

## **EVALUATION OF INTERNAL CONTROL IN BUSINESS SYSTEMS USING COSO FRAMEWORK: A CASE STUDY OF A BARBERSHOP BUSINESS IN AMBON CITY**

**Yavia Auditia Radjawane<sup>1</sup>, Elisabeth Penti Kurniawati<sup>1\*</sup>**

<sup>1</sup>Universitas Kristen Satya Wacana, Salatiga, Indonesia

\*elisabeth.kurniawati@uksw.edu

**Abstrak:** Usaha mikro, kecil dan menengah (UMKM) memiliki peranan besar dalam menunjang keberhasilan perekonomian negara. Oleh karenanya, pelaku bisnis perlu menerapkan pengendalian internal yang memadai untuk mencapai tujuan bisnis secara efektif. Masalah utama yang dihadapi oleh para pelaku UMKM saat ini adalah belum optimalnya penerapan pengendalian internal dalam sistem bisnis yang berisiko menyebabkan kegagalan usaha. Pengabdian kepada masyarakat ini bertujuan untuk mengevaluasi pengendalian internal organisasi bisnis menggunakan kerangka COSO (*Committee of Sponsoring Organizations of the Treadway Commission*) yang mencakup lingkungan pengendalian, penilaian risiko, aktivitas pengendalian, informasi dan komunikasi, dan pemantauan. Program pengabdian ini berbentuk penelitian case study dengan menggunakan metode Service Learning yang melibatkan usaha barbershop dengan tujuh cabang di Kota Ambon. Pengumpulan data dilakukan melalui wawancara, dokumentasi dan observasi secara langsung dengan pihak-pihak terkait bisnis barbershop sebagai peatu UMKM. Hasil kegiatan pengabdian menunjukkan bahwa penerapan pengendalian internal pada usaha jasa *barbershop* ini belum sepenuhnya memenuhi standar memadai. Evaluasi ini dapat mengidentifikasi kendala pada masing-masing komponen pengendalian sehingga menyediakan informasi penting bagi pelaku bisnis barbershop untuk menetapkan rencana tindak lanjut yang tepat. Program pengabdian ini memberi kontribusi literatur mengenai penerapan pengendalian internal menggunakan COSO *framework* pada UMKM. Implikasi praktisnya adalah organisasi usaha barbershop perlu untuk memperbaiki penerapan pengendalian internal pada komponen lingkungan pengendalian, penilaian risiko, aktivitas pengendalian dan pemantauan.

**Kata Kunci:** pengendalian internal, Usaha Mikro, Kecil dan Menengah (UMKM), kerangka COSO

**Abstract:** Micro, small and medium enterprises (MSMEs) play a pivotal role in supporting the success of the country's economy. Therefore, business organisations must implement adequate internal controls to achieve business goals effectively. The main problem MSME entrepreneurs face is the suboptimal application of internal control in their business system, which can potentially cause business failure. This community service program aims to evaluate the internal control of business organisations using the COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework, which includes the control environment, risk assessment, control activities, information and communication, and monitoring. This service programme is a case study using the Service Learning method involving a barbershop business with seven branches in Ambon City. Data were collected through interviews, documentation and observation of stakeholders in the barbershop business organisation as MSME entrepreneurs. The results show that the implementation of internal control in the barbershop business has not fulfilled adequate control standards. This evaluation can identify constraints and challenges in each of the business's internal control components. It provides important information for barbershop businesses to establish appropriate strategic action plans. This service programme contributes literature regarding the implementation of internal control using the COSO framework in MSMEs. The practical implication is that barbershop business organisations should improve the implementation of internal control in the components of the control environment, risk assessment, control activities and monitoring.

**Keywords:** internal control, Micro, Small and Medium Enterprises (MSMEs), COSO framework

## Introduction

Micro, Small and Medium Enterprises (MSMEs) play a significant role in Indonesia's economic growth. MSME is a business run by individuals, households or business entities with a small size. Based on the results of a report by the Coordinating Ministry for Economic Affairs of the Republic of Indonesia in 2022, MSMEs contributed a large value to the Gross Domestic Product (GDP), which was 60.5% (Kementerian Koordinator Bidang Perekonomian Republik Indonesia, 2022). Therefore, MSMEs must be developed to advance the national economy.

MSMEs in Indonesia are still considered to ignore the concept and practice of internal control. From this perspective, an internal control system is required to protect the wealth of a business entity (Saadah, 2019). A business has a risk of failure without implementing an effective internal control system to minimise the issues faced in both the large and small business sectors, such as MSMEs (Nqala & Musikavanhu, 2023; Nursita et al., 2024).

The internal control system is required in response to rampant fraud in a business. For example, Kuy Steak employees in Bekasi City committed fraud even though the business owner had installed surveillance or CCTV cameras at the business location (Janati & Ihsanuddin, 2023). A similar case occurred in Batam City in 2021 when a supermarket employee broke into the business manager's safe deposit box, causing a total loss of IDR 20 million (Maulana & Ika, 2021). One of the barbershop businesses in Ambon City also faced similar problems. Based on initial interviews with supervisors, this business has not fully implemented an internal control system. As a result, one of the fraud cases was cash theft by cashier staff at one of the branches of this business.

Purbowati and Nurhayanti (2021) state that a poor internal control system causes organisational failure due to a lack of supervision from management, which triggers fraud. An organisation can avoid detrimental risks to the business if it establishes a proper internal control system (Kalau & Leksair, 2020). Internal control plays a crucial role in detecting and preventing fraud that threatens the business organisation's tangible or intangible resources and can affect the organisation's reputation (Chandra et al., 2021). A well-managed internal control system effectively protects business continuity from fraudulent practices. It means that the better internal control implemented in business management, the more effective it will be in preventing fraud (Amalia & Suryatimur, 2022; Armelia & Wahyuni, 2020; Azzahra & Sutjahyani, 2024; Setyaningsih & Nengzih, 2020). When internal control in a business is implemented properly, fraud tends to decrease (Febrianti et al., 2021; Monoarfa et al., 2023; Mufidah & Masnun, 2021).

The gap between the internal control framework and the facts of its implementation in MSMEs requires solutive action according to business characteristics. This community service activity utilises the internal control conceptual framework established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The COSO Internal Control Framework is the appropriate framework for MSME entrepreneurs because it can help business owners and managers understand the components of internal control in effective ways (Nqala & Musikavanhu, 2023). The COSO internal control conceptual framework is considered effective and efficient in evaluating the internal control system, enabling the achievement of business

objectives and can adapt to the operational environment to prevent unwanted risks (Oktaviani & Harahap, 2022). The internal control framework by COSO consists of five interrelated components: the control environment, risk assessment, control activities, information and communication, and monitoring (COSO, 2013).

Based on the background above, this community service program focused on the quality of internal control, particularly in barbershop businesses in Ambon City. Therefore, this program aims to analyse the conceptual components of internal control in barbershop business management based on the COSO framework.

## **Method**

This community service used the Service Learning (SL) method with a case study approach to a barbershop business unit in Ambon City. This business, which was established in 2016, provides men's haircut services. This business has seven branches with 39 workers comprising five supervisors, five cashiers and 29 stylists. Each branch of this business earned a revenue of 35 - 60 million rupiah monthly. This revenue is obtained from haircutting services and the sale of men's hair care products ranging from children to adults.

Data were collected through a series of interviews, documentation and observation. Semi-structured interviews were conducted with business owners and staff through questions that referred to the indicators of internal control management. In this interview, the researcher can elaborate on the questions to obtain significant data through flexible and open-ended interviews (Sugiyono, 2019). Meanwhile, documentation was used to collect data related to business-owned documents such as organisational structure, purchase and sales notes, transaction records, Standard Operational Procedure (SOP) and other supporting documents. Documentation is a data collection technique that involves collecting or copying existing secondary data (Saat & Mania, 2020). Furthermore, observations were conducted by visiting the business units to observe daily operational activities and to assess the implementation of internal control management. Observation is a data collection technique used to monitor the object under study directly (Artaye et al., 2022).

The stages of data analysis are data reduction, data presentation, and conclusions. Adequate and inadequate' are two criteria for assessing internal control components. If the entity's business practices fulfil its requirements, it is categorised as 'adequate'. Conversely, if the entity's business practices do not fulfil its requirements and therefore need recommendations to assist the internal control system, it is categorised as 'inadequate'.

## **Results and Discussion**

### **Control Environment**

The control environment is the foundation of all internal control components that create two important principles: discipline and structure (Darminto & Iswahyudi, 2019). The control environment components include integrity, ethical values, competence, commitment and human resources. However, not all components of the control environment have been applied in the

barbershop business process in Ambon City.

Based on the results of interviews with owners and supervisors as key informants, several control components that have not been implemented include commitment to integrity and ethical values in written documents, employee termination policies for those who violate integrity and code of ethics, provisions for promotion, competency improvement policies, and dismissal policies for incompetent employees. In addition, there is no written policy on integrity or ethical values presented to employees during recruitment. The business also does not have a written Standard Operational Procedure (SOP).

Barbershop businesses' internal controls include establishing structures, reporting mechanisms, authority, and responsibility. The owner has a well-established organisational structure with two divisions: financial supervisor and supervisor. This barbershop business has cashier and stylist employees who serve customers daily. The control mechanism from the owner to obtain information and check financial reporting is entrusted to the financial supervisor, who regularly visits each business branch. The financial supervisor will receive daily transaction reports from the cashier and report them to the business owner. The owner will monitor the monthly finances and observe any progress or financial issues that may occur.

The barbershop business also has a transparent reporting mechanism. Cashiers and stylists from each branch will report any issues related to barber needs to the general supervisor division. The cashier will also report any issues regarding financial responsibilities and needs to the financial supervisor division. Furthermore, both divisions will report each result to the owner. Another internal control implemented is the employee rotation policy, where stylists who have worked for a long time will move to a new branch to guide new stylists. In recruiting employees, education level is not a requirement to apply. There were also no specific criteria for candidates applying for the cashier position.

Meanwhile, the stylist position considers work experience and visual health. For applicants who have work experience in traditional barbershops, they will receive training for 1 month. Applicants with barber work experience will be accepted with some adjustments to the new rules. Work performance evaluations have not been conducted routinely or implemented in all business branches. However, business units have implemented incentive policies based on employee performance.

Based on the control environment component analysis, this business must create a written code of conduct policy document and socialise it with employees and candidates at each business branch to ensure that all workers understand the code of conduct. Business owners and supervisors are also expected to implement regular evaluations and provide a role model to ensure the implementation of the code of ethics is running well. The company should also have a written policy document for employees who lack integrity, violate the code of ethics and lack competence. This document contains the punishment for workers who do not perform their duties based on the code of ethics. It will encourage employees to maintain their competency standards, which will improve the business organisation's performance. Organisations can also apply consistent punishments such as written warnings, suspensions and dismissals in case of severe code of conduct violations that deteriorate the business's reputation.

In the recruitment process, companies should require a certificate of expertise for applicants who apply for stylist positions. This effort will add value to the quality of stylist competence and increase customer satisfaction. To show appreciation for the employees who perform best each month, the owner can award them as '*staff of the month*' in each branch. Even simply, rewards will make employees feel valued as a form of public recognition of performance and dedication that can boost work motivation.

### Risk Assessment

Based on the data obtained by the service team, the barbershop business has not yet conducted a risk analysis to identify issues that could hamper the business. The main focus of business risks and challenges is the effort to maintain services amidst the increasing competition of barbershops in Ambon City. For this reason, owners are recommended to continuously maintain the quality of services to gain customer trust amid increasingly fierce business competition.

Interviews with supervisors as key informants revealed several possible risks that might occur based on the level of impact. The identified risks are employees not performing their duties and responsibilities, lack of stylist expertise, and minimal utilisation of social media for business promotion. The business unit must recognise the risks to make the right decision to address the issues (Setyawan et al., 2021). **Table 1** presents the matrix of risks identified through the data collection process.

**Table 1.** Barbershop Business Risks Matrix

No	Risk Description	Potential Occurrence	Level of Impact	Ranking of Risks
1.	Employees do not undertake their work responsibly	3	4	12
2.	Lack of competitive stylist expertise	3	3	9
3.	Lack of promotions through social media	4	2	8
4.	Management unable to achieve business targets	2	3	6
5.	The difference between manual and computerised financial reports	2	3	6
6.	The difference between cash and report recording	2	3	6
7.	Delayed supply of hair care products from vendors	2	3	6
8.	Competitiveness in price with rival businesses	2	3	6
9.	Customer complaints due to service queues	2	2	4
10.	Software in the business system is not regularly updated	2	2	4
11.	Financial report errors, both daily and monthly	1	4	4
12.	The business unit lost its database	1	4	4
13.	Cash thievery by employees from either the cashier division or finance supervisor	1	3	3
14.	Software error	1	3	3
15.	Business barriers due to natural disasters	1	2	2

Source: Primary Data, 2024

Description: The range of probability and impact is 1 – 5 (1 = very low, 2 = low, 3 = moderate, 4 = high, 5 = very high)

Based on the analysis of the risk assessment component in **Table 1**, the barbershop business should implement periodic risk identification when there are significant changes in

worker performance. By utilising the risk matrix in [Table 1](#), the business organisation can readily deal with possible risks that might hinder the business's operation. The business owner was also required to conduct a fraud risk assessment. Controlling business operations relies not solely on employee trust but on regularly evaluating employee performance and potential violations. Thus, the owner can observe the business dynamics as a basis for designing business development strategies and mitigating the risk of fraud.

### **Business control management**

Based on the interview, the barbershop business has a control strategy by distributing job descriptions in each position in the organisational structure. The stylist handles haircut services, the cashier handles daily financial transactions, and the financial supervisor handles daily financial accounting and monthly reporting. Furthermore, the general supervisor generally handles the needs and affairs of the business organisation. The general supervisor is responsible for supplying the necessities to each branch and maintaining business assets.

The finance supervisor handles the checking, authorisation of receipts, and disbursements of daily business transactions. Cashiers send supervisors daily financial reports. Supervisors check daily transactions by validating them by comparing manual and computerised records through the application. Daily transactions are carried out in cash and non-cash so that supervisors carry out authorisation daily as a control measure and prevent financial report errors.

The utilisation of information technology in barbershop business development is one aspect of business control. Optimising the use of technology by establishing business development policies and procedures can help the entity achieve its goals (Setyawan et al., [2021](#)). In this aspect, the cloud-based cashier application system records the barbershop business's daily transactions. Access to this application is controlled through username and password protection, which is only known by cashiers and financial supervisors. Cashiers and supervisors set different passwords for each branch to minimise other employees' abuse of the application. Password protection is an effort to secure secret data and important organisational information. The barbershop business has also implemented controls related to authorisation in the software used by business management. In this aspect, stylists only have the authority to see each transaction and employee data. Stylists have the right to read transaction data and to compare manual and application transaction data. Thus, they can estimate the wages each month.

Control mechanisms are also carried out in the financial management aspect. Cashiers have the authority to create sales transaction data, payment methods used, and payment status. They also record employee shifts according to a predetermined daily schedule. Cashiers cannot change or set any menu options in the application. When a transaction input error occurs, they should report it to the financial supervisor. The finance supervisor then guides the appropriate steps to address the issue.

The finance supervisor has the authority to administer the application, for instance, inputting product items, updating prices, checking stock, and setting the stylist's name on duty.

The business owner can create, read and update the application display through a custom website from a cloud-based cashier application system. From the website, the owner and financial supervisor only have the authority to check daily business transaction data. The owner and financial supervisor also have the privilege to delete the list of services and products in case of data updates. They also have access to employee data, such as updating positions and adding, removing, and rotating employees. Meanwhile, the general supervisor only has the authority to read data in the application, particularly regarding data on stock items requiring daily restocking. **Table 2** provides the analysis results of job descriptions and their respective access rights for Create, Read, Update and Delete (CRUD) on the barbershop business application system.

**Table 2.** Analysis of Job Description and Access Rights

Entity - Attributes	Job Description	Data on type services		Product Sales Data			Transaction Data			Employee Data			State
		List of Services	Price	Product items	Price	Stock	Sale	Payment Method	Payments Status	Name	Position	Shift	
Position													
Business Owner	Determine the types of services and product items for sale, receive financial and non-financial reports, and organise the employee recruitment process	C R U D	C R U D	C R U D	C R U D	C R U D				C R U D	C R U D	C R U D	Fulfilled
Financial Supervisor	Determine the types of services and product items, receive daily transaction records, and assist the owner in the employee recruitment process	C R U D	C R U D	C R U D	C R U D	C R U D				C R U D	C R U D	C R U D	Fulfilled
General Supervisor	Restocking business needs and maintaining the assets	R	R	R	R	R				R	R	R	
Cashier	Inputting customer transactions and recording employee shifts	R	R	R	R	R	R	R	R	R	R	C R	Fulfilled
Stylist	Providing services to customers, confirming the number of services that have been undertaken and checking the suitability of individual employee data									R	R	R	Fulfilled

Source: Primary Data, 2024

To support business assets' control and security process, the barbershop business owner has installed CCTV in each branch in a strategic area that can closely monitor every activity. Owners and financial supervisors can monitor these CCTV cameras remotely through gadgets or other devices. In addition, CCTV footage can be used to check back to ensure employee fraud. Cashier activities are also of particular concern because they can be fraudulent when

inputting daily cash income and expenditure data.

The barbershop business has implemented controls to protect business assets. Business assets such as are placed in a proper and safe place. Control in the barbershop business is also carried out by monitoring current assets, where the cashier makes a daily report containing the amount of petty cash and information about the amount of inventory sold and remaining every day to the supervisor. The general supervisor monitors the fixed assets directly every month through reports from each branch to the business owner. The report contains information on the quality of business assets and the demand for deteriorated replacement assets. The barbershop business also does not have a formal written document regarding punishment for violating employees. The absence of this document triggered several violations, especially in the daily financial transaction report.

### **Information and Communication**

Regarding information and communication, the quality of information requires linking the activity data of each party in the business organisation (Saadah, 2019). Communication includes procedures for assigning organisational stakeholders and responsibilities regarding the appropriate control structure in financial reporting (Darminto & Iswahyudi, 2019). Based on the results of the interviews, business owners and supervisors stated that the communication pattern and the process of exchanging information between the workers have been running quite well. Supervisors evaluate and monitor every business need through daily routine inspections to build good communication and information exchange processes. The business owner always tries to build good communication between employees through effective communication to understand the needs of each division.

The barbershop business has established communication between business owners, supervisors and employees. The business organisation operates the communication and information delivery system through technology platforms such as WhatsApp, which involves all employees. Control efforts through communication and information aspects also include customers. Customers can provide suggestions and criticisms of service quality through a telephone number that supervisors can access. From these suggestions and criticisms, business owners can identify problems as early as possible and determine strategies to solve them appropriately and effectively. External communication also involves pomade suppliers as one of the product items for sale. Business organisations also communicate with the government as external stakeholders regarding business permits based on official regulations and laws. Based on the information and communication component analysis, barbershop business organisations generally carry out adequate internal control practices. However, in the aspect of checking daily transactions by the financial supervisor, it is recommended that checking and confirming with the cashier be carried out regularly to reduce misinformation.

### **Monitoring**

The monitoring component is a way to evaluate the implementation of a business organisation's internal controls to conclude the quality level of those controls (Saadah, 2019). A good business organisation has a continuous and sustainable monitoring system through

various evaluation approaches regularly and incidentally (Darminto & Iswahyudi, 2019). Based on the results of interviews with business owners, barbershop business organisations have not implemented an internal audit system periodically. Business management has not used fraud detection software because such equipment requires a large investment. A general supervisor inspects each branch regularly and secures the business's physical assets. Supervisors periodically check the system, security tools and business equipment through established procedures. General supervisors also monitor business activities through surveillance cameras at each branch.

Supervisors' findings on daily employee performance monitoring will be reported to the business owner for immediate follow-up. The barbershop business organisation has not implemented a collective performance evaluation system involving all business branches. Performance evaluations are only carried out at certain branches biannually or triannually if there are urgent problems. From the results and discussion of each component of internal control in barbershop business organisations in Ambon City as the subject of research, Table 3 presents the results of the evaluation of internal control practices based on the COSO Framework in this barbershop service business.

**Table 3.** Evaluation of the Implementation of Internal Control of a Barbershop Business based on the COSO Framework

Components	Implementation	Description
Control Environment	<ul style="list-style-type: none"> <li>- Having an unwritten policy on integrity and code of ethics (verbalised only)</li> <li>- Having no termination policy for employee misconduct or employees with a lack of integrity</li> <li>- The business owner monitors the supervisor's report</li> <li>- The business has an organisational structure with specific job descriptions (no staff with double positions)</li> <li>- Having a policy that regulates a transparent business reporting mechanism</li> <li>- The business organisation divides the authority and responsibility of each worker</li> <li>- The recruitment process considers the qualifications of job candidates</li> <li>- New employees undergo pre-employment training</li> <li>- Having no termination policy for decreasing the competence of employees</li> <li>- Business organisations do not conduct regular briefings and performance evaluations</li> <li>- Having a bonus policy</li> <li>- Having no specific reward policy to encourage employee performance</li> </ul>	<ul style="list-style-type: none"> <li>- Adequate</li> <li>- Inadequate</li> <li>- Adequate</li> </ul>
Risk assessment	<ul style="list-style-type: none"> <li>- Having a clear business goal</li> <li>- Not conducting business risk analyses</li> <li>- No risk assessment of fraud</li> <li>- No identification and analysis of external changes that may affect business operations</li> </ul>	<ul style="list-style-type: none"> <li>- Adequate</li> <li>- Inadequate</li> <li>- Inadequate</li> <li>- Inadequate</li> </ul>
Control Activities	<ul style="list-style-type: none"> <li>- Implementing financial risk controls</li> <li>- Implementing controls for the security of current assets</li> <li>- Not implementing a comprehensive control to protect the</li> </ul>	<ul style="list-style-type: none"> <li>- Adequate</li> <li>- Adequate</li> <li>- Inadequate</li> </ul>

Components	Implementation	Description
	<ul style="list-style-type: none"> <li>security of fixed assets</li> <li>- Applying software for daily financial accounting</li> <li>- Business financial recording software is updated regularly</li> <li>- Having monthly financial report documents and one accounting period</li> <li>- Installing surveillance cameras (CCTV), but several cameras have not yet covered the cashier area</li> <li>- Implementing a security system for the software used</li> <li>- Having no policy related to work security.</li> <li>- Having no policy on employee misconduct</li> </ul>	<ul style="list-style-type: none"> <li>- Adequate</li> <li>- Adequate</li> <li>- Adequate</li> <li>- Inadequate</li> <li>- Adequate</li> <li>- Inadequate</li> <li>- Inadequate</li> </ul>
Information and Communication	<ul style="list-style-type: none"> <li>- Checking of daily transactions by supervisors</li> <li>- Having periodic financial statement documents that provide accounting information</li> <li>- Establishing internal communication among each employee.</li> <li>- Establish external communication through criticism and suggestion services.</li> <li>- Establish communication with barbershop product suppliers</li> </ul>	<ul style="list-style-type: none"> <li>- Adequate</li> <li>- Adequate</li> <li>- Adequate</li> <li>- Adequate</li> <li>- Adequate</li> </ul>
Monitoring	<ul style="list-style-type: none"> <li>- No identification of control needs</li> <li>- Regular transaction checks</li> <li>- Not conducting separate evaluations through regular internal audits</li> <li>- Evaluate and communicate control weaknesses and obstacles encountered in the business operations</li> </ul>	<ul style="list-style-type: none"> <li>- Inadequate</li> <li>- Adequate</li> <li>- Inadequate</li> <li>- Adequate</li> </ul>

Source: Primary Data, 2024

Based on the analysis of the monitoring component, barbershop businesses in Ambon City should conduct periodic risk assessments. The implementation of internal auditors also needs to be considered by business owners through continuous and sustainable inspection and evaluation of procedures. This method ensures that the business's operational processes run consistently under the business's goals and vision. Barbershop business organisations must also conduct risk management to identify potential business continuity risks. In addition, the role of the financial supervisor needs to be optimised to check and reconcile transaction records periodically. This step aims to ensure the sufficiency and accuracy of transaction data.

## Conclusion

This community service programme can evaluate the implementation of internal control in MSMEs by providing adequate recommendations for business entities through a service-learning approach. Internal control components based on the COSO framework can be utilised to appropriately evaluate the implementation of internal control in MSMEs. The evaluation of the barbershop business shows that among the five components of internal control, merely information and communication fulfilled the standard of adequate business implementation. Meanwhile, the other four business internal control components must be improved and re-evaluated.

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