

Evaluation of Internal Control System Using COSO Framework

(Case Study: Koperasi Nirwana Arta Mandiri)

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Abstrak— Good business activities undertaken by businesses (companies) or entities (business units other than companies) are not spared from the possibility of risks that can harm any business actor. One of the risks that often arises is the risk of irregularities that affect the financial, for it needed internal controls in order to control the risk. The framework that can be used in internal control is the COSO framework. In this study, the method used is based on the 5 components of the COSO framework and the 17 principles as the data analysis stage, with multiple data sources documentation (organizational structure, articles of association, financial statements and memos) and interviews. The data analysis technique is by data presentation, verification and triangulation. Koperasi Nirwana Arta Mandiri has implemented some internal controls but seen from other components such as the control environment and risk assessment is still inadequate and require improvements to improve the effectiveness of the internal control itself.

Keywords— Internal Control, COSO framework.

I. INTRODUCTION

Internal control is one important part in achieving organizational goals. Responsibility for internal control differs between management and auditors. Management is responsible for establishing and operating the entity's internal control. While the auditor is responsible for understanding and testing the internal control over financial reporting. With the internal control is expected an organization can be directed, monitored and measured resources in anticipation of the occurrence of fraud and protect the organizational resources both tangible and intangible. For that we need special attention related to the internal control system.

From the things that may occur above then appears a guide to implement internal controls that is COSO (*Committee of Sponsoring Organization of the Treadway Commission*). COSO Framework is joint initiative from five private sector voluntary organizations aimed at developing a framework and guidance on Risk Management, Internal Control, and Prevention Fraud. There are 5 internal control components in COSO that is Control Environment, Risk Assessment, Control Activities, Information and Communication, Monitoring. Using the COSO framework can be directly demonstrated the weaknesses of internal control and produce what steps will be taken for the effectiveness of the built-in controls. Case study conducted on Koperasi Nirwana Arta Mandiri.

II. LITERATUR REVIEW

Audit

Implementation of internal audit within an organization aims to achieve the vision and mission set by the policy of the company leadership in order to improve the effectiveness and efficiency of the company[1]. Data auditing can bring some benefits to the organization. They can be categorized into efficient savings, risk management, and access and reuse[2]. Audit plays an important role in developing and improving the global economy and business enterprises [3]. Thus an IT audit must be conducted to maintain the security of the information system as an organizational asset to maintain the integrity of stored and processed information and of course to improve the effectiveness of the use of information technology and support efficiency in the organizational environment[4]. Mulyadi [2010] argued in general auditing is a systematic process of obtaining and evaluating objectively objective statements about economic activities and events, with a view to establishing the degree of conformity between the statements with predetermined criteria and the delivery of the results to the interested user [5]. According Sukrisno Agoes (2004), "An examination conducted critically and systematically by an independent party, the financial statements have been prepared by management along with notes bookkeeping and supporting evidence, in order to be able to give an opinion on the fairness of the financial statements"[6]. Implementation of COSO framework principles in an Indonesian company will provide a proof of adaptation of COSO framework to companies in Indonesia[7]. Through the implementation of these control components, COSO predicts that management can release more reliable financial and management reports, improve compliance with laws and regulations, and improve the efficiency and effectiveness of operations, thus acquiring and maintaining a company's main objectives [8]. Assessing the level of fraud can be done with five forms of control made by the Committee of Sponsoring Organizations (COSO) in 2004, how the control environment in the company, how risk assessment, how control activities, how information and communication, and how appropriate supervision in case of fraud (COSO, 2004) [9].

COSO Framework

The Committee of Sponsoring Organization of Treadway Commission (COSO) is joint initiative from five private sector voluntary organizations aimed at developing a framework and guidance on Risk Management, Internal

Control, and Fraud Prevention. The five organizations consist of American Accounting Association (AAA), American Institute of Certified Public Accountant (AICPA), Financial Executive International (FEI), The Association of Accountant and Financial Professionals in Business (IMA), dan The Institute of Internal Auditor (IIA). In COSO Framework there are 5 components of internal control that is: Control Environment, Risk Assessment, Control Activities, Information and Communication, Monitoring. 5 components of Coso framework can be seen in Figure 1 [10].



Figure 1. 5 Component COSO Framework

In an effective internal control system under COSO (2013), it must meet five major interrelated components. The five internal control components are [11] :

TABLE I. INTERNAL COSO CONTROL COMPONENTS

Control Environment	Is a set of standards, processes, and structures that form the basis of internal control throughout the organization. Directors and management establish clear policies regarding the importance of internal controls and expected standards of conduct. The control environment is a reflection of the attitude and actions of the owner & management, thus becoming the foundation of all other internal control components. The atmosphere created from the control environment greatly affects
Risk Assessment	It is a dynamic and recurring process for identifying and analyzing risks in achieving entity goals and determining how risks should be managed. In this context, unlimited risk of unfeasible financial statements, but also consider the
Control Activities	is an act governed by policies and procedures to assist ensuring that the organization's direction to mitigate risks that affect the achievement of objectives has been implemented. Control activities are conducted at all levels and at various stages in business processes and

	reporting. Examples of control activities are authorization, approval, verification, reconciliation, review, separation of duties and responsibilities
Information and Communication	Information is required to carry out internal control responsibilities in support of achieving financial reporting objectives. Communication is an ongoing and repetitive process of providing, sharing and obtaining the information necessary to design, implement and evaluate internal controls, and to assess effectiveness. In other words this information and communication is a form of identification, capture and exchange of information in a particular form and time frame in such a way as to make the people within the organization able to carry out its duties and responsibilities both internally (to all levels of the organization) and external (to parties who are concerned).
Monitoring	It is an activity to ascertain whether each of the five internal control components exists and functions. Any deficiencies found should be evaluated and communicated in a timely manner to the board of directors.

The COSO Framework clarifies these five components in the 17 principles that serve as the requirement for effective internal controls within a company, where in the previous framework they are only implicitly defined. These seventeen principles are described in table II [12].

TABLE II. 17 COSO INTERNAL CONTROL CONSULTING

Component	Princi	
Control Environment	1	Commitment to integrity and
	2	Independence of directors to management in running
	3	Creating a structure, reporting lines, authorization and
	4	Commitment to competence
	5	Develop accountability
Risk Assessment	6	Establish clear goals
	7	Identification and analysis of risks that affect the achievement of objectives
	8	Assess the potential risk of
Control Activities	9	Identify and analyze significant changes
	10	Establish and develop control activities
	11	Establish and develop general control activities on

	12	Apply control through policies and procedures
Information and Communication	13	Obtain, produce and use quality and relevant information
	14	Communicate internally
	15	Communicating externally
Monitoring	16	Carry out regular evaluation and continuous
	17	Evaluate and communicate deficiency weaknesses

III. RESEARCH METHOD

Some research methods used in this study among others:

- 1) Research Approach, This research uses 5 components of internal control and 17 principles as data analysis phase.
- 2) Research Design, There are 4 components that form the basis for designing quantitative research, ie research questions, research propositions (if any), unit analysis and criteria to interpret the findings.
- 3) Research Questions, As for the research questions posed are as follows:
 - a. How is the application of internal control in Koperasi Nirwana Arta Mandiri based on the principle contained in COSO?
 - b. In the internal control of Koperasi Nirwana Arta Mandiri, what components are not sufficient?
 - c. What components are prioritized in the improvement and development of the internal control system of Koperasi Nirwana Arta Mandiri?
- 4) Analysis Unit, In this study, there is only one unit of analysis that will be discussed are Koperasi Nirwana Arta Mandiri.
- 5) Interpreting the Findings The purpose of this study was to assess the extent to which the effectiveness of the internal control components was inadequate and to suggest component improvements to the Koperasi Nirwana Arta Mandiri. The criteria are made to support these objectives are as follows:
 - a. Internal control to be evaluated is internal control that has been run on Koperasi Nirwana Arta Mandiri.
 - b. Comparison of internal control components by using 17 COSO principles.
- 6) Data Source, the data used are:
 - a. Documentation, in the form of organizational structure, articles of association, business process chart, financial statements and memos used as a means of internal control implementation.
 - b. Results of interviews, direct information from parties related to the object of research.
- 7) Data Collection Procedure, The procedure in collecting data in this research is by interview. Interview stage through two stages, the first interview is aimed to obtain a general description of the implementation of the ongoing internal controls. The second interview is addressed to the authorities in making the policy with the aim of validating the interim results obtained from the first interview, while the respondent in the second stage involves the chairman, vice chairperson, secretary and treasurer.
- 8) Analytical Technique, This research menggunakan some analysis techniques such as data presentation, data verification and Triangulation

IV. ANALYSIS AND RESULT

Results of Questionnaire Analysis

In accordance with the research design that has been prepared in the previous chapter, the research results will be presented following the implementation framework, the first is the screening of internal control activities in the business process of Koperasi Nirwana Arta Mandiri by using 17 COSO principles by interviewing the first respondent group, then verify by interviewing the second group of respondents, then compiling the results of the verification, assessing the priorities, comparing with the Follow-up Reports of the Audit Result, last drawing conclusions and mapping them into the business process chart.

First Stage Interview Analysis Results

This evaluation uses a structured question set based on the 17 COSO principles adopted from the format developed by Ernst & Young 2014. Each component and principle will be spelled out in a few questions in order to better capture the current state of internal control. Questions used in the form of check list that reveal the positive and negative answers that amounted to 100 questions. The answers of the respondents either positive or negative answers, if judged not in accordance with the results of observation, it will be written further information about the topic. The answers given by respondents will validate with source triangulation, so only the majority answer to the same question will be used to draw conclusions.

TABLE III. RESULTS OF INTERVIEW ANALYSIS STAGE FIRST

Coso Framework	The COSO Principle	Total of Interview Questions	Results Positive Response	Negative Response Result
Control Environment	Principle 1	8	6	2
	Principle 2	7	4	3
	Principle 3	8	8	0
	Principle 4	5	4	1
	Principle 5	5	4	1
Risk Assesment	Principle 6	7	7	0
	Principle 7	6	4	2
	Principle 8	5	5	0
Control Activities	Principle 9	3	2	1
	Principle 10	7	6	1
	Principle 11	6	5	1
Information and Communication	Principle 12	4	3	1
	Principle 13	6	6	0
	Principle 14	8	8	0
Monitoring	Principle 15	3	2	1
	Principle 16	7	5	2
	Principle 17	5	5	0
Total		100	84	16

Based on the data in tabel III it can be concluded that of the 17 COSO principles being evaluated, adequate internal controls are:

1. Principle 3: Create structure, line of reporting, authorization and accountability
2. Principle 6: Establish goals clearly
3. Principle 8: Assess the potential risk of fraud
4. Principle 13: Acquire, produce and use quality and relevant information
5. Principle 14: Communicate internally
6. Principle 17: Communicate externally

As for the 11 other control principles still contain weaknesses.

Second Stage Interview Analysis Results

In the second stage of the interview the cooperative management committee was assigned to verify the deficiency of the implementation of internal control in Koperasi

Nirwana Arta Mandiri. Respondents answer will be accommodated and validated by using triangulation, considering the respondent's answer is a description or not a positive statement and negative, it will be analyzed against the pattern of variations of accepted answers to draw conclusions. The conclusion of the interview with the board as follows:

1) Of the 11 weaknesses identified in the first phase of the interview, there are 3 items that have been basically implemented adequately, among others:

- a. Training program for the board.
- b. Manual review process related to financial reporting, and approval.
- c. Whistleblower channel for external parties.

2) There are 2 items that are considered minor related to the operational and reporting systems that are still manual, among others:

- a. Use of the app by third parties.
- b. Periodical assessment of the environment of Information Technology (IT).

Thus the result of assessment of internal control at Koperasi Nirwana Arta Mandiri which has been verified identifying 11 weaknesses in internal control which still need improvement as shown in table as follows.

TABLE IV. RESULTS OF INTERVIEW ANALYSIS OF SECOND STAGE

Komponen COSO	No	Defisiensi Pengendalian Internal setelah
Control Environment	1	There is no code of ethics/fact integrity/core value written Which can be a guide integrity and ethical
	2	There has been no training or socialization that incorporates material integrity and code of
	3	There is already a mechanism of determining the level and deviation
	4	Evaluation of competence is only at the beginning of recruitment, follow-
	5	Do not have realistic financial targets
Risk Assessment	6	Mapping only internal risks, not including risks
	7	No person or group has any responsibility to anticipate significant external
Control Activities	8	Financial reporting system used manual with the help of computers,
	9	Still using manual system, and not securing
	10	Formal policies and procedures for securing the confidentiality of data and
Monitoring	11	There is already a mechanism for assessing whether or not the control is negligible and determining the magnitude of the

V. CONCLUSION

Based on the results of analysis and discussion, it can be concluded as follows:

1) The internal control system of Koperasi Nirwana Arta Mandiri identified in this research:

Control environment:

- a. The absence of code of ethics / fact integrity / core value written that can be used as guidance of integrity and ethical behavior in Koperasi Nirwana Arta Mandiri.
- b. Koperasi Nirwana Arta Mandiri has never created any training or socialization that incorporates material integrity and code of ethics.
- c. Koperasi Nirwana Arta Mandiri already has a mechanism to determine the level and deviation of code implementation, but not perfect (raw).
- d. Evaluation of competence in Koperasi Nirwana Arta Mandiri is only done at the beginning of recruitment, continued evaluation until now has not run.
- e. Koperasi Nirwana Arta Mandiri does not yet have a realistic financial target

Risk Assessment:

- a. Koperasi Nirwana Arta Mandiri mapping only internal risk, not including external risk.
- b. Koperasi Nirwana Arta Mandiri has not appointed a person or group that has a responsibility to anticipate external changes that have a significant impact on organizational goals

Control Activities:

- a. The financial reporting system used in Koperasi Nirwana Arta Mandiri is a computer-assisted manual system, with this system of internal control attached to individuals.
- b. By applying the manual system, Koperasi Nirwana Arta Mandiri also does not secure important data periodically.
- c. The formal policies and procedures for securing data and information confidentiality within the Koperasi Nirwana Arta Mandiri are inadequate.

Monitoring:

Koperasi Nirwana Arta Mandiri already has a mechanism for assessing whether or not the control is negligible and determining the magnitude of its impact, but no consequences are applied as a follow-up to the assessment.

2) With regard to the above conclusions, the internal control components that have been in accordance with COSO are information and communication, but other components of control still contain weaknesses, such as control environment, risk assessment, control activities and monitoring.

3) The priority of improvement over the weakness of the internal control system in the first Koperasi Nirwana Arta Mandiri is the supervision that exists within the control activities component, and the second priority is the creation of a code of ethics in writing which is included in the component of environmental improvement control.

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