

Analysis of the Implementation of Internal Controls Based on the Coso Framework (Study on MSMEs in North SULAWESI)

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Abstract

This research aims to analyze the implementation of internal control in MSMEs using the COSO framework. Based on the COSO concept, internal control provides adequate assurance regarding the achievement of organizational goals in operations, reporting and compliance aspects. Research was conducted on fifteen MSMEs that produce furniture in North Sulawesi. The research method uses qualitative methods. Data collection was carried out through interviews with MSME owners and observation of company documents. Data analysis uses

three aspects of COSO's internal control objectives, namely operations, reporting, and compliance. Data analysis stages include data reduction, data presentation, and drawing conclusions. The research results show that the internal control implemented by MSMEs in North Sulawesi, especially in the furniture production sector, is inadequate because there are still many weaknesses, especially in the aspects of financial management, reporting, and compliance with tax regulations. This has an impact on not achieving the reporting and compliance objectives of MSMEs. In order to achieve this goal, MSMEs can use financial recording applications to manage their finances so that the weaknesses in internal control can be overcome. The author's motivation for conducting this research is to provide awareness. With this research, it is hoped that MSME business owner will be able to apply good internal control principles and help MSME business owner to implement appropriate and ideal internal controls for furniture production businesses compared to MSMEs which are managed without knowledge of the foundations of the internal control system. The contribution of this research can not only be used for MSMEs in the field of furniture production, but also for other MSMEs that are facing problems in business management, inability to manage risk and safeguarding assets. In the end, there will be a difference between MSMEs that are aware and implement good internal controls and MSMEs that do not implement internal controls. MSMEs that have implemented effective internal controls will be able to withstand business competition and be able to maintain business continuity.

Keywords: *Internal Control, Operations Objectives, Reporting Objectives, Compliance Objectives*

Introduction

The MSME sector is a sector that plays a very important role in encouraging economic growth and recovery in Indonesia. The role of MSMEs in national growth includes absorbing labor, equalizing income, developing the rural economy, increasing non-oil and gas exports, and increasing Gross Domestic Product (GDP). The characteristics of MSMEs are also very unique, where their number dominates the structure of the Indonesian economy and continues to increase every year. The contribution of MSMEs is recorded to reach around 61% of national GDP and absorbs 97% of the total workforce. In every crisis period, MSMEs even become buffers, are resilient, and can recover well.

The government continues to strive to develop every business of MSME actors. The government's development efforts for MSMEs cover various aspects including financial literacy. Research by Rumbianingrum & Wijayangka (2018) regarding the influence of financial literacy on the management of MSMEs shows that financial literacy has a 32.4% influence on financial management. The level of education, receipt of financial information, and age of MSMEs are causes of low financial literacy among MSME actors. Financial literacy is knowledge, skills and beliefs, which influence attitudes and behavior to improve the quality of decision making and financial management in order to achieve prosperity. According to Xu & Xia (2012), financial literacy is awareness and knowledge about financial products, financial institutions, and concepts regarding skills in managing finances. Financial management has a very significant role in determining the level of success of MSMEs.

One element in managing company finances is recording existing financial transactions through an accounting system. The accounting system consists of transaction evidence documents, recording tools, reports and procedures used by the entity to record transactions, report results and internal controls (Mulyadi, 2018). The existence of an accounting system will help companies coordinate and monitor their operational activities

and make it easier for companies to prepare financial reports and tax reporting (Korompis et al., 2023).

Nowadays there are still many MSMEs that do not keep financial records and prepare financial reports (Risnarningsih & Tanuwidjaja, 2015; Risnarningsih & Suhendri, 2015; Mandey et al., 2018; Rohendi, 2019; Uno et al., 2019; Simanjuntak et al., 2020; Mubiroh & Ruscitasari, 2019; Risal & Wulandari, 2021; Rumambi et al., 2021; Rumambi et al., 2022) so that the accounting system in MSMEs is still weak. Problems related to transaction systems, controlling transaction data, financial recording and preparing financial reports and tax reporting show that MSMEs do not yet have an adequate, efficient and effective accounting system. MSME development strategies include improving the business processes of MSME actors through financial literacy programs (Arianto, 2020). This program requires better financial management of MSMEs, such as recording, controlling and reporting accounting information. For this reason, the accounting system is built from a network of procedures that connect various parts involved in the company's operational activities, relate to each other and work together harmoniously to achieve one particular goal.

In order for the system to run effectively and efficiently, an internal control system is needed to ensure that the existing accounting system can operate properly. According to Mulyadi (2016), the internal control system includes organizational structure, methods and procedures that are mutually coordinated to maintain organizational assets, check the accuracy and reliability of accounting data, encourage efficiency, and encourage compliance with management policies. Juita's research (2022) emphasizes the importance of paying attention to the internal control system as an integral part of empowerment programs oriented towards strengthening the competitiveness of MSMEs. Umrani & Johl (2016) found that 50% of MSMEs in Malaysia experienced bankruptcy due to misuse of company assets, misuse of company funds, reporting errors and illegal investments. These factors are factors that are managed in internal control.

Weaknesses in implementing the internal control system affect the effectiveness and efficiency of implementing MSME activities. Research by Enow & Kamala (2016) found that many MSMEs have not implemented internal controls properly. In fact, the implementation of good internal control has a big influence on the financial management of MSMEs.

When MSMEs only carry out simple accounting records, this will affect the quality of the accounting information produced. Likewise, the process of checking raw materials which is only implemented when receiving an order shows that there is no adequate control system over raw materials which can have an impact on delays in the production process and completion of orders from customers. In this context, internal control is not only related to the financial reporting process but is also related to the efforts of company management to exercise good control over the implementation of its business activities. COSO (2013) states that all parties in an entity/organization influence internal control, and that internal control provides adequate confidence regarding the achievement of organizational goals in operational, reporting and compliance aspects. The COSO concept is used as a strategy to improve entity management and the quality of financial reports.

Therefore, to support the sustainability of MSME businesses through the implementation of an accounting system, this research aims to analyze the implementation of MSME internal control in the furniture production sector by using aspects of operational objectives, reporting objectives and compliance objectives from the COSO framework as an analytical tool. Wirawan et al (2021) research on culinary MSMEs was carried out to analyze the implementation of internal control objectives related to the effectiveness and efficiency

of operations in MSMEs, financial reporting in MSMEs and compliance with MSME regulations. Several previous studies used control environment components, risk assessment, control activities, information and communication and monitoring activities as analytical tools (Bahar & Ginting, 2018; Firmansyah & Pramiudi, 2020). There is also research that analyzes internal control from aspects of organizational structure, authorization systems and recording procedures, healthy practices and employees whose quality is in accordance with their responsibilities (Wulandari et al., 2018).

Effective internal control is the basic framework for implementing the company's operational activities. Internal control helps organizations effectively and efficiently adapt to changes in the business and operating environment, mitigate risks to acceptable levels, and support decision making and good organizational governance. This means that internal control between one entity and another will be different because each entity has different business processes and business characteristics.

Literature Review

Internal control is implemented by MSME actors to help the entity achieve its goals and maintain and improve performance. The internal control system is useful for supporting the realization of the effectiveness and efficiency of the accounting process which aims to achieve the reliability of financial reports (Hardiningsih et al., 2020). The internal control system is very important because the quality of a company's financial reports depends on whether the system is good or not (Sumaryati et al., 2020). Internal control of the accounting system refers to the relevant rules and regulations of the company to ensure the integrity of the normal business activities of accounting, accounting data, and the accuracy of the company's assets, in accordance with accounting principles and related accounting systems, controls, business processes, etc. management measures (Yan Xiaoqin, 2012). In another sense, an internal control system is policies and procedures that protect company assets from misuse, ensure that the information presented is accurate and ensure that laws and regulations have been followed (Warren et al., 2017).

The internal control system needs to rely on the internal control network, internal control procedures, manual accounting internal control organization and the interaction of the three to achieve internal control of the accounting system. Internal control is an important foundation so that the accounting system can run well (Biao Liu, 2016). According to Mulyadi (2016) the aim of the internal control system is to safeguard the organization's assets, check the accuracy and reliability of accounting data, encourage efficiency, and encourage compliance with management policies. Internal control is a basic factor to support the achievement of goals and protect the assets of company owners (Cika, 2017).

COSO (2013) defines internal control as a process, effected by an entity's board of directors, management, and personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance. This definition provides the basic concept for internal control. Internal control is a process consisting of ongoing tasks and activities and as a tool to achieve goals. The implementation of internal control is not only related to manual policies and procedures, systems and forms, but is influenced by the people who carry out their duties and actions at every level of the organization. The implementation of internal control can be adjusted to the entity structure, is flexible for all entities or certain business processes and allows management to obtain adequate confidence in the controls that have been implemented.

Achieving objectives relating to operations, reporting, and compliance is related to the effectiveness and efficiency of operations, reliability of reports, and compliance with regulations. The effectiveness and efficiency of an entity's operations including operational and financial performance targets as well as protecting assets from loss. Effectiveness is related to achieving organizational goals, while efficiency is related to using resources in the most optimal way to achieve certain outputs (Wirawan et al., 2021). Cika's (2017) research conducted on 86 MSMEs in Albania found that operational effectiveness is achieved when there is effective internal control.

Reliability of reports relates to internal and external financial and non-financial reporting and may include reliability, timeliness, transparency, or other requirements as established by regulators, recognized standards setters, or entity policies. Reliable reports will help decision makers, including owners, in managing their business (Wirawan et al., 2021). One of the factors causing weaknesses in internal control is the human resource factor in producing reports required by management (Wandini & Budiasih, 2017). Lack of accounting background causes weaknesses in providing reports to management (Bruwer et al., 2019).

Regulatory compliance relates to compliance with the laws and regulations that an entity complies with. The regulations in question are broad/general regulations such as government regulations which also include policies and regulations set by the owner or management of the company (Wirawan et al., 2021). Compliance with management regulations and decisions can be obtained by implementing effective internal control (Cika, 2017). Disobedience to regulations is a factor causing problems (Gramling & Schneider, 2018) and failure in MSMEs (Umrani & Johl, 2016).

Methodology

This research uses qualitative research methods. The aim of this research is to analyze the implementation of internal control in MSMEs based on the COSO framework. Research was conducted on fifteen MSMEs in the furniture production sector in North Sulawesi. The sample selection was based on research objectives with the assumption that the same business sector generally has the same business processes so that analysis of internal control can use the same criteria.

Data collection was carried out through an in-depth interview process with MSME owners and observation of company documents. Intensive interviews were conducted with a small number of informants to explore their perspectives on a particular idea, program, or situation so that the researcher could obtain more detailed information about a person's thoughts and behavior or explore a new problem in depth (Boyce & Neale, 2006). Data collection covers operational, reporting and compliance aspects of the entity in accordance with the implementation of COSO's internal control objectives which consist of business forms, business processes and company management. Data analysis stages include data reduction, data presentation, and drawing conclusions (Miles et al., 2014). Data reduction is done by summarizing, selecting, and focusing on the implementation of internal control. Data analysis uses all three aspects of COSO's internal control objectives. The presentation of the data is focused on the implementation of operations objectives, reporting objectives, and compliance objectives. Based on the results of data analysis, conclusions are drawn regarding the implementation of internal control in MSMEs.

Results

The results of data collection was found in Table 1.

Table 1. Data Collection Results

Types of Data	Findings
Form of business: - Legal entity (CV) - Individual	3 MSMEs 12 MSMEs
Business fields	Furniture production
Types of product	Tables, chairs, cupboards, doors, room dividers, kitchen sets, beds
Business process	<ol style="list-style-type: none"> a. Receive goods orders b. Make purchases of materials c. Producing ordered goods d. Make sales e. Carry out product promotions f. Make financial records g. Preparing financial statements h. Pay taxes i. Prepare tax reports j. Report taxes
Company management	<p>MSMEs in the form of individual businesses:</p> <ul style="list-style-type: none"> • managed by the owner and family members as workers • operational activities include receiving orders, purchasing materials, producing, promoting products, and making sales • verbal promotion of products by customers • product completion time as agreed with the customer • complete orders in a timely manner • no accounting records • proof of transactions is not stored • the owner does not understand accounting • no stock of raw materials • no recording of raw material stock • no financial reports • no tax ID number -NPWP • do not pay taxes • not making tax reports • there is no organizational structure because everything is done by the owner • source of capital from the owner <p>MSMEs in the form of legal entities:</p> <ul style="list-style-type: none"> • managed by the owner, has four to ten workers recruited from outside the company • operational activities include receiving orders, purchasing materials, producing, promoting products, and making sales • use social media (whatsapp and FB) as a promotion • product completion time as agreed with the customer

	<ul style="list-style-type: none"> • complete orders in a timely manner • accounting records in the form of cash incoming and outgoing, carried out by the owner/director • proof of transactions is archived for large expenditures • there is a stock of raw materials to ensure smooth production • no recording of raw material stock • owners and employees do not understand accounting • prepare financial reports to complement tax reports (profit/loss reports and balance sheets using external services) • have a tax ID number namely NPWP • pay taxes • make tax reports namely SPT • report annual taxes • there is a simple organizational structure, consisting of a Director, permanent employees and daily workers • source of capital from the owner
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Source: Processed Data, 2023

Implementation of Internal Control to Achieve Operational Goals

According to COSO (2013), achieving operational objectives is related to the effectiveness and efficiency of MSME operational and financial activities. Effectiveness is related to achieving organizational goals, while efficiency is related to using resources in the most optimal way to achieve certain outputs. The organization's objectives are achieved through the implementation of purchasing, production and sales activities carried out by MSMEs, whether in the form of individual business entities or legal entities.

Supporting factors for the success of achieving organizational goals are the promotion of furniture products and the completion of product orders is always carried out in a timely manner. It can be said that the process of achieving organizational goals has been carried out effectively. Apart from that, effectiveness in terms of completion of the production process in order to meet the stipulated time for product completion that has been agreed upon or has appeared in the system. Control over effectiveness can be carried out through routine control, both of human resources and of the equipment or production machines used. In the context of efficiency, the use of resources by MSMEs in carrying out their operational activities is demonstrated by the full involvement of owners in individual businesses and the existence of a simple organizational structure in MSMEs that are legal entities. Efficiency is also reflected through the efficient use of raw materials and overhead costs because by minimizing costs or expenses, MSMEs can achieve predetermined output or goals which are generally profit-oriented.

Individual businesses have workers from family members and legal entity businesses have workers recruited from outside the company so that the presence of these workers will facilitate the implementation of MSME operational activities. From a financial perspective, MSMEs use capital from the owner. Weaknesses in carrying out operational activities are that individual MSMEs that have limited capital do not provide stock of raw materials so that there can be delays in the production process. The positive thing about MSMEs with legal entity is that because their business scope is larger than individual MSMEs, they provide a stock of raw materials to anticipate possible obstacles to the production process when there is a scarcity of wood raw materials.

Implementation of Internal Control to Achieve Reporting Objectives

Reporting objectives include aspects of the availability of financial data, financial records, as well as the availability of financial reports and reports for internal needs. In order for MSME financial reports to be reliable, the reports are prepared using data from financial transactions and the availability of transaction evidence which will be used as a basis for carrying out financial records. In this case, individual MSMEs do not carry out financial management because the preparation of financial reports is not well structured, which is reflected in the absence of proof of transactions, financial recording is still done manually so that no financial reports are produced.

On the other hand, MSMEs with legal entity also do not manage their finances optimally because they only store large amounts of transaction evidence while small amounts of evidence are ignored. Financial recording is only limited to incoming and outgoing cash. The preparation of financial reports uses external services due to limited human resources in MSMEs who do not understand accounting. These conditions affect the reliability of financial reports because the financial information contained in financial reports does not yet reflect the overall financial performance of MSMEs. Apart from that, the purpose of preparing financial reports is only to fulfill the tax obligations of MSMEs as business entities. Financial reports should be prepared with the aim of measuring business performance so that they can be used in decision making by both external and internal parties of the company. By taking advantage of the current digital era, MSMEs can use applications to support the preparation of good financial reports, making business operations easier both when recording income and expenses and when making financial reports for each period.

Another important factor related to fulfilling reporting objectives is recording raw material stock. Raw material stock data helps companies to streamline the production process. This furniture company in North Sulawesi uses wood as one of the main raw materials. Under certain conditions, wood is difficult to obtain, so maintaining the availability of wood raw material stocks will help facilitate the implementation of the company's operational activities. For this reason, companies need records of raw material stocks so that their availability can be controlled. These stock records will be a reference for companies in purchasing wood raw materials. Apart from that, having stock records can make it easier for companies to control and avoid the possibility of fraud.

Implementation of Internal Control to Achieve Compliance Objectives

Compliance objectives relate to an entity's compliance with applicable laws and regulations. In a broad context, based on tax provisions in Indonesia, casual work is referred to as work carried out by individuals who have special skills as an effort to earn income that is not tied to an employment relationship. Tax is imposed on income in connection with work, services and activities carried out by individuals who are Domestic Tax Subjects. Individuals and legal entities have the obligation to register to obtain a Taxpayer Identification Number (NPWP) no later than one month after the start of business or freelance work. By having a NPWP, individuals or legal entities are called taxpayers and have the obligation to calculate, pay and report their taxes in accordance with applicable regulations.

From Table 1 it can be seen that individual MSMEs do not register themselves as taxpayers and do not make tax reports. On the other hand, MSMEs that are legal entities, like it or not, have to register themselves as taxpayers, because NPWP is one of the requirements

for establishing a company. By reporting their taxes, MSMEs that are legal entities achieve compliance goals because they have a NPWP, calculate, pay taxes and report them annually.

The aim of compliance is basically not only seen from compliance with tax regulations but also compliance with financial accounting standards that apply to micro, small and medium entities. Financial accounting standards for MSMEs explicitly describe the concept of a business entity as one of its basic assumptions and to be able to prepare financial reports based on these standards, an entity must be able to separate the personal wealth of the owner from the assets and business results of the entity.

To support the application of the business entity concept, companies need to fulfill aspects of transparency and accountability in financial reporting. Transparency is a form of openness carried out by companies to provide information to parties who need information, such as the public, shareholders, other entrepreneurs and the government. Accountability is responsibility for managing resources to achieve the goals set by the company. Therefore, MSMEs need to prepare financial reports using these accounting standards. Referring to Table 1, individual MSMEs do not make financial reports. MSMEs are legal entities due to limited human resources who do not understand accounting, preparing financial reports using external services.

Discussion

Implementation of internal controls to support the achievement of goals and protect company assets (Cika, 2017) and refers to the relevant rules and regulations of the company to ensure the implementation of company business processes and the accuracy of company assets through information in financial reports. This system is a policy and procedure that protects company assets from misuse, ensures that the information presented is accurate and ensures that laws and regulations have been followed (Warren et al., 2017).

Therefore, the implementation of internal control focuses on achieving organizational goals and as an effort to safeguard company assets. For this reason, the company's operational activities need to be carried out efficiently and effectively, meaning that all company business activities are aimed at achieving profits using existing resources. The company's performance achievements and wealth position are recorded in the financial reports. Preparing financial reports is necessary so that existing financial information can be used by parties with an interest in the company in making economic decisions. Presentation of financial reports also shows the company's compliance with applicable standards and regulations.

This is emphasized in the COSO framework where internal controls are implemented to provide adequate confidence for company owners regarding the achievement of objectives related to operations, reporting and compliance. If viewed from the aspect of operational objectives, the implementation of internal control in furniture MSMEs has focused on the efficiency and effectiveness of implementing the company's operational activities, but limited capital and existing human resources have become obstacles in financial management. If viewed from the aspect of reporting objectives, the implementation of internal control in furniture MSMEs is inadequate because 80% of MSMEs have not met reporting objectives. If seen from the aspect of compliance objectives, the implementation of internal control in furniture MSMEs is inadequate because 80% of MSMEs have not met compliance objectives. The high percentage of reporting objectives not being achieved is because individual MSMEs have limited capital and owners and employees do not understand accounting. This condition has an impact on achieving compliance goals because the absence of financial reports has an

impact on fulfilling MSME tax obligations. Weaknesses in implementing internal control caused by human resources not understanding accounting were also found by Wandini & Budiasih (2017) and Bruwer et al (2019). Disobedience to regulations is a factor causing problems (Gramling & Schneider, 2018) and failure in MSMEs (Umrani & Johl, 2016).

Conclusion

Overall, the implementation of internal control by furniture MSMEs in North Sulawesi is inadequate because there are still many weaknesses, especially in the aspects of financial management, reporting and compliance with tax regulations. To overcome these weaknesses, MSMEs can use various currently available financial recording applications in managing their finances so that they can meet reporting and compliance objectives. In this era of digitalization, MSMEs must be able to adapt to technological advances in order to increase their competitiveness and business sustainability. This research not only contributes to MSMEs in the furniture production sector, but also to other MSMEs who face obstacles in business management, inability to manage risks and secure assets. MSMEs that are aware and implement effective and adequate internal controls will be able to survive in business competition and be able to maintain business continuity.

This research has limitations because the analysis of the implementation of internal control was only carried out on MSMEs in the furniture production sector. To provide a complete picture of the implementation of internal control, further research can be carried out on MSMEs in other business fields which have different characteristics and business processes. Research can also be carried out in a wider scope by comparing the implementation of internal control of MSMEs in developing countries.

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