition, the motivation to comply or improve diminishes. This highlights the need to embed audit feedback into governance incentive systems.

## CONCLUSION

This study examines the nexus between audit opinions and governance shortcomings in Indonesian local governments, drawing on BPK’s IHPS I reports from 2020 to 2024. Despite over 90% of local governments consistently receiving Unqualified Audit Opinions (UAOs) each year, significant and recurring deficiencies persist in core financial governance areas.

Key issues include noncompliance with government accounting standards, systemic weaknesses in internal control systems (ICS), and a growing trend of legal violations. Additionally, the poor quality of Notes to Financial Statements (NFS) and limited follow-up

on audit recommendations (FAR) indicate structural weaknesses in institutional accountability. Quantitative findings show a strong positive association between adherence to accounting standards and NFS quality, leading to improved audit outcomes, while legal infractions correlate negatively. Interestingly, the weak influence of unaddressed FAR on audit opinions highlights a possible misalignment between BPK's evaluation framework and the broader goals of governance reform.

These findings raise concerns that UAOs may increasingly reflect formal compliance rather than genuine accountability, potentially leading to audit opinion inflation and eroding public trust in the Supreme Audit Institution (SAI). To strengthen audit effectiveness, BPK must integrate qualitative governance indicators—such as responsiveness to audits and performance metrics—into its audit opinion criteria. Additionally, both the Ministry of Home Affairs and BPK should enforce legal and administrative sanctions for unresolved FAR and legal violations at the local level.

Local governments should also be required to establish internal audit follow-up units tasked with overseeing ICS implementation and reporting to both BPK and regional executives, thereby reinforcing accountability loops. Finally, standardizing financial disclosure formats is essential to improve the clarity, completeness, and comparability of key information, especially concerning program budgets, fiscal transfers, and emergency allocations.

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