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# AN EVALUATION OF INTERNAL CONTROL IMPLEMENTATION: CASE STUDY OF EXHIBITION COMPANY

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## ABSTRACT

*This study aimed to evaluate the revenue cycle implemented in the Exhibition Company to identify the weaknesses and limitations of internal controls related to revenue cycles by referring to the COSO's Internal Control Framework. The study uses a qualitative descriptive approach by assessing the current revenue cycle implemented at the Exhibition Company and the internal control. The process of collecting data is through interviews and observation. Based on the evaluation, there are weaknesses in internal control in the revenue cycle applied by the company. This study indicates that the internal control is still not effective following the COSO framework, leading to the possibility of a fraudulent act in the company. Therefore, as its business continues growing, it is essential to focus more on its revenue cycle system and internal control to implement an effective and efficient procedure to support its operating performance. Furthermore, it suggests improvement as needed based on COSO's internal control framework to overcome the discovered potential weaknesses.*

***Keywords*****:** *Revenue Cycle, Internal Control, Evaluation, COSO Framework*

## INTRODUCTION

Recently, economic development and business have grown significantly, becoming more complex and tend to be driven by technological advances. Meanwhile, the company is focusing more on increasing transparency and accountability for the integrity of the internal control system that supports business decisions and organizational governance. Internal control is one of the critical parts to achieving organizational goals (Rae et al., 2017). The internal control system is a concept that encapsulates the integrity structure, ethical values, and all company activities to optimize the company's goals (Stringer & Carey, 2002).

Internal control within a business entity can affect the business operations of a company. Proper internal control can keep business operations more accountable and transparent because every business activity within the entity is documented following existing procedures (Wicaksono, 2013). Furthermore, internal control can provide a system that can support identifying parts that have potential risks and limitations (Çika, 2018).

The internal control system reflects the supporting structure that manages business strengths, weaknesses, threats, and opportunities to achieve the desired results. It is a potential tool to utilize resources more efficiently at every level of the organization.

Basically, the function of internal control within the company is to provide all standards and procedures to assure the transaction process is avoided from inaccuracies, theft, and misleading (Attah-Botchwey, 2018). Therefore, to support the company to achieve its goals, there needs to be a manager or management that can plan, coordinate, control activities, and support the effectiveness of its business operations so that it becomes more transparent, effective, and efficient (Ayam, 2015). Internal control is process-oriented, focusing more on business processes than on the outcomes of the methods.

Committee of Sponsoring Organizations of the Treadway Commission (COSO) 's Internal Control-Integrated Framework defines internal control as "a process, influenced by an entity's board of management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: 1) operational effectiveness and efficiency 2) reliability of financial reporting 3) compliance with existing laws and regulations" (Schandl & Foster, 2019; The Committee of Sponsoring Organizations of the Treadway Commission, 2013). COSO framework focuses on five elements of internal control: control environment, risk assessment, control activities, information and communication, and monitoring activities (Graham, 2015). The objectives identify what the organization wants to achieve and the components to determine what is required to achieve these objectives.

The five internal control components are:

1. Control Environment
   The Control Environment is a basic standard dan structure that provides internal control within the organization. Reasonable environment control will create a conducive atmosphere and set the tone for implementing effective internal control. Adequate internal control requires human resources who have integrity and ethics. The company is responsible for upholding such integrity and ethics. The code of ethics is made in writing, formally, and socialized to all members of an organization. Management activities show the importance of internal control in a company for employees.
2. Risk Assessment
   Risk Assessment is a dynamic process to identify and analyze risks in achieving the company's objectives. Besides that, risk assessment is the basic form for determining how risks should be managed and identifying areas where possible threats or risks of inaccuracies or losses will occur. In the risk assessment, management needs to consider the impact of possible changes in the internal and external environment and potentially manage these impacts.
3. Control Activities
   The action established by the organization's policies, procedures, and standards to help ensure management directives to reduce risks to the achievement of objectives that perform at all levels of the organization, at various steps of the business processes, and through the technological environment. Examples of control activities are proper authorization of transactions and activities, validation, review, and segregation of responsibilities. Control activities are essential for implementing internal controls to minimize the occurrence of errors or fraud.
4. Information and Communication
   The company requires communication and information to implement its internal control responsibilities to achieve financial reporting objectives. Communication is an ongoing and repetitive process of providing and acquiring the information required to design, implement, and evaluate internal controls and assess their effectiveness. Besides that, information and communication is a form of identifying, recording, and exchanging information in a particular state and time frame to carry out their duties and responsibilities both internally and externally.
5. Monitoring Activities
   Monitoring is ongoing evaluations to ensure that each of the five components of internal control, including the rules that affect the principles within each part, are present and functioning and also identifies the possible elements where the most significant risk or threat of inaccuracies or loss would exist. The most significant threat will be receiving more attention and control. An awareness of the organization's integrity and ethical values reinforces the accountability culture for employees, which is reflected in the extent of monitoring activities (Stringer & Carey, 2002).

An exemplary implementation of internal controls can improve the accountability and transparency of business operations (Ayam, 2015). This can happen because every business activity in the entity is well-documented and can prevent abnormality. The company's operational activities should be well arranged and coordinated to reduce the occurrence of fraud and to be more effective, efficient, and transparent (Lawson et al., 2017).

Small-medium enterprises usually have internal controls that are influenced by certain issues inherent in small companies. These issues are characteristic of small companies due to lack of segregation of duties, not many employees, simple bookkeeping, limitation of internal controls, and the possibility to override management ((Büyükçoban & Ünkaya, 2016). The company must develop an efficient and effective internal control system in the accounting cycle to detect or prevent fraud (Foster et al., 2010). Internal control is not only designed for a multinational company but also small-medium enterprise businesses. The previous study shows differences in the implementation of internal control in each company depending on size, organization structure, and operating performance (Çika, 2018; Liu et al., 2017; Stringer & Carey, 2002). In Turkey, internal control effectively detects fraudulent acts in the financial statement. It has led to the economic competence of small and medium enterprises, which is different from large companies that have a better vision of fraud indicators in financial statements. (Büyükçoban & Ünkaya, 2016).

In Nigeria, measures of internal control systems, including the control environment and control activities, positively affect the Small-Medium Enterprises' operating performance (Adegboyegun et al., 2020). Hence, Small-Medium Enterprises should maintain and take advantage of the positive impact of the control activities and control environment to improve their operating performance. Besides that, Small Medium Enterprises face challenges implementing internal control due to employee-related issues like indiscipline in working hours, unclear duties and responsibilities, and lack of cooperation.

Then, (Monday et al., 2014) evaluated the impact of internal control on the performance of small-medium enterprises in Lagos. The study employing a random technique sampled 200 small business owners in Lagos State. It was found that internal control has a significant effect on operating efficiency, profitability, and company viability Small-Medium Enterprises in Lagos. Therefore, this study recommends that Small-Medium Enterprise managers consider internal control issues to increase revenue and reduce the risk of fraud and loss.

Internal control is a critical element in the business cycle, especially in sales and the cash receipt cycle, which is the central core of business in the company. The revenue cycle plays a role in describing a set of activities of direct exchange of finished goods or services for cash in a single transaction between a seller and a buyer (Romney et al., 2006). The essential purpose of the revenue cycle is to provide the right product in the right place at the right time for the right price. However, the revenue cycle can generally be divided into three primary activities: sales, accounts receivable management, and cash receipts. These activities are interrelated; If one has a problem, it will affect other activities.

This study purposes of evaluating the implementation of internal control in one of the exhibition organizing companies. The company is classified as a small-medium business based on the company's annual sales turnover. The company has several branch offices in Central Java, East Java, Sumatra, Kalimantan, Sulawesi, and Bali. Each branch has two or three employees depending on the store's exhibition volume. Generally, Exhibition Company managed exhibitions engaged in property, clothes, automotive, and other products. Each branch employee consists of administrative staff, marketing staff, and operational staff. They have a responsibility and report to the manager of the branch.

The company uses the system, namely Accurate, for recording and reporting on all branch operations. However, the system is not integrated with branches only operates centrally at the head office. Therefore, the branch office will be generated a report manually by filling out the agreement form, customer billing, exhibition date, price, and kind of product. The document was then sent to the head office via email. Furthermore, the head office will fill in manually in the Accurate system by referring to the form emailed to the branch.

Since Exhibition Company belongs to the small business category, which usually ignores the importance of internal control in operations, small business owners tend to apply a combination of self-interest and personal financial considerations as their goal. The system used to support the operational activities of the Exhibition Company tends to be centralized. This raises the potential for manipulation of information originating from the branch. In addition, there are bad debts in the company's operational activities and even the uncollectible receivable. In addition, there are also frequent fake claims received from branches due to the company's limited internal control.

Based on the descriptive above, the problems that will be discussed in this study are: (1) identify the possible risks in revenue cycle related to ongoing operational activities, (2) evaluate of current company's internal control using COSO's elements to anticipate and managing uncollectible accounts, and (3) propose recommendation to existing internal control based on COSO's internal control framework.

## METHODS

The study uses a qualitative descriptive approach by assessing the current revenue cycle applied at the Exhibition Company and the internal control applied in that cycle. Natural processes are used in qualitative research to understand phenomena in terms specific to a topic. The researcher does not manipulate the interest in the phenomenon being discussed. The description model represents an image of the details of an event, social situation, or relationship. The results of descriptive research are in the form of a comprehensive explanation of the topic studied (Saunders et al., 2016). This study applies a case study model to analyze the business processes of the Exhibition Company based on the principles of the five elements of COSO internal control and then identify the potential risks in operational activities primarily regarding its revenue recognition and bookkeeping method. The procedure in collecting data in this research uses a semi-structured interview with open questions from general to specific questions that allow the interviewee to provide more comprehensive answers. This type of data is obtained from the company's executive level, which deals with sales and promotion activity, from the board of directors to the managers, and direct observations by the author.

## RESULT AND DISCUSSION

### A. Current Business Process of Exhibition Company

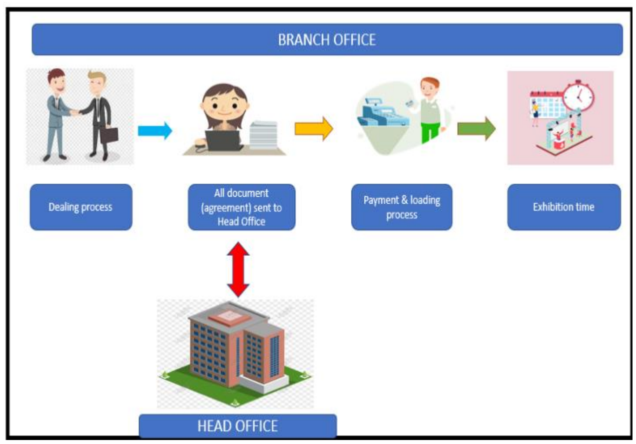


Figure 1 Business Process of Exhibition Company

Based on figure 1, the business process can be described as below:

1. Initially, the customer will submit an offer to the branch marketing staff related to the selected exhibition.
2. Then, the administrative staff of the branch office will submit a proposal document with information on the size of the booth, the exhibition period, the type of product selected by the customer during the exhibition, and the exhibition venue

chosen by the prospective customer. The branch office manager must sign the contract document before the document is sent to the head office. The document will be sent by email to head office.
3. The Head Office administrative staff will verify all contracts sent from each branch by completing approval from the marketing supervisor and administrative supervisor. All information based on contracts will be input to the Accurate system that only operates at the Head Office to produce a bill following the agreed rental price. The documents are made in two copies and must have approval from the Finance manager.
4. After the approval process is completed in Head Office, the agreed invoice and contract will be returned via email to the branch office to accompany a signature from the prospective customer.
5. The payment for exhibition bills is centered on the head office account number. Then, Head Office provides a notification to the branch regarding the status of the payment. When payment is completed, the Head Office will issue a permit for a warehouse-approved loading dock for exhibition equipment based on the approval of the operational supervisor, and a printout document will be sent to the branch office and submitted to related parties.
6. The branch office administrative staff have responsibility for the outstanding payment report. If the payment amount is different from the Bill, the branch office staff should be responsible for the underpayment Bill from the prospective customer.
7. During the exhibition time, the company will assign one staff to assist and be in charge of the exhibition booth design for customers.

**B. Identify Risk and risk management in the revenue cycle.**

Based on the interview process with the employee of Exhibition Company, the researcher defines several potential risks embedded in the company and risk management to mitigate the risk.

Table 1 Potential Risk in Revenue Cycle

| **Activities** | **Potential Risk** | **Risk Management** |
|---|---|---|
| Billing Method and supporting document | The documents such as Bills/Invoices are not numbered regularly, and there are inconsistencies in document numbering. The branch office can manipulate the amount on the Bill and additional contract clauses submitted to the head office | It provides pre-number documents and synchronization to make the verifying process less complicated and avoid fraud by the branch office. Furthermore, Head Office can directly contact the customer to verify the amount stated on the agreed bills. Moreover, this is very useful for audit purposes in terms of evaluating the validity, existence, and completeness. |
| Billing and term of payment | There is a possibility of unpaid exhibition bills from the customer and lead to uncollectable accounts receivable. Usually, the customer will run away from responsibility. This happens because of a lack of internal | Head Office will mention the term of payment in the agreed Bill. The Bill must be paid off before the exhibition is held. |

| Activities | Potential Risk | Risk Management |
|---|---|---|
| | control on the revenue cycle. | |
| Unreported exhibition activities by branch office | The branch office marketing staff did not inform the Head Office about the existing exhibition activities. | The head office will do inspections regularly to the exhibition venue without prior notice to a branch office. |
| Policy of Reimbursement | Fictitious reimbursement transactions claimed by the branch office. | Every reimbursement transaction must be supported by an official receipt from the store, and handwritten forms of receipts are not allowed. |

**C. Evaluation The Internal Control in The Revenue Cycle according to COSO's Element.**

To provide the proper recommendations, the researcher tries to evaluate the internal controls that the company has implemented. The evaluation process compares field facts and findings in the existing internal control system concerning the COSO internal control. The company has implemented two elements of COSO internal control: risk assessment and control activities. Risk can be defined as the possibility of an event that may occur and have a negative impact on the achievement of company goals. In this case, the company has already determined possible risks in its activity and overcome them. Moreover, the control activities consist of policies and procedures which help ensure the direction from management on internal controls and have been implemented to determine the risks (Romney et al., 2006).

The company has implemented risk management to mitigate the possibility of the risk occurring, but some activities still have some shortcomings. First, the Bill should be well pre-numbered and synchronized to prevent price manipulation. However, there is still the possibility of cooperation between marketing staff and customers to manipulate contract value. These documentation and business activities' recommendations are aligned with the control activities and the information and communication components of COSO's internal control model. Second, the Head Office should make a sudden visitation to avoid unreported exhibition practices. However, fraudulent actions can occur because when the head office staff visited the exhibition, no fraud was found. Still, it could potentially happen in other exhibition areas. Third, the head office required that every submission of reimbursement must be submitted in an official receipt form. But there is still a risk because the head office does not know the main purpose of the money reimbursed, whether for personal use or not related to the company's operations. Furthermore, the control of activities carried out is still centralized at the head office and has not accommodated activities at branches. This also impacts the implementation of rules that are applied to the tendency to have gaps for the occurrence of risks that have been carried out.

There are three COSO elements that have not been appropriately implemented in the company: the control environment, information and communication, and monitoring. The control environment is the main of all control activities; management should control all company parties, either at the head office and also branches. It is a shared view of understanding and preventing risk by creating corporate value and work culture. Besides that, communication and information are the processes of delivering information at every level of the company. So, it can be concluded, the basis of all the risks on this company is the absence of standard procedures.

# CONCLUSION

Based on the evaluation, the exhibition company's internal control procedures are still not adequate and lacking in a certain way. The company only applies two of COSO's internal control elements, risk assessment and control activity. Besides that, the controlling environment as the main element in internal control has not been implemented yet, followed by aspects of information and communication and control elements. The interview results with respondents stated that the internal control standards were not yet in place due to the ineffectiveness of the company's adoption of COSO internal control elements. Furthermore, the internal control system is centralized only at the Head office, so it can not accommodate internal control activity in the branch. This can result in applied internal controls likely still to have a gap in case of identified risks.

This study was limited because the researcher generated the data from one company, and the interview process was only from the selected employee. Therefore, caution should be exercised in the interpretation of the results. Besides that, the researcher 'can't access documents related to the revenue cycle, not all, because the management limits it. However, the finding from this study remains valid. Future researchers can explore the impact of internal control systems on other companies or universities.

The company should improve its handling of documentation for better control and reliability of their business transactions. Appropriate segregation of duties should be implemented within the company to minimize the possibility of fraud and employee theft. It is also recommended to conduct audits by Head Office periodically. In addition, the researcher provides several recommendations that are considered more appropriate and adequate according to COSO's Internal Control, as follows:

Tabel 2 Recommendation COSO's Element

| No. | Descrip-tion | COSO's Element | Limita-tion | Recomm-endation |
|---|---|---|---|---|
| 1 | Non-Standard of Internal Control | Control Environment | Different Risk management | The management need to improve internal control standards with the perspective of COSO elements; Management actively reminds company values and culture to all branches |
| 2 | A centralized system which is only used in Head office, not integrated with the branch office. | Control Environment | Fraudulent act by branch office that may reduce branch office revenue. | Branch Office should implement an Accurate system to mitigate potential fraud and maintain the company's business continuity. |
| 3 | Do inspection regularly to exhibition venue to prevent unreported event by the branch office. | Control Activities | Exhibition fraud doesn't happen in the place that visited by Head office representative. | The head office made an agreement with malls or Building management for the exhibition location due to CCTV video recording and imposed sanctions on dismissing regional managers and branches involved. |
| 4 | Bill is not | Control | Branch | The |

| No. | Descrip-tion | COSO's Element | Limita-tion | Recomm-endation |
|---|---|---|---|---|
| | well prenumbered | Activities | marketing staff and customers work together to commit fraud by manipulating the Bill. | contract preparation process, including the agreement on exhibition prices at the branch, requires approval from the head office; the approval process involves finance managers to operation supervisors, not limited to branch managers. |
| 5 | The reimbursement process is based on the official receipt. | Control activities | Many fictitious claims due to fraudulent transaction receipt. | All operational transactions should be recorded to an Accurate system to prevent Fictitious claims. Use recommended vendors to process the operational activities. |

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