Analysis of Relationship between Effectiveness of Internal Control System and Audit Opinions on Local Government Financial Statements

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Abstract: *This study aims to analyze and to describe the relationship between the effectiveness of the internal control system (ICS) and the audit opinion of the Audit Board (the AB) of the Republic of Indonesia on Local Government Financial Statements (LGFS). In addition, this study also aims to explain the consideration of ICS effectiveness in formulating audit opinion. This study uses an explanatory sequential mixed method. This study uses a different approach than previous research by considering materiality factors in assessing ICS's effectiveness. The sample of this study is fifty-four AB Audit Reports on LGFS in Indonesia. Analytical tools used include content analysis, correlation analysis, mean difference tests, and textual data analysis. Content analysis is performed on fifty-four ICS Audit Reports year 2017, correlation analysis utilizes Somer's d and Kendall's tau c, and mean difference test analysis uses Kruskal Wallis. Meanwhile, textual data analysis is carried out on interviews with nine auditors from three AB representative offices in Java. This study shows that ICS's effectiveness has a strong and positive relationship with an audit opinion on LGFS. In addition, the average score of ICS effectiveness is different for each group of LGFS audit opinions. This fact shows that AB has considered ICS effectiveness in formulating audit opinions. The interview results show that the relationship between the effectiveness of ICS and audit opinion is indirect. The AB considers the effectiveness of ICS in the phase of determining audit planning materiality rate and in the phase of analyzing the impact of ICS findings on the fairness of LGFS. This result implies that the government should revise audit regulations by removing ICS effectiveness as one factor that must be considered in the formulation of audit opinion because ICS effectiveness and audit opinion are not directly related..*

Keywords: *Internal Control System, Local Government, Audit Opinion, Financial Statements*

Abstrak: *Penelitian ini bertujuan untuk menganalisis dan mendeskripsikan hubungan antara efektivitas sistem pengendalian internal (SPI) dan opini audit Badan Pemeriksa Keuangan Republik Indonesia (BPK RI) terhadap Laporan Keuangan Pemerintah Daerah (LKPD). Selain itu, penelitian ini juga bertujuan untuk menjelaskan pertimbangan efektivitas SPI dalam proses merumuskan opini audit. Penelitian ini menggunakan metode campuran sekuensial penjelasan. Penelitian ini menggunakan pendekatan yang berbeda dibandingkan dengan penelitian sebelumnya dengan*

mempertimbangkan faktor materialitas dalam menilai efektivitas SPI. Sampel penelitian ini adalah lima puluh empat laporan hasil pemeriksaan atas laporan keuangan pemerintah daerah di Indonesia. Alat analitik yang digunakan meliputi analisis isi, analisis korelasi, uji perbedaan rata-rata, dan analisis data tekstual. Analisis isi dilakukan pada lima puluh empat Laporan Pemeriksaan SPI tahun 2017, analisis korelasi menggunakan Somer's d dan Kendall's tau c, dan analisis uji beda rata-rata menggunakan Kruskal Wallis. Sementara itu, analisis data tekstual dilakukan pada hasil wawancara dengan sembilan auditor dari tiga kantor perwakilan BPK di Jawa. Hasil penelitian ini menunjukkan bahwa efektivitas SPI memiliki hubungan yang kuat dan positif dengan opini audit. Selain itu, skor rata-rata efektivitas SPI berbeda untuk setiap kelompok opini audit. Fakta ini menunjukkan bahwa BPK telah mempertimbangkan efektivitas SPI dalam merumuskan opini audit. Hasil wawancara menunjukkan bahwa pola hubungan antara efektivitas ICS dan opini audit adalah tidak langsung. BPK mempertimbangkan efektivitas SPI dalam fase penentuan tingkat materialitas perencanaan audit dan dalam tahap menganalisis dampak temuan SPI pada kewajaran LKPD. Implikasi dari hasil penelitian ini adalah bahwa pemerintah sebaiknya merevisi regulasi pemeriksaan keuangan dengan menghilangkan efektivitas SPI sebagai salah satu faktor yang harus dipertimbangkan dalam perumusan opini audit karena efektivitas SPI dan opini audit tidak berhubungan langsung.

Kata Kunci: *Sistem Pengendalian Internal, Pemerintah Daerah, Opini Audit, Laporan Keuangan*

1. Introduction

To support the realization of good governance in the state administration, state finance must be managed professionally, openly, and responsibly. To achieve this, state finance must be managed by paying attention to general principles such as results-oriented accountability, professionalism, proportionality, openness, and financial audit by free and independent examining bodies.

State finances audit includes examining the management of state finances and responsibility of state finances. The constitution mandates the task to the Audit Board of the Republic of Indonesia (the AB of RI) (Republik Indonesia, 1945). To carry out the constitutional duties, the AB of RI is given authorities to conduct three types of audits: financial audit, performance audit, and audit with specific objectives (Republik Indonesia, 2004).

A financial audit is an audit of government financial statements. This audit is intended to provide an opinion statement about the fairness of the information presented in the government's financial statements (Republik Indonesia, 2004). There are four types of opinions that can be given on government financial statements, namely Unqualified Opinion, Qualified Opinion, Adverse Opinion, and Disclaimer Opinion (Badan Pemeriksa Keuangan, 2014).

The audit opinion is the auditor's professional statement regarding the fairness of financial information presented in financial statements based on these criteria: (1) conformity with government accounting standards, (2) adequacy of disclosures, (3) compliance with laws and regulations, and (4) effectiveness of the ICS (Republik Indonesia, 2004). The four criteria are accumulative so that they must be considered entirely in the formulation of opinions, including ICS's effectiveness. Therefore, the auditor must carry out testing and evaluate the implementation of government ICS when doing a financial audit (the Republic of Indonesia, 2004). In addition, the 2017 State Financial Audit Standards also requires the AB of RI to prepare three types of audit report, namely (1) Audit Report for Financial Statements, (2) Audit Report for ICS, and (3) Audit Report for Compliance with Laws and Regulations.

Based on the description above, it can be concluded that ICS's effectiveness is one of the essential criteria in formulating audit opinion. The more effective the internal control system, the better the audit opinion of the financial statements obtained. The reliability of financial statements is a function of internal control effectiveness (Li et al., 2012). In the context of financial reporting, effective ICS can prevent or detect and correct material misstatements on time (Ikatan Akuntan Publik Indonesia, 2013) because ICS is intended to provide sufficient confidence in the achievement of organizational goals through effective and efficient activities, reliability of financial reporting, the security of state assets, and compliance with laws and regulations (the Republic of Indonesia, 2008). Conversely, an ineffective ICS may result in incomplete accounting records and/or inadequate available documents and/or the system does not produce valid accounting data.

Previous researchers have analyzed the relationship between ICS and audit opinion of local government financial statements (LGFS). They state that number of audit findings on ICS has a significant effect on the audit opinion of LGFS (Kusumawati and Ratmono, 2017; Widodo and Sudarno, 2017; Munawar, 2016; Fatimah et al., 2014). An increasing number of weaknesses in the ICS also contributed to a decline in an audit opinion of LGFS (Kawedar, 2010). Those results are supported by Ningsih (2016) study, which states that the most frequent factor that causes qualifications of accounts of LGFS is the ICS weakness.

However, different results are concluded by Safitri and Darsono (2015). Using the Audit Report of LGFS 2010-2012 in Java, they conclude that the ICS's weakness does not significantly influence the AB's audit opinion. Suwanda (2015) also states that the implementation of ICS does not significantly influence the quality of LGFS.

Based on previous research, it can be seen that there are still differences in conclusions regarding the relationship between the effectiveness of ICS and audit opinions on LGFS. Some studies (see Kusumawati and Ratmono, 2017; Widodo and Sudarno, 2017; Munawar 2016; Fatimah et al. 2014, Kawedar 2010, Ningsih, 2016) state that ICS effectiveness has a significant effect on audit opinion of LGFS and other studies (see Safitri and Darsono, 2016; Suwanda 2015) state otherwise. Those studies mentioned above only use several internal control findings as a proxy for ICS weakness and ignore the concept of audit materiality. In fact, in determining audit opinion, the auditor considers the state financial audit standards, level of conformity, adequacy of financial statement disclosures associated with determining materiality level, entity's response to results of the audit, and the representation letter (Badan Pemeriksa Keuangan, 2014). Therefore, this study aims to confirm the relationship between ICS and audit opinion on LGFS by improving the ICS effectiveness assessment method. In addition, this study also analyzes how ICS's effectiveness is considered in the formulation of the audit opinion. This study shows that the effectiveness of ICS has a strong and positive relationship with an audit opinion on LGFS. Besides, this study concludes that ICS affects audit opinion indirectly by determining the rate of planning materiality of financial statements.

This study contributes by improving the measurement of ICS effectiveness by considering the number of ICS findings and considering the materiality of the amount of the findings. This is because the materiality of the ICS findings amount is one of the variables considered in the formulation of the audit opinion. Another contribution of this study is to provide a framework of argumentation about the relationship between ICS and audit opinion that has been difficult to find in previous studies. In practical terms, this study's results contribute to the AB in terms of policy-making in the formulation of the audit opinion, particularly the consideration of the effectiveness of ICS in the formulation of the audit opinion.

2. Literature Review and Hypothesis Development

2.1 Internal Control System (ICS)

The Internal Control System is an integral process for actions and activities carried out continuously by the leaders and all employees to provide adequate assurance of organizational goals through effective and efficient activities, reliability of financial reporting, safeguarding state assets, and compliance with laws and regulations. ICS consists of the control environment, risk assessment, control activities, information and communication, and internal control monitoring (Republik Indonesia, 2008).

Auditors of the AB must obtain an adequate understanding of the internal control system relevant both in terms of time and substance to the audit or material nature of the subject matter (Republik Indonesia, 2017a). In financial audits, relevant controls may relate to financial reporting, but not all financial reporting controls are relevant to audits (Ikatan Akuntan Publik Indonesia, 2013). In various literature such as Statement on Auditing Standards (SAS) 130 (American Institute of Certified Public Accountant 2015) and Auditing Standard 5 (Public Company Accounting Oversight Board, 2007), this internal control is known as internal control over financial reporting (ICFR). ICFR is an ICS specifically designed to provide adequate assurance that the financial statements produced are reliable, reported, and prepared following government accounting standards.

2.2 Effectiveness of ICS

Republic Indonesia (2017b) divides ICS's effectiveness on financial reporting into three-level, namely effective, effective with exceptions, and contains material weaknesses. ICS is effective if there are no significant deficiencies and material weaknesses. ICS is effective with exceptions if there are significant deficiencies that do not result in material weakness if combined. Meanwhile, ICS contains material weaknesses if there are one or more material weaknesses, or there is a combination of significant deficiencies that result in material weaknesses.

For research purposes, referring to Republic Indonesia (2017b), ICS containing material weaknesses is further classified into three-level, namely ICS with (1) contains material weaknesses and are not pervasive, i.e., if existing material weaknesses do not have a broad impact on financial statements; (2) contains material and pervasive weaknesses, i.e., if existing material weaknesses have a broad impact on financial statements; and (3) contains material, pervasive, and limiting weaknesses, i.e., if there are restrictions on the scope of the audit and possible effects on financial statements are material and pervasive.

2.3. Audit Opinion on LGFS

There are four types of opinions that can be given on government financial statements, namely Unqualified Opinion, Qualified Opinion, Adverse Opinion, and Disclaimer Opinion (Badan Pemeriksa Keuangan, 2014). Based on ISSAI 4706 in the LGFS Guidelines 2016, there is an additional form of communication in the auditor's report in the form of an Emphasis on Matter Paragraphs and the Other Matter Paragraphs. The emphasis of Matter Paragraphs is included in the auditor's report if the auditor has obtained sufficient and appropriate audit evidence that there is no material misstatement of the matter in the financial statements. According to Practice Note ISSAI 1706, one example of the relevant conditions to be included in the Emphasis of Matter Paragraphs is a significant internal control deficiency. Thus, local governments whose LGFSs are fairly presented following Government Accounting Standards but have significant ICS deficiency findings can be given Unqualified Opinion with Emphasis on Matter Paragraphs.

2.4. Relationship between Effectiveness ICS and Audit Opinion

Various regulations and references regarding auditing do not explicitly explain the relationship between the effectiveness of ICS and the audit opinion on LGFS. What is always explained explicitly is the relationship between the effectiveness of ICS and the audit strategy. However, this study provides arguments about the relationship between the effectiveness of ICS and audit opinion on LGFS.

According to the Republic of Indonesia (2008), the purpose of ICS is to provide adequate confidence in achieving organizational goals through effective and efficient activities, reliability of financial reporting, safeguarding state assets, and compliance with laws and regulations. Thus, in the context of financial reporting, effective ICS is ICS, which, either individually or together with other controls, can prevent or detect and correct material misstatements promptly (Ikatan Akuntan Publik Indonesia, 2013). An ineffective ICS may result in incomplete accounting records and/or inadequate available documents and/or the system does not produce valid accounting data. These three conditions are conditions that do not allow the auditor to carry out an adequate audit procedure, which may result in the auditor giving a "qualified opinion" due to scope limitations (if material but not pervasive) or "disclaimer opinion" (if material and pervasive) (BPK 2016). The relationship between ICS effectiveness and audit opinion is evident in the provision of an audit opinion on government financial statements, which states that the formulation of an audit opinion is carried out by considering, among other things, the reliability of ICS.

If ICS's effectiveness is at the level of "effective" or "effective with the exception", management declares that the financial statements have been prepared based on adequate ICS. In ICS with an "effective with exception" level, management will state that their ICS is adequate because there are no material weaknesses found. However, if ICS's effectiveness is at the level of "containing material weaknesses", management cannot declare that their ICS is adequate (Republik Indonesia, 2017b). Based on the description, the possible relationship between the level of effectiveness of ICS and audit opinion on LGFS is as follows.

Table 1.
Possible Relationship between ICS Level and Audit Opinion

No.	ICS Effectiveness Level	Possible Audit Opinions
1	Effective	Unqualified Opinion
2	Effective with Exceptions	Unqualified Opinion with a Paragraph Emphasis on a Matter
3	Contains Material Weakness, Not Pervasive	Qualified Opinion
4	Contains Material Weaknesses and Pervasive	Adverse Opinion
5	Contains Material Weaknesses, Pervasive and Scope Restrictions	Disclaimer Opinion

Table 1 shows that the worse the ICS condition, the worse the audit opinion on LGFS is. This is because effective ICS will minimize the possibility of misstatements in the financial statements. Based on this explanation, we propose an alternative hypothesis as follows.

Ha: There is a significant and positive relationship between the effectiveness of ICS and the audit opinion on LGFS.

3 Research Method

This study used an explanatory sequential mixed method. With this method, authors first conduct quantitative research, analyzed the results, and then arrange the results to explain them in more detail with qualitative research (Creswell, 2016).

This study is carried out through three stages. Firstly, the authors assess the level of ICS effectiveness by analyzing and assessing the level of the weakness of ICS findings in the AB Audit Reports based on five criteria stipulated in Minister of Finance Regulation No. 14/PMK.09/2017. Secondly, the authors use correlation analysis to assess the relationship between ICS and LGFS opinion's effectiveness. A mean difference test analysis strengthens correlation analysis. Thirdly, the authors interview to determine how the auditors undertake the process of understanding ICS and ICS testing and how auditors consider ICS in the formulation of audit opinion on LGFS.

3.1 Population and Samples

The population of this study is 542 AB Audit Reports on LGFS, according to the number of local governments in Indonesia. The sample chosen is fifty-four AB Audit Reports on LGFS consisting of eighteen reports with Unqualified Opinion, eighteen reports with Qualified Opinion, and eighteen reports with Disclaimer Opinion. The selection of eighteen samples per type of audit opinion is carried out because the smallest number of multiples of the three types of audit opinion is eighteen, namely LGFS, with a disclaimer opinion. Based on the 2018 Semester I Audit Results Summary Report, no LGFS received an adverse opinion.

3.2 Data and Data Collection Technique

This study uses both primary and secondary data. The secondary data is the LGFS containing in the AB report for the fiscal year 2017. This data is collected directly from the AB. The primary data is interview data collected by in-depth interviews with nine auditors with roles as Team Leader, Technical Controller, or Responsible Agency for the AB Representatives in Jawa Tengah Province, the AB Representatives in Jawa Timur Province, and the AB Representatives in Daerah Istimewa Yogyakarta Province. Interviews are conducted in a semi-structured manner using interview questions.

3.3 Operational Definition of Variables

The variables in this study are the effectiveness of ICS and audit opinions on LGFS. The ICS effectiveness variables are categorized into an ordinal scale, namely effective = 1, effective with exceptions = 2, containing material weaknesses, not pervasive = 3, containing material and pervasive weaknesses = 4, and containing material weaknesses and scope restrictions = 5. Effectiveness internal control is obtained from analyzing the level of internal control deficiencies reported to the AB Audit Report on the internal control system.

The audit opinion on LGFS variables are also categorized in the form of an ordinal scale and sorted according to the order of opinion quality from the best to the worst (Badan Pemeriksa Keuangan, 2014), namely unqualified opinion = 1, unqualified opinion with paragraphs emphasizing a matter = 2, qualified opinion = 3, adverse opinion = 4, and disclaimer opinion = 5.

3.4 Data Analysis Technique

This study's analytical tools include content analysis, correlation analysis, mean difference tests, and textual data analysis. The effectiveness of internal control is measured by scoring techniques based on the ICS effectiveness criteria for financial reporting, as stipulated in Minister of Finance Regulation No. 14/PMK.09/2017. The relationship between the effectiveness of ICS and opinion is measured by using Somer's d correlation analysis and Kendall's tau c. Mean different tests are carried out using Kruskal Wallis. Meanwhile, to explain how ICS's effectiveness is considered in the formulation of audit opinions is obtained from textual data analysis of interview results with AB Auditors.

In more detail, content analysis is carried out in the following stages: (1) understanding and reviewing the AB Audit Report for ICS, (2) analyzing the level of ICS weakness by considering factors F1 to F5, (3) preparing a working paper evaluating the findings of the ICS in the following format.

Table 2.
Working Paper of ICS Findings Assessment

No	Description of Findings	Consideration Factors					Average	Level of Findings
		F1	F2	F3	F4	F5		
1								
2								
...								
n								

Details of considering factors "F1" to "F5" are "F1" is indicating fraud, "F2" is the level of subjective judgment and complexity in determining account values, "F3" is possible deficiencies repeatedly occur, "F4" is the size of the account balance includes the magnitude of the finding value relative to the account balance. The affected transactions and the assertions of the financial statements involved, and "F5" is ICS entity level findings that significantly affect the financial statements.

A column of "F1" up to "F5" is filled with number "1" if it is low, "2" if it is medium, and "3" if it is high. Factors of "F1" to "F5" have a similar weight rating.

Column "Level of Findings" is filled with "inconsequential" if the value in the "Average" column is 1.0 to 1.5; "significant deficiency" if the value in the "Average" column is > 1.5 to 2.5; and "material weakness" if the value in the "Average" column is > 2.5 to 3.0.

The conclusion of the effectiveness of ICS as a whole is categorized as "ICS is effective" if there are no significant deficiencies and material weaknesses; "ICS is effective with exceptions" if there is one or more significant deficiencies which, when combined, do not result in material weaknesses; "ICS contains material weaknesses and is not pervasive" if there are one or more material weaknesses or there is a combination of significant deficiencies that result in material weaknesses but are not pervasive; "ICS contains material weaknesses and pervasive" if there are one or more material weaknesses or there is a combination of significant deficiencies that result in material weaknesses and are pervasive to the entire financial statement; and "ICS contains material weaknesses, pervasive, and scope limitations" if there are one or more material weaknesses or there is a combination of significant deficiencies that result in material weaknesses are pervasive and there are limitations scope so the auditor cannot obtain sufficient and adequate evidence.

4 Results and Discussion

4.1 Level of Findings of ICS Weaknesses

There are a total of 419 ICS weaknesses findings from fifty-four Audit Reports. Results of the analysis of those ICS findings show that 67.30% of the findings are at the level of significant deficiency, and 25.06% of the findings are at the level of material weakness. Meanwhile, only 7.64% of the findings are at the inconsequential level.

If detailed by type of audit opinion, material weakness findings are increasing directly proportional to the worsening audit opinion on LGFS. The proportion of each level of ICS weakness findings per type of opinion can be seen in Table 3.

An increase in the proportion of material weakness findings that are in line with the decline in the quality of audit opinions indicates that the ICS's effectiveness is considered in the formulation of audit opinion on LGFS. This is because the worse the

ICS's condition (marked by an increase in material weakness findings), the worse the audit opinion will be.

Table 3.

The proportion of Level of Findings of ICS Weaknesses per LGFS Audit Opinion

No	Audit Opinion	Inconsequential	Significant Deficiency	Material Weakness
1	Unqualified	11,96%	86,92%	1,12%
2	Qualified	6,63%	70,45%	22,92%
3	Disclaimer	3,52%	50,88%	45,60%

Details of the level of the weakness of ICS per local government can be seen in appendix1.

4.2 Level of ICS Effectiveness

Results show that no local government has an effective ICS. There are a significant portion of local governments (20 out of 54) that has ICS with levels containing material weaknesses but not pervasive. The details of the effectiveness of ICS per opinion can be seen in Table 4.

Table 4.

Level of ICS Effectiveness per LGFS Audit Opinion

No	Opinion	Effective with Exceptions	Contains Material Weakness, Not Pervasive	Contains Material Weakness, Pervasive, Scope Limitation	Total
1	Unqualified	16	2	-	18
2	Qualified	-	18	-	18
3	Disclaimer	-	-	18	18
	Total	16	20	18	54

Details of the effectiveness of ICS per local government can be seen in Appendix 2. Table 4 above shows that all local governments with Qualified and Disclaimer Opinions have ICS at the level of "containing material weaknesses but not pervasive" and "containing material weaknesses, pervasive, and scope restrictions". This situation is as expected. However, the unexpected result is that there are two local governments with unqualified opinions but still have ICS containing material weaknesses. Although

the amount is only small (2 of 16 or about 12.5%), from the point of view of the compliance presentation framework, this condition shows the potential of incorrect opinion on the financial statements. This condition indicates that the auditors may not consider ICS's effectiveness in the formulation of the audit opinion, as stated in the auditing standards for state finances.

However, when viewed from the lens of the fairness presentation framework, ICS containing material weaknesses does not necessarily result in a material misstatement of financial statements. In the two cases above, the auditors have likely modified their audit strategies following the existing ICS effectiveness conditions and conclude that there were no material misstatements found in the two LGFSs.

4.3 Relationship between Effectiveness of ICS and Audit Opinion

For statistical analysis, the level of ICS effectiveness and LGFS audit opinions are transformed into an ordinal scale, as explained in section 3.3. Operational Definition of Variables above.

Next, Somer's d and Kendall's tau c correlation analyzes are performed to analyze the correlation between ICS effectiveness and audit opinion. Kendall's tau c and Somer's d are used because the research variables are from the same object, and there are lots of data with the same rank. The results of the correlation analysis can be seen in Table 5 and Table 6.

Table 5.
Somer's d Test Results

Description	Value	Asymptotic Standardized Error	Approximate T	Approximate Significance
Symmetric	0,965	0,024	37,470	0,000
ICS Effectiveness_ Dependent	0,963	0,026	37,470	0,000
Opinion_Dependent	0,967	0,023	37,470	0,000

Table 6.
Kendall's tau c Test Results

Value	Asymptotic Standardized Error	Approximate T	Approximate Significance
0,963	0,026	37,470	0

The Somer’s d test results for the conclusion are the correlation values with audit opinion variables as dependent variables. The significance value of Somer’s d and Kendall’s tau c is smaller than 5% so that the measurement results are statistically significant. That is, the effectiveness of ICS and audit opinion is significantly correlated.

The two measurements' correlation coefficient values (0.967 for Somer's d and 0.963 for Kendall's tau c) show a robust correlation between the two variables. The effectiveness of ICS and audit opinion correlates significantly and positively. This means that the more effective an ICS, the better the audit opinion.

To strengthen the correlation analysis, the two variables are tested again using the Kruskal Wallis test. The initial step of testing is performed by changing both variables' ordinal scale into an interval scale. The changing scale is carried out using the "method of successive interval (MSI)" technique. Kruskal Wallis test results can be seen in Table 7.

Table 7.
Kruskal Wallis Test Results

	Opinion	N	Mean Rank
ICS	1,00	18	10,50
	2,00	18	26,50
	3,00	18	45,50
	Total	54	
Asymp. Sig.			0,000

The significance of the Kruskal Wallis test results above is less than 5%. Therefore, it can be concluded confidently that there are differences in the mean values of ICS effectiveness for each audit opinion group.

The correlation analysis results and mean difference tests above show a significant and positive relationship between ICS effectiveness and LGFS audit opinion. These indicate that the effectiveness of ICS has been considered in the formulation of audit opinions. Thus, the alternative hypothesis proposed in this study is accepted. The results of this study confirm previous studies which state that ICS effectiveness has a significant effect on audit opinion of LGFS (see Kusumawati and Ratmono, 2017; Widodo and Sudarno, 2017; Munawar 2016; Fatimah et al. 2014, Kawedar 2010,

Ningsih, 2016). This study also proves that the compliance presentation framework applies to the formulation of audit opinions on local government financial reports. The effectiveness of ICS, which has been conceptualized to determine the audit strategy in auditing business organizations, is considered to formulate audit opinions in local government organizations. This shows that giving an audit opinion on the LGFS considers the presence or absence of material misstatements in the financial statements and considers the appropriateness of carrying out organizational activities. This fact demonstrates that the audit of government organizations is different from the audit of business organizations.

4.4 The Consideration of ICS Effectiveness in Formulating Audit Opinion

How is the effectiveness of ICS considered in the formulation of opinion? These problems were answered by conducting interviews with nine auditors at the AB Representative at Jawa Tengah Province, the AB Representative at Jawa Timur Province, and the AB Representative at Daerah Istimewa Yogyakarta Province. The three representatives were chosen to consider ease of access and lower research costs compared to sampling at other representatives without disrupting the quality of the study.

The interview results show that auditors conclude the effectiveness of the ICS from the COSO questionnaire At the time of the preliminary audit. This conclusion is used as one criterion in determining the audit planning materiality (PM) rate. PM rate is a measure of materiality that will be used to assess whether a misstatement in the LGFS affects audit opinion or not. The PM rate is then multiplied by the total expenditure to obtain the PM value. The conclusion is obtained based on the following interview excerpt.

"Yes. For the LGFS examination, the percentage of materiality level used to determine PM based on entity-level risk consists of 6 elements, **one of which is the effectiveness of ICS.**"

³. The COSO questionnaire is a series of questions to answer the fulfillment of five components of internal control within the government.

On the other hand, ICS's findings are quantified to a nominal impact on financial statements' fairness. The impact of these findings can be in the form of misstatements or scope restrictions. Then, the impact of the ICS's weaknesses is compared with the PM values previously obtained to determine opinions on LGFS. If the impact is not material (less than 50% of PM), the opinion is an Unqualified Opinion. If the impact is material but not pervasive, the opinion is Qualified Opinion. Whereas if the impact is material and pervasive, adverse or disclaimer's opinion depends on whether or not limitations to the scope therein.

Interview results indicate that the ICS's effectiveness is not used directly in the formulation of audit opinions. Auditors use ICS's effectiveness as one of the components determining the rate of planning materiality (PM) and the determinants of substantive inspection strategies to ascertain whether misstatements caused by ICS weaknesses occur. PM is a measure of materiality that will be used to assess whether a misstatement in the LGFS affects the audit opinion or not. The more effective the ICS, the higher the PM value so that the financial statements' materiality limit will increase. On the other hand, the determination of the audit opinion on LGFS is carried out based on the accumulated analysis of the value of the findings relating to ICS compared to the financial statements' materiality value. With the increase in the materiality limit of financial statements (i.e., effective ICS and high PM), the probability of getting an unqualified opinion will increase. Thus, the relationship between the effectiveness of ICS and audit opinions on LGFS is indirect. Among the interview excerpts showing this are as follows.

"Cannot be connected directly because it is a device for determining PM, then when the opinion was included there ... When there was a finding of its value ... eee ... the quantitative was there, or the impact could be calculated ... if it was above half a PM then it will definitely hit ... **If half a PM hit means the ICS already counted there.** How much PM is it? That's the formula from the ICS. So there are findings above half a PM that means it's already severe ... "

5. Conclusion, Limitation, and Implication

5.1 Conclusion

Correlation analysis results show that ICS's effectiveness and audit opinion on LGFS have a strong and positive relationship. In addition, the analysis of mean difference tests also showed that the average value of the effectiveness of ICS is different for each level of LGFS audit opinion. This means that the ICS conditions for local governments with Unqualified Opinions will differ from the ICS condition of local governments with Qualified Opinions, Adverse, or Disclaimer Opinions. These two facts show that ICS's effectiveness correlates with LGFS audit opinion and has been considered by the AB in the audit opinion formulation process.

The interview results explained that the pattern of the relationship between ICS effectiveness and audit opinion is indirect. The effectiveness of ICS is considered when determining audit planning materiality (PM) and when quantifying the impact of ICS weaknesses on the fairness of financial statements.

5.2 Limitation and Implication

This study has several limitations. First, this study only used fifty-four Audit Reports and three AB representative offices as research samples based on purposive sampling. Therefore, the results of this study cannot be generalized to other AB representative offices. Second, this study does not analyze audit working paper documents to describe the process of understanding and testing the ICS so that the triangulation of techniques cannot be done to validate the results of interviews. Third, this study does not include intervening variables in measuring the correlation between ICS effectiveness and audit opinion on LGFS

The indirect relationship between ICS effectiveness and audit opinion shows that ICS should not be one of the criteria in formulating audit opinion. Conclusions about the level of ICS effectiveness are used to determine audit strategy, not the audit opinion. Therefore the government should revise regulations, such as the State Financial Audit Act and State Financial Audit Standards, which state that ICS is one factor that must be considered in the formulation of the audit opinion.

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Appendix 1

The Level of Weakness of Internal Control System per Local Government

No	Local Government	Audit Opinion	Inconsequential	Significant Deficiency	Material Weakness	Number of Findings
1	Kota Gorontalo	Unqualified	1	11	1	13
2	Kabupaten Banggai Laut	Unqualified	0	7	0	7
3	Kota Semarang	Unqualified	3	5	0	8
4	Kabupaten Ogan Komering Ulu	Unqualified	2	5	1	8
5	Kota Tangerang Selatan	Unqualified	2	5	0	7
6	Kabupaten Mamasa	Unqualified	0	4	0	4
7	Kabupaten Kapuas	Unqualified	0	2	0	2
8	Kabupaten Pelalawan	Unqualified	0	6	0	6
9	Kabupaten Bangka Tengah	Unqualified	2	5	0	7
10	Kabupaten Asahan	Unqualified	2	6	0	8
11	Kota Yogyakarta	Unqualified	0	6	0	6
12	Kabupaten Lombok Barat	Unqualified	0	4	0	4
13	Kabupaten Berau	Unqualified	0	4	0	4
14	Kabupaten Lamandau	Unqualified	0	4	0	4
15	Kabupaten Kepulauan Meranti	Unqualified	1	2	0	3
16	Kabupaten Aceh Besar	Unqualified	1	6	0	7
17	Kota Surabaya	Unqualified	2	11	0	13
18	Kota Bogor	Unqualified	0	4	0	4
Number of Findings for Unqualified Opinion			16	97	2	115
19	Kota Bandung	Qualified	1	8	1	10
20	Kabupaten Tolitoli	Qualified	0	5	2	7
21	Kabupaten Bangka Selatan	Qualified	1	2	3	6
22	Kota Medan	Qualified	0	4	3	7
23	Kabupaten Langkat	Qualified	0	4	1	5
24	Kabupaten Katingan	Qualified	1	8	1	10

No	Local Government	Audit Opinion	Inconsequential	Significant Deficiency	Material Weakness	Number of Findings
25	Kota Tarakan	Qualified	0	5	2	7
26	Kabupaten Belu	Qualified	3	3	1	7
27	Kabupaten Sampang	Qualified	0	7	0	7
28	Kabupaten Pegunungan Arfak	Qualified	0	7	2	9
29	Kabupaten Mahakam Ulu	Qualified	0	7	3	10
30	Kabupaten Yalimo	Qualified	0	8	3	11
31	Kota Bengkulu	Qualified	0	6	1	7
32	Kabupaten Sambas	Qualified	0	2	1	3
33	Kabupaten Halmahera Tengah	Qualified	0	4	2	6
34	Kota Padangsidimpuan	Qualified	1	6	1	8
35	Kabupaten Maluku Barat Daya	Qualified	0	5	2	7
36	Kabupaten Lampung Timur	Qualified	3	7	1	11
Number of Findings for Qualified Opinion			10	98	30	138
37	Kabupaten Nias Selatan	Disclaimer	0	2	6	8
38	Kabupaten Boven Digoel	Disclaimer	1	1	4	6
39	Kabupaten Puncak	Disclaimer	0	4	3	7
40	Kabupaten Waropen	Disclaimer	0	7	6	13
41	Kabupaten Mamberamo Raya	Disclaimer	0	3	6	9
42	Kabupaten Tolikara	Disclaimer	0	1	6	7
43	Kabupaten Biak Numfor	Disclaimer	1	6	5	12
44	Kabupaten Simalungun	Disclaimer	0	8	3	11
45	Kabupaten Sarimi	Disclaimer	0	4	4	8
46	Kabupaten Mappi	Disclaimer	0	4	2	6
47	Kabupaten Nias Barat	Disclaimer	1	7	3	11
48	Kabupaten Bolaang Mongondow	Disclaimer	0	5	2	7
49	Kabupaten Morowali Utara	Disclaimer	1	7	3	11

No	Local Government	Audit Opinion	Inconsequential	Significant Deficiency	Material Weakness	Number of Findings
50	Kabupaten Buru Selatan	Disclaimer	0	4	4	8
51	Kabupaten Kepulauan Aru	Disclaimer	0	6	4	10
52	Kabupaten Seram Bagian Barat	Disclaimer	1	7	5	13
53	Kabupaten Mamberamo Tengah	Disclaimer	0	7	4	11
54	Kabupaten Dogiyai	Disclaimer	1	4	3	8
Number of Findings for Disclaimer Opinion			6	87	73	166
TOTAL FINDINGS			32	282	105	419

Appendix 2

The Effectiveness of Internal Control System per Local Government

No	Local Government	Effectiveness of Internal Control System	Audit Opinion
1	Kota Gorontalo	Contains Material Weakness, Not Pervasive	Unqualified
2	Kabupaten Banggai Laut	Effective with Exceptions	Unqualified
3	Kota Semarang	Effective with Exceptions	Unqualified
4	Kabupaten Ogan Komering Ulu	Contains Material Weakness, Not Pervasive	Unqualified
5	Kota Tangerang Selatan	Effective with Exceptions	Unqualified
6	Kabupaten Mamasa	Effective with Exceptions	Unqualified
7	Kabupaten Kapuas	Effective with Exceptions	Unqualified
8	Kabupaten Pelalawan	Effective with Exceptions	Unqualified
9	Kabupaten Bangka Tengah	Effective with Exceptions	Unqualified
10	Kabupaten Asahan	Effective with Exceptions	Unqualified
11	Kota Yogyakarta	Effective with Exceptions	Unqualified
12	Kabupaten Lombok Barat	Effective with Exceptions	Unqualified
13	Kabupaten Berau	Effective with Exceptions	Unqualified
14	Kabupaten Lamandau	Effective with Exceptions	Unqualified
15	Kabupaten Kepulauan Meranti	Effective with Exceptions	Unqualified
16	Kabupaten Aceh Besar	Effective with Exceptions	Unqualified

No	Local Government	Effectiveness of Internal Control System	Audit Opinion
17	Kota Surabaya	Effective with Exceptions	Unqualified
18	Kota Bogor	Effective with Exceptions	Unqualified
19	Kota Bandung	Contains Material Weakness, Not Pervasive	Qualified
20	Kabupaten Tolitoli	Contains Material Weakness, Not Pervasive	Qualified
21	Kabupaten Bangka Selatan	Contains Material Weakness, Not Pervasive	Qualified
22	Kota Medan	Contains Material Weakness, Not Pervasive	Qualified
23	Kabupaten Langkat	Contains Material Weakness, Not Pervasive	Qualified
24	Kabupaten Katingan	Contains Material Weakness, Not Pervasive	Qualified
25	Kota Tarakan	Contains Material Weakness, Not Pervasive	Qualified
26	Kabupaten Belu	Contains Material Weakness, Not Pervasive	Qualified
27	Kabupaten Sampang	Contains Material Weakness, Not Pervasive	Qualified
28	Kabupaten Pegunungan Arfak	Contains Material Weakness, Not Pervasive	Qualified
29	Kabupaten Mahakam Ulu	Contains Material Weakness, Not Pervasive	Qualified
30	Kabupaten Yalimo	Contains Material Weakness, Not Pervasive	Qualified
31	Kota Bengkulu	Contains Material Weakness, Not Pervasive	Qualified
32	Kabupaten Sambas	Contains Material Weakness, Not Pervasive	Qualified
33	Kabupaten Halmahera Tengah	Contains Material Weakness, Not Pervasive	Qualified
34	Kota Padangsidimpuan	Contains Material Weakness, Not Pervasive	Qualified
35	Kabupaten Maluku Barat Daya	Contains Material Weakness, Not Pervasive	Qualified
36	Kabupaten Lampung Timur	Contains Material Weakness, Not Pervasive	Qualified
37	Kabupaten Nias Selatan	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
38	Kabupaten Boven Digoel	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
39	Kabupaten Puncak	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer

No	Local Government	Effectiveness of Internal Control System	Audit Opinion
40	Kabupaten Waropen	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
41	Kabupaten Mamberamo Raya	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
42	Kabupaten Tolikara	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
43	Kabupaten Biak Numfor	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
44	Kabupaten Simalungun	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
45	Kabupaten Sarmi	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
46	Kabupaten Mappi	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
47	Kabupaten Nias Barat	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
48	Kabupaten Bolaang Mongondow	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
49	Kabupaten Morowali Utara	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
50	Kabupaten Buru Selatan	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
51	Kabupaten Kepulauan Aru	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
52	Kabupaten Seram Bagian Barat	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
53	Kabupaten Mamberamo Tengah	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer
54	Kabupaten Dogiyai	Contains Material Weakness, Pervasive, Scope Limitation	Disclaimer