
Analysis of the Implementation of an Internal Control System Based on the Committee of Sponsoring Organizations of the Treadway Commission Framework in the Preparation of Financial Statements of KSP Kopdit Hiro Heling

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ABSTRACT

This study aims to analyze the implementation of an internal control system based on the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework in the preparation of financial statements at KSP Kopdit Hiro Heling Cooperative. This Research employs a qualitative approach using a case study method, in which data were collected through interviews, observations, and documentation. The results indicate that the implementation of the COSO-based internal control system at KSP Kopdit Hiro Heling has not been fully effective. Several components, including the control environment, risk assessment, control activities, and monitoring, still exhibit weaknesses, while the information and communication component has been implemented relatively well. These weaknesses contribute to cash discrepancies, lack of transparency, and potential unreliability in financial reporting. Therefore, strengthening the internal control system through improving human resource competence, organizational structure, and supervisory functions is necessary to ensure that cooperative financial statements are accurate, transparent, and accountable.

Key words: Internal Control System, COSO Framework, Financial Statements, Credit Cooperative, Stewardship Theory.

1. INTRODUCTION

Rapid economic development can have positive impacts, such as improved living standards, job creation, and increased national income. However, potential negative impacts include increased pollution, exploitation of natural resources, and the potential for economic inequality if not managed properly. Historically, economic development in Indonesia began during the Dutch and Japanese colonial periods, which brought many hardships and suffering to the people, not to mention the need to comply with the colonisers' desires. During that period, the economic development experienced by the Indonesian people was very difficult, until finally, in 1895 or 1896, a savings and loan cooperative called 'De Purwokertosche Hulp-en Spaarbank der Inlandsche Hoofden,' meaning the Savings and Loan Bank for Priyayi (the noble class) of Purwokerto, was established by R. Aria Wiriadmadja in Purwokerto, Central Java. The purpose of establishing the

cooperative at that time was to provide loans to civil servants or aristocrats facing financial difficulties and trapped in high-interest debt with loan sharks. The cooperative then grew rapidly and was eventually emulated by Boedi Utomo. Not only that, a national figure who strongly supported cooperatives was Drs Moh. Hatta, the first Vice President of the Republic of Indonesia, earned him the title Father of Indonesian Cooperatives. Officially, the Indonesian Cooperative Movement was born on July 12, 1947, at the First Congress in Tasikmalaya, which is commemorated as Indonesian Cooperative Day.

According to Fray (1908), the definition of a cooperative is “A cooperative is an association with the aim of working together, consisting of those who are disadvantaged, carried out with a spirit of selflessness in such a way that each member is able to fulfill their obligations as a member and receive compensation proportional to their opportunities within the organization.” A cooperative is one option among many for achieving better economic conditions (Sanga, 2022).

An internal control system is a system designed to assist an organisation, in this case a cooperative, in achieving good economic conditions for the cooperative’s purposes. The control system is the internal control within a cooperative that supports the cooperative’s operational activities, such as securing assets and presenting financial reports that are transparent, accountable, and justifiable.

According to Novita (2022), a business entity requires an internal control system to help the company achieve its performance and Profitability goals and prevent the loss of resources caused by fraud. (Novita, 2022) also states that internal control is a system designed to safeguard company assets, maintain the integrity of financial data, and ensure the achievement of the company’s objectives. The internal control system is expected to provide continuous improvement recommendations, including for companies engaged in business.

Previous research on COSO-based internal control systems generally emphasizes the importance of the five components: control environment, risk assessment, control activities, information and communication, and monitoring. However, most studies remain descriptive, merely indicating whether the COSO components have been implemented, without critically evaluating the gap between the ideal COSO standards and actual practice in savings and loan cooperatives.

In the context of cooperatives, particularly KSP Kopdit Hiro Heling, the implementation of COSO cannot be assessed solely on the basis of the existence of SOPs, the use of accounting information systems, or routine reporting. Evaluation must focus on the effectiveness of control implementation, including the extent to which segregation of duties is carried out, how the risk of cash discrepancies is mitigated, whether each member transaction has adequate documentation, and whether the internal audit function operates independently.

The gap in this research lies in the limited studies that develop COSO evaluation based on the characteristics of medium-scale savings and loan cooperatives. Therefore, this study contributes theoretically by expanding the application of COSO in the context of credit cooperatives through an evaluative-critical approach. In practice, this study provides an internal control evaluation model that cooperatives can use to assess weaknesses in COSO implementation, particularly in oversight structure, cash risk mitigation, transaction documentation, and SOP compliance monitoring.

One internal control system that can address a lack of internal control in a business entity or organisation is COSO-based internal control (Committee of Sponsoring Organisations of the Treadway Commission). COSO is a framework for improving internal control systems within an organisation. The main purpose of COSO is to help organisations achieve their objectives effectively and efficiently, as well as to assure the reliability of financial reporting (COSO, 2022).

Implementing COSO as an internal control framework can help organisations and financial institutions optimise the usefulness of accounting information systems, improve operational effectiveness, enhance transparency and accountability, and minimise the risk of errors and fraud in financial reporting (COSO, 2022).

Minister of Cooperatives and Small and Medium Enterprises Regulation Number 12 of 2015 concerning Accounting Guidelines for Cooperatives in the Real Sector states that financial statements must provide information that is relevant, easy to understand, and simple. In line with this, the implementation of financial management requires compliance with regulations and sound internal controls; structural task separation must be emphasised to ensure a clear, directed coordination flow (Alfina Sari, 2023).

However, its implementation in Indonesian cooperatives, especially credit cooperatives, still faces various challenges. KSP Kopdit Hiro Heling Cooperative, a credit cooperative in Maumere, is currently facing challenges with its Internal Control System. This is due to a reduction in the Internal Control Division's membership, resulting in insufficient independent control activities within the cooperative.

The problems experienced by KSP Kopdit Hiro Heling Cooperative regarding internal control align with the author's interviews with several sources at the cooperative. Therefore, the author intends to analyse the cooperative's internal control system using the COSO framework.

The main objective of this writing is to determine the extent of the implementation of the COSO Framework-Based Internal Control System that KSP Kopdit Hiro Heling Cooperative has carried out in the preparation of Financial Statements. This writing also aims to provide recommendations on the steps KSP Kopdit Hiro Heling should take to optimally implement and improve its Internal Control System, with the hope of enhancing a more transparent and accountable cooperative management system. By focusing on the internal control systems within cooperatives, this writing aims to contribute to the development and improvement of COSO-based internal control systems, particularly in the cooperative sector.

2. LITERATURE REVIEW

Stewardship Theory

Stewardship theory, proposed by Donaldson and Davis in 1989, is based on human qualities such as trustworthiness, honesty, responsibility, and integrity. The theory indicates a close relationship between organisational satisfaction and success; thus, it has a psychological and sociological foundation, in which executives, as stewards, strive to achieve their organisation's goals (Sanjaya, 2017).

Stewardship theory is built on philosophical assumptions about human nature, namely that humans are inherently trustworthy, capable of acting responsibly, possess integrity, and are honest towards others (Usamah in Lestari, 2013). Stewardship theory can serve as an accountability mechanism, ensuring proper monitoring, auditing, and reporting to help achieve organisational objectives (Harryanto, 2014).

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Cooperative

Epistemologically, the word 'cooperative' comes from the Latin 'Cooperate', which in English is 'Cooperative.' 'Co' means together, and 'operation' means to work, so 'Cooperation' means working or striving together.

According to Jumaidi (2021:3), a cooperative is a business entity that organises the utilisation and empowerment of its members' economic resources, based on cooperative principles and economic business rules, to improve the standard of living of its members, especially the local community in the working area in general.

Therefore, based on the definition above, the author concludes that cooperatives are a people's economic movement and the backbone of the national economy. Thus, cooperatives allow several people or entities to work together voluntarily to carry out activities aimed at improving their members' lives.

Internal Control System

According to Romney and Steinbart (2015:226), internal control is an important operational process of a company and an integral part of management activities that provides reasonable assurance that the company can achieve maximum profit. Internal control must be implemented as effectively as possible in a company to prevent and avoid errors, fraud, and irregularities. Therefore, it is necessary to develop a control framework over the existing systems in the company, consisting of various internal control measures, so Nurcahyo (2023) states that the internal control system is a system of supervision and management implemented by company management to ensure that business operations are effective, efficient, and accountable, operating properly, and minimizing risks that hinder the achievement of business objectives.

Based on the description above, the author concludes that internal control is an important component of an organisation that helps achieve more effective and efficient objectives. A good internal control system can affect an organisation's ability to achieve its goals, and its presence can minimise risks or problems arising from unreliable financial or operational reporting.

Internal Control System Based on the COSO Framework

COSO stands for the Committee of Sponsoring Organisations of the Treadway Commission. It is an independent organisation initiated by the private sector to combat the widespread fraud occurring in America at the time. Founded in 1985, the organisation aims to Research the factors of fraud in financial reporting and develop recommendations for government organisations, auditors, the SEC, and educational institutions.

Internal control, according to COSO (Committee of Sponsoring Organisations of the Treadway Commission), is a process influenced by the board of directors, management, and other personnel of an entity, designed to provide reasonable assurance regarding the achievement of objectives in operational effectiveness and efficiency, reliability of financial reporting, and compliance with applicable laws and regulations.

Overall, internal control, as defined by COSO, aims to provide recommendations for sustainable improvements to inadequate internal control systems within an organisation, in this case, a cooperative. COSO-based internal control also aims to produce financial statements free of fraud. It includes five control components according to the COSO framework, namely Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring.

Financial Report

Financial statements present a company's financial records over an accounting period and reflect the company's performance (Pakpahan, 2020). High-quality financial statements are

indicated by clarity, accuracy, and honesty (Putra, 2017) in (Pakpahan, 2020). High-quality financial statements help parties involved make decisions in economic activities—Rudiantoro and Siregar (2012), in Pakpahan (2020). Mardiasmo (2009), cited in Mutiana et al. (2017), adds that accounting and financial statements entail a process of collecting, processing, and communicating information that is useful for decision-making and for assessing organisational performance.

3. RESEARCH METHOD

This study uses a qualitative case study approach. This approach was chosen because the research aims to deeply evaluate the implementation of an internal control system based on the COSO framework in the preparation of financial statements at KSP Kopdit Hiro Heling. A case study is used because the research object has specific characteristics: a savings and loan cooperative that has changed its internal control structure due to the streamlining of the Internal Control Division. (Creswell, 2016: 253).

The informants in this study were selected through purposive sampling, namely those directly involved in the internal control process, financial report preparation, and cooperative operational activities. The main informants include the General Manager, the Head of the General Administration and Finance Division, the Head of the Credit, Training, and Promotion Division, and field officers involved in the process of receiving member installments.

Data collection techniques were carried out through in-depth interviews, observation, and documentation (Sugiyono, 2022:246). Interviews were conducted to gather information on the implementation of internal controls, obstacles to the application of SOPs, emerging risks, and monitoring mechanisms. An observation was conducted to examine the cooperative's operational practices, particularly the processes of cash receipt, transaction recording, member services, and the implementation of field officers' duties. Documentation was used to examine SOPs, SOMs, organizational structure, daily cash reports, financial statements, and supporting transaction documents.

Data analysis was carried out systematically through several stages. First, data reduction, which involves sorting relevant data according to the five COSO components. Second, thematic coding, which involves coding findings based on the categories of control environment, risk assessment, control activities, information and communication, and monitoring. Third, categorization of findings, which involves grouping empirical evidence according to COSO evaluation indicators. Fourth, data presentation, which involves presenting the analysis results in the form of evaluative narratives and evaluation matrices. Fifth, drawing conclusions, which involves formulating the gaps between the ideal COSO standards and the actual practices of the cooperative.

To enhance the credibility of the data, this study uses source triangulation and technique triangulation. Source triangulation is conducted by comparing information from the General Manager, division heads, finance staff, and field officers. Technique triangulation is carried out by comparing the results of interviews, observations, and documentation (Sugiyono, 2007, p. 246). Thus, the study's conclusions are not based solely on informants' statements but are also supported by operational evidence and cooperative documents.

4. RESULTS AND ANALYSIS

The Internal Control System, based on the COSO framework, is designed to ensure that the financial statement preparation process complies with applicable standards and regulations. In addition, COSO-based internal control over the preparation of cooperative financial statements can provide reliable financial information free from fraud and potential risks, and present financial statements that are accountable and transparent. COSO is an internal control designed to provide positive impacts and results for an organisation in achieving its objectives. The implementation of an internal control system based on the COSO framework in the preparation of financial statements of the cooperative at KSP Kopdit Hiro Heling aims to see whether its implementation has been carried out in accordance with the five components of COSO, which consist of the Control

Environment, Risk Assessment, Control Activities, Information & Communication, and Monitoring. In line with this, based on the explanation above regarding the issue of inadequate internal control, the author intends to analyse how the internal control system at KSP Kopdit Hiro Heling is based on the five control components according to COSO in the preparation of financial statements.

Financial statements are documents in the form of records that contain financial data and information of a company or financial institution over a certain period. The financial statements presented must comply with applicable standards and regulations; accurate financial statements can provide information to users and organisations to help them achieve their goals. Thus, the implementation of an internal control system at KSP Kopdit Hiro Heling, based on the COSO framework, aims to support the preparation of high-quality financial statements and to ensure their validity, reliability, accuracy, and compliance with applicable accounting standards.

Based on the author's interview with a resource person at KSP Kopdit Hiro Heling regarding the financial statement preparation process, the author concludes that the results are not entirely adequate; several obstacles were encountered during the preparation of the financial statements. Therefore, the author intends to analyse the implementation of an internal control system based on the COSO framework in the preparation of financial statements at Koperasi KSP Kopdit Hiro Heling using the five COSO components and relate them to the issues occurring at KSP Kopdit Hiro Heling, namely the downsizing of members in the internal control division, discrepancies in cash bookkeeping, and a lack of transparency/accountability in collecting member instalments. The five COSO components are as follows:

1) Control Environment

The control environment is a component that forms the foundation for an organisation to create a work environment characterised by integrity, honesty, and clear guidelines for employees in carrying out their duties in accordance with their roles and responsibilities. This component sets the tone at the top for all other controls. It is viewed from five aspects. However, based on the results of interviews and discussions regarding the control environment, the author draws conclusions based on issues occurring at KSP Kopdit Hiro Heling, namely the downsizing of members in the Internal Control Division at KSP Kopdit Hiro Heling, indicating a weakening of the organisation's commitment to competence and an inadequate organisational structure. The Internal Control Division serves as the guardian of integrity within an organisation, such as a cooperative, and downsizing indicates weak internal oversight and accountability. Although the interview results above indicate that there are sanctions and legal processes for fraud perpetrators, which reflects a commitment to integrity values, the downsizing of the Internal Control Division is not in line with this commitment. Furthermore, issues related to the lack of transparency and accountability in taking member instalments indicate weaknesses in the enforcement of integrity and ethical values at the operational level. This creates opportunities for employees to act outside the SOPs and SOMs, thereby posing a fraud risk. Although KSP Kopdit Hiro Heling has a strict sanction mechanism, this issue indicates that these ethical values have not been fully enforced at all levels, particularly regarding individual accountability. However, overall, weaknesses in every aspect of the control environment—from integrity and ethical values, to commitment to competence, organisational structure, delegation of authority and responsibility, and HR policies and practices—directly contribute to the occurrence of cash discrepancies. These cash discrepancies ultimately affect the reliability, accuracy, and timeliness of KSP Kopdit Hiro Heling's financial reporting.

2) Risk Assessment

Risk assessment is the process of identifying and analysing risks that could result in Material misstatements in the preparation of financial statements. This component involves identifying risks that threaten the achievement of reliable financial reporting objectives. Based on the interview

results, the author concludes that these risks exist and are the most influential factors affecting the accuracy and reliability of financial statement preparation. Although the aforementioned risks can occur in practice, the risk analysis and risk responses at KSP Kopdit Hiro Heling have not been effective in preventing these occurrences. Overall, KSP Kopdit Hiro Heling has not fully identified risks, such as cash recording errors, delays in cash deposits from field officers, and the risk of not having transaction evidence for members. Without adequate risk assessment and identification, cash errors repeatedly occur and affect financial reporting. As a result, the cash balance presented in the financial statements may be misstated, reducing the reliability and relevance of the cooperative's financial reports.

3) Control Activities

Control activities are policies and procedures that ensure existing and potential risks are minimised, enabling the preparation of financial reports in accordance with the organisation's objectives. The components of control activities consist of several aspects. These aspects have not been fully implemented properly. Therefore, in line with the issue mentioned above, namely the reduction of members in the internal control division, it directly reduces independent detective control activities. The lack of personnel means that the frequency and depth of internal audit inspections decrease, making it difficult to detect cash discrepancies and fraud promptly. The existence of regular inspections and strategic plans to form a specialised fraud audit team demonstrates an understanding of the need for detective internal controls. However, downsizing weakens the capacity to conduct these inspections. Therefore, control activities in this regard are considered less than optimal.

4) Information and Communication

This component involves the collection and exchange of relevant financial operational information, ensuring that accurate financial information is processed through the system and communicated to the interested parties. Based on the author's interview regarding the financial accounting system used in preparing and reporting financial information, KSP Kopdit Hiro Heling has implemented and uses the Cooperative Credit Financial Accounting System called SIKOPDIT Online, which is already in accordance with the Financial Accounting Standards (SAK) for Private Entities (EP), so that the main mechanism for processing financial information can be effectively conveyed. In addition, the communication used involves employee reporting, which aligns with the above interview results: employees must submit a monthly report to the General Manager regarding their tasks, responsibilities, and target achievements.

5) Monitoring

Monitoring is the process of assessing the quality of internal control performance over time. In this monitoring component, there are aspects of internal control that can support better monitoring; however, in practice, these aspects have not been fully implemented. In line with the interview results above, during the General Manager's monitoring and supervision of employee performance, several employees have not performed their duties optimally in accordance with the set job descriptions. Therefore, in line with the issues mentioned above regarding cash discrepancies and the lack of transparency and accountability when members collect their instalments, this demonstrates that ongoing monitoring activities failed to detect deviations promptly or to follow up on the findings effectively. Although there are routine evaluation procedures and regular periodic inspections, this issue proves that the current monitoring mechanisms have not been implemented optimally. From the discussion above, it is concluded that the application and implementation of the internal control system based on the COSO framework in the preparation of financial statements at KSP Kopdit Hiro Heling have several components that have not been fully realised. These components include the control environment, risk assessment, control activities, and monitoring. Therefore, an analysis of the application of the COSO framework at KSP Kopdit Hiro Heling can

help improve the internal control system related to the preparation of cooperative financial statements.

Not only that, but the author also concludes the relationship between the internal control system based on the COSO framework in the preparation of financial statements and the Stewardship theory. The relationship between stewardship theory and the COSO framework is complementary. From several points supporting the relationship between the two, it can be noted that:

a. Strengthening the Control Environment

This component is a key component of COSO that encompasses integrity and ethical values. The Stewardship theory gives this component life. If management has a stewardship mentality, an honest organisational culture will naturally form, making internal control no longer seen as a burden but as a responsibility. However, in the discussion above, the values of integrity and ethics are seen as weaknesses because they have not been fully enforced across all levels. Therefore, the stewardship theory supports strengthening the control environment.

b. Accountability and Transparency

The Stewardship theory demands managerial accountability to the owners. The COSO framework facilitates this demand through the Information and Communication component, both during the financial reporting process and the evaluation of employee performance. Without a COSO system, the good intentions of a steward are difficult to prove. However, with the implementation of the COSO framework, financial report transparency has an objective standard. In line with this, based on the discussion above regarding the information and communication component, KSP Kopdit Hiro Heling has properly implemented this during the preparation and reporting of the cooperative's financial statements and employee performance.

c. Risk Mitigation Without Conflicts of Interest

Within the framework of Stewardship supported by Risk Assessment based on the COSO framework, managers proactively identify risks that could undermine owners' trust and immediately mitigate them. In line with the discussion above regarding risk analysis and risk assessment at KSP Kopdit Hiro Helin, the General Manager has so far been able to minimise risks affecting the accuracy and reliability of financial reports. Nevertheless, risk analysis and risk assessment at KSP Kopdit Hiro Helin need to be properly implemented and carried out.

d. Reliability of Reporting

The ultimate goal of the relationship between the two is to ensure the quality of financial reporting. Stewardship ensures that managers present accurate financial statements in accordance with applicable standards and regulations, while COSO aims to ensure that managers are capable of doing so through verification mechanisms.

The research results indicate that the implementation of the COSO-based internal control system at KSP Kopdit Hiro Heling has not been fully effective. This finding is not only evident in the existence of SOPs and SOMs, or in the use of SIKOPDIT Online, but also in the extent to which the five COSO components truly function in preventing errors, fraud, and unreliability in financial reporting.

In the control environment component, the cooperative has established rules in the form of SOPs and SOMs. However, the existence of these rules does not fully guarantee the effectiveness of control, as some employees still fail to carry out their duties in accordance with the provisions. The downsizing of the Internal Control Division is a major weakness as it reduces the independence of the supervisory function. When the General Manager assumes the internal control function, there is a risk of overlap between the executive and supervisory functions. This condition indicates that the control environment does not fully support the principles of accountability and segregation of duties.

In the risk assessment component, the cooperative has recognized risks in the preparation of financial statements, including recording errors, cash discrepancies, and potential fraud. However, awareness of these risks has not been followed by a systematically documented risk identification and mitigation mechanism. The cooperative does not yet have a risk matrix that explains the types of risk, causes, impacts, risk levels, and the control actions required. As a result, the same risks can recur, affecting the reliability of the financial statements.

In the control activity component, weaknesses are evident in the inconsistent implementation of transaction documentation and cash reconciliation. Findings that members did not receive receipts when making installment payments indicate a serious weakness in transaction evidence procedures. In addition, cash discrepancies in the books show that the cross-checking mechanism between physical cash and accounting records is not yet functioning optimally. This condition increases the risk of misstatement in financial reports and weakens the audit trail.

In the information and communication components, the cooperative has used SIKOPDIT Online for financial preparation and reporting. This shows that the information system aspect has supported financial recording and reporting. However, the effectiveness of the information system still depends on the validity of the initial data. If field transactions lack sufficient evidence, the information entered into the system may not be entirely accurate. Thus, the use of a digital system must be reinforced with disciplined transaction documentation.

In the monitoring component, the cooperative has evaluated employee performance. However, monitoring has not been fully effective, as some employees still fail to perform tasks in accordance with their job descriptions. In addition, the presence of cash discrepancies and transactions without evidence indicates that the monitoring mechanism has not detected irregularities promptly. This indicates that the monitoring conducted is still administrative in nature and has not fully served as a tool for detecting and correcting internal control weaknesses.

5. CONCLUSION

Based on the research results, the implementation of an internal control system based on the COSO framework in the preparation of financial statements at KSP Kopdit Hiro Heling has not been fully effective. Of the five COSO components, the information and communication component has been functioning relatively well through the use of SIKOPDIT Online and internal reporting. However, the other four components, namely control environment, risk assessment, control activities, and monitoring, still show implementation weaknesses.

The main weakness lies in supervisory independence, due to the streamlining of the Internal Control Division. This condition prevents the oversight function from operating optimally because there is an overlap between managerial and control functions. In addition, the still recurring cash discrepancies and installment transactions without receipt evidence indicate that control activities are not yet fully capable of ensuring compliance with SOPs and the reliability of transaction documentation.

Theoretically, this study argues that the COSO framework should be adapted to credit unions' characteristics. COSO should not be understood merely as the five components of internal control in general, but must be translated into operational indicators of cooperatives, such as the separation of supervisory functions, control of cash transactions, documentation of member installments, daily reconciliation, and follow-up on findings. Thus, this study extends the application of COSO to medium-sized credit cooperatives.

Practically, the research results indicate that KSP Kopdit Hiro Heling needs to reinforce the independent internal control function, improve transaction documentation, implement regular cash reconciliations, develop an operational risk matrix, and ensure that every supervisory finding is followed up in a measured manner. These efforts are important so that the cooperative's financial statements can be prepared more reliably, transparently, accountably, and in accordance with the principles of sound cooperative governance.

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