*Indonesia Auditing Research Journal, 15 (3) (2026), pp. 300-310*

Published by: Institute of Accounting Research and Novation (IARN)

Indonesia Auditing Research Journal

Journal homepage: https://journals.iarn.or.id/index.php/ARJ/index

# Audit risk assessment in small enterprises gaps and challenges

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**Article Info**

***Article history:***

Received May 25, 2026
Revised Jul 19, 2026
Accepted Jul 28, 2026

***Keywords:***

Audit challenges;
Audit gaps;
Audit quality;
Audit risk assessment;
Small enterprises

**ABSTRACT**

The study is intended to explore the implementation of audit risk assessment in small enterprises and to identify the gaps and practical challenges that auditors face. A qualitative descriptive approach was adopted with data collection through interviews, observations and document analysis of public accountants. The findings suggest that although the risk assessment procedures are conceptually in line with auditing standards, their implementation in practice is still sub-optimal. There are material deficiencies in knowledge of the entity, assessment of internal controls, setting of materiality and retention of adequate audit documentation. Small enterprises are more likely to have higher inherent and control risks due to weak internal control systems, limited financial records and low accounting competence. All these factors increase the probability of material misstatements. Auditors are also faced with unreliable data and unstructured business processes, which hinder the effective implementation of risk-based auditing. Under such circumstances the auditor may have to rely more on professional judgment which may impact on the consistency and reliability of the audit. The research stresses the importance of more adaptive and context-sensitive audit approaches that are more relevant to the specific features of small enterprises and pragmatic insights to improve the quality of the audit and the effectiveness of the risk assessment practices.



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## 1. INTRODUCTION

Small businesses are a major source of economic growth, job creation, and financial inclusion, particularly in developing countries. Their financial information is increasingly used by investors, creditors, regulators, and other stakeholders for decision-making and accountability purposes (Zulfikar et al., 2022). Nevertheless, the quality of financial reporting among small businesses remains a significant concern due to resource constraints, inadequate accounting systems, limited internal controls, and the low financial literacy of business owners (Anggraeni et al., 2021; Ariani et al., 2024). These limitations increase the risk of material misstatement and create substantial challenges for auditors in assessing the reliability of financial information(Cristescu, 2018). Moreover, reporting delays may indicate underlying financial and organizational difficulties, including an increased risk of bankruptcy and weaker organizational performance, rather than merely reflecting administrative inefficiencies (Lukason & Camacho-Miñano, 2019). Taken together, these conditions make the development of a more adaptive audit approach increasingly urgent. Small businesses differ from larger entities in terms of organizational complexity, availability of accounting expertise, formalization of internal controls, and resource capacity; therefore, uniformly applying conventional audit procedures may not adequately reflect their specific risk profiles. An adaptive risk-based approach is consequently needed to align the nature, timing, and extent of audit procedures with the actual risks and operational characteristics of small businesses. Such an approach can enable auditors to concentrate limited audit resources on areas with a higher likelihood of material misstatement while maintaining an appropriate level of audit assurance. This need provides an important rationale for developing an audit framework that is both risk-sensitive and proportionate to the characteristics of small businesses.

Risk assessment is a key step in risk-based auditing because it enables auditors to identify risks of material misstatement and focus audit procedures on high-risk areas (Utami et al., 2021)(Karla M. Johnstone, Audrey A. Gramling, 2019). Auditing standards require auditors to understand the entity, assess internal controls, and evaluate inherent and control risks(Darwish & Al Astal, 2025). However, these procedures are not always fully implemented in small enterprises, particularly in audit planning, materiality determination, and risk identification (Irsanto et al., 2025; Saputri, 2023; Susan, 2020; Wood et al., 2019). Small enterprises often have simple organizational structures, limited segregation of duties, weak internal controls, and inadequate documentation (Alayli, 2022; Gopinath et al., 2018). Financial records may also be incomplete, manual, or inconsistent, making it difficult to obtain sufficient audit evidence (Gustina, 2020). These conditions increase audit risk and create challenges in applying standard risk assessment procedures(Hudakova et al., 2023).

These challenges reveal a gap between auditing standards and actual practices in small enterprises. Although previous studies have examined audit quality and financial reporting, limited attention has been given to the practical implementation of audit risk assessment(Țîrcovnicu & Haţegan, 2023). Weak internal controls, limited accounting competence, time constraints, and the lack of tailored audit guidelines may further reduce audit effectiveness(Ulupui et al., 2024). Therefore, further research is needed to support a more adaptive and context-specific risk-based audit approach for small enterprises.

Previous studies have examined risk-based auditing and the financial reporting limitations of small enterprises; however, limited attention has been given to how these characteristics affect the practical implementation of audit risk assessment. This study addresses this gap by identifying discrepancies between auditing standards and actual audit practices, particularly in entities with limited documentation, weak internal controls, and owner-managed decision-making. Unlike previous studies, this study provides empirical evidence on how these characteristics influence auditors' risk assessment and reliance on professional judgement. The findings therefore provide a basis for developing a more adaptive and proportionate risk-based audit approach tailored to the specific risk profiles of small enterprises. The study thus seeks to investigate the implementation of audit risk assessment in small enterprises, by focusing on the gaps between standards and practice, and the challenges faced by auditors. This research is designed to provide an in-depth understanding of real-world audit practices and the constraints that affect it through qualitative approach. It is hoped that the findings will contribute to the development of more adaptive audit methodologies and more practical audit methodologies adapted to the characteristics of the small enterprise.

The study has theoretical and practical implications overall. Theoretical contribution to the literature on risk-based auditing lies in the emphasis on the limitations of applying the standardised approach to different entities such as small enterprises(Božović et al., 2025). In practice it provides auditors and regulators with insights to improve audit guidance, professional judgement and risk assessment practices. The research question that this study will attempt to answer is: What are the gaps and challenges presented in the application of the audit risk assessment in small enterprises?

## 2. LITERATURE REVIEW

### Risk-Based Audit Approach in Financial Auditing

The risk-based approach to auditing uses an assessment of audit risk which aims to identify and evaluate the possibility of material misstatement in the financial statements(Karla M. Johnstone, Audrey A. Gramling, 2019; Moeller, 2012; O. Ray Whittington, 2022). This approach highlights the importance of understanding the entity, its environment, and its internal control system as a basis for designing effective audit procedures(Utami et al., 2021). Within the professional auditing standards, risk assessment is comprised of the assessment of inherent risk, control risk and the overall risk of material misstatement, which together direct the auditor on the nature, timing and extent of audit procedures. A well performed risk assessment process makes the audit more efficient and is a great contribution to the quality of the audit.

### Characteristics and Risks of Small Enterprises

The effectiveness of audit risk assessment is heavily dependent on the nature of the entity being audited. Small enterprises' financial reporting practices are frequently limited by a lack of resources, weak accounting systems, and low financial literacy among business owners(Anggraeni et al., 2021; Ariani et al., 2024). There are a lot of small businesses that do not fully comply with the relevant accounting standards, thus resulting in incomplete or unreliable financial information(Zulfikar et al., 2022). Low adoption of information technology in financial reporting(Tran et al., 2025), also increases the risk of errors and the possibility of material misstatements(Gustina, 2020). Such state of affairs means that small firms are riskier by nature than large firms.

### Weaknesses in Internal Control Systems

Small enterprises generally have weak and informal control systems, from the perspective of internal control. The poor implementation of internal controls, lack of standard operating procedures and proper segregation of duties reduces the effectiveness and reliability of internal controls for audit purposes (Alayli, 2022; Gopinath et al., 2018). Thus, auditors will conclude that the control risk is high and will emphasise substantive testing rather than reliance on control procedures(Raqee et al., 2025). This trend increases the audit effort and also highlights the deficiencies of traditional audit methodologies in the small business context.

### 4. Gap Between Auditing Standards and Practice

Empirical studies also show a significant gap between auditing standards and their practice. Auditors often find it difficult to fully implement risk assessment procedures, especially in the documentation of audit planning, determination of materiality, and in the identification of fraud and regulatory compliance risks(Irsanto et al., 2025; Susan, 2020). The key problems are the inadequate documentation and the scarce availability of reliable financial data in small businesses. Hence, auditors may comply conceptually with auditing standards but their practical application is often lacking resulting in variations in audit quality.

### Complexity of Auditing Small and Medium-Sized Entities (SMEs)

Auditing small and medium-sized entities (SMEs) poses specific challenges. These are very different from what we see in the audit of large organizations. These are due to difficulty of obtaining relevant and reliable information and informal nature of business operations. These conditions emphasize the importance of adjusting risk-based audit approaches to organizations with a low level of organizational complexity but with a relatively high level of risk (Țîrcovnicu & Hațegan, 2023). This suggests the need for additional research on how to successfully adapt audit methodologies to SMEs.

**Challenges Faced by Auditors in Risk Assessment**

Beyond entity-specific factors, auditors also face a number of operational challenges when performing risk assessments(Spira & Page, 2003). These include time, money and the lack of specific audit guidelines for small businesses. In such circumstances, the auditor may have to rely very heavily on professional judgement in assessing audit risk. However, such dependence without sufficient supporting evidence may enhance subjectivity and may influence the reliability and consistency of audit outcomes (Ulupui et al., 2024).

**The Role of Technology in Risk Assessment**

Recent research suggests that technological developments, notably in artificial intelligence and machine learning, could significantly improve auditors' risk assessment (Božović et al., 2025). These technologies enable auditors to analyze the data more deeply, identify anomalous patterns more easily, and perform audit procedures more efficiently. In practice, however, many small companies have already been unable to make use of these innovations. This is mainly due to shortage of resources, lack of technical skills and various technological constraints which makes difficult to implement in their context.

**Research Gap and the Need for Methodological Development**

In general, the literature reveals two major problems in the auditing of small enterprises: the existence of gaps between auditing standards and their implementation, and the number of problems which do not allow an efficient risk assessment(Gopinath et al., 2018; Irsanto et al., 2025; Susan, 2020). The findings suggest that a traditional risk-based approach to auditing may not be entirely appropriate for small enterprises unless suitably adapted(Țîrcovnicu & Hațegan, 2023; Ulupui et al., 2024). There is therefore an urgent need to develop more flexible and contextual audit methodologies to respond to the specific characteristics and limitations of small enterprises.

**Expected Research Outcomes**

This study is expected to provide a more comprehensive understanding of how audit risk assessment is implemented in small enterprises, while clearly identifying the gaps between auditing standards and their practical application. It is also anticipated to reveal the key factors that influence the effectiveness of audit risk assessment, including limitations in internal control systems, the quality of financial data, and the competence of human resources. Furthermore, the study is expected to offer conceptual recommendations for developing more adaptive, flexible, and context-specific risk-based audit approaches that are better aligned with the characteristics of small enterprises.

**Research Contributions**

a. Theoretical Contribution

This study is expected to contribute to the development of auditing literature, especially in the area of risk-based auditing in small enterprise contexts. It also adds to the ongoing debates concerning the divergence between auditing standards and their application, and can be a useful reference for future studies on audit risk assessment, such as the integration of novel technologies like artificial intelligence in auditing practices.

b. Practical Contribution

This research is expected to give guidance to the auditor in improving the effectiveness of audit risk assessment in small enterprises, especially by taking into account the existing limitations. The findings may help to develop more efficient and relevant audit strategies for public accounting firms. Furthermore, this study may be helpful to small business owners in encouraging improved financial reporting practices and internal control systems.

c. Policy Contribution

The results of this study are expected to provide valuable insights for regulators and standard-setters in formulating more practical auditing guidelines, which are more relevant to the real conditions of small enterprises. It can also be a useful resource when formulating policies that take account of the everyday challenges faced by small business. In so doing, these policies can improve audit quality and promote greater transparency and accountability in financial reporting. Ultimately, such efforts can help to build a more reliable and consistent auditing environment, as well as to strengthen trust in the financial information produced by small enterprises.

## 3. RESEARCH METHOD

This research used a qualitative method with a descriptive design(Chasan-Taber, 2014) to investigate the audit risk assessment implementation in small enterprises, especially to find out the gaps and challenges in practice. A qualitative approach is considered appropriate, because it can provide a deep understanding of complex phenomena in their real-life context, especially when the boundaries between theory and practice are not well defined(Sugiyono, 2024). This design enables the researcher to capture the experiences, perceptions and professional judgements of auditors in conducting risk assessments. The research was conducted at a public accounting firm in Bandung, Indonesia which was chosen because it actively participated in auditing small enterprise financial statements.

The study is limited to auditors with direct experience in conducting audit engagements for small enterprises. Informants were purposively sampled to ensure that participants have relevant expertise and practical exposure to audit risk assessment processes. The sample of informants consists of public accountants, heads of audit teams and members of audit staff that have been involved in the planning and the execution of audits.  Informants were selected purposively based on three criteria: (1) direct involvement in auditing small enterprises, (2) at least three years of audit experience, and (3) active participation in audit risk assessment, including planning, risk identification, and audit procedures. The inclusion of public accountants, audit team leaders, and audit staff with different responsibilities was intended to capture diverse perspectives and ensure that the data reflected actual audit practices in small enterprises. The main instrument in this study is the researcher as a human instrument that is responsible for collecting, interpreting and analysing the data. Various tools were used to facilitate data collection such as semi-structured interview guides, audio recording devices and field notes. These instruments were designed to provide consistency yet flexibility for informants to elaborate on their experiences and views of risk assessment practices.

Data were collected from both primary and secondary sources. Primary data were obtained through in-depth semi-structured interviews focusing on the implementation of audit risk assessment, gaps between auditing standards and actual practices, and challenges encountered during audit engagements (Ulupui et al., 2024).  Secondary data included professional auditing standards, financial accounting standards for small businesses, regulatory frameworks, and relevant empirical studies (Sugiyono, 2024; Zulfikar et al., 2022).

Triangulation was employed to enhance the credibility and trustworthiness of the findings by cross-validating evidence from different methods and sources(Rahariyanto & Rahayu, 2022). Method triangulation combined interviews, passive observation, and document analysis to compare informants' perceptions with actual audit practices and documentary evidence. Source triangulation compared information across informants to identify consistency, differences, and recurring patterns. Any inconsistencies were re-examined across interviews, observations, and documents before conclusions were drawn. Thus, triangulation reduced reliance on a single source or method and strengthened the credibility of the findings.

Data were analyzed using the interactive model of Miles and Huberman, consisting of data reduction, data display, and conclusion drawing and verification. Relevant data were selected and organized to identify patterns, relationships, and recurring themes related to audit risk assessment, gaps, and implementation challenges. Conclusions were developed iteratively and continuously verified across interviews, observations, and documents to ensure that the findings were supported by consistent evidence from multiple sources and methods.

The study aims to generate comprehensive and credible findings that reflect the real conditions of audit risk assessment practices in small enterprises using this methodological approach. The approach also helps to identify practical gaps and challenges, thus providing a strong foundation for developing more adaptive and context-specific audit frameworks.

## 4. RESULTS AND DISCUSSIONS

**Overview of Informants and Research Context**

The informants in this study were public accountants, audit team leaders, and audit staff with direct experience in auditing the financial statements of small enterprises. Most had more than three years of audit experience and were actively involved in various small-enterprise audit engagements. Small enterprises are generally characterized by simple organizational structures, limited accounting systems, and a high dependence on owner-managed decision-making (Gopinath et al., 2018). These characteristics significantly affect the practical assessment of audit risk. Limited documentation and internal controls increase audit uncertainty and require greater reliance on professional judgment. Consequently, current audit methodologies may be less effective when applied uniformly to small enterprises, as standardized procedures may not fully accommodate their limited documentation, weak internal controls, and owner-dominated processes. This highlights the need for a more adaptive and risk-based audit approach that aligns audit procedures with the specific characteristics and risk profiles of small enterprises.

**Implementation of Audit Risk Assessment in Small Enterprises**

The results indicate that, conceptually, auditors have applied audit risk assessment procedures in accordance with professional auditing standards, particularly in understanding the entity and assessing the risk of material misstatement (Karla M. Johnstone, Audrey A. Gramling, 2019; Țîrcovnicu & Hațegan, 2023). This includes preliminary procedures to understand the business, identify significant accounts, and assess inherent and control risks. However, in practice, the implementation is not fully optimized. Auditors find it difficult to obtain reliable and complete financial data because many small enterprises use manual and incomplete recording systems (Bérard & Claveau, 2017). One informant stated: *"We have a hard time tracking transactions sometimes because the records are incomplete and not kept in a systematic way."* This limitation restricts the auditor's ability to conduct a comprehensive risk identification process. The suboptimal implementation of audit risk assessment is mainly caused by limited and unreliable financial documentation, weak internal controls, manual accounting systems, and limited accounting competence within small enterprises. These conditions reduce the availability of sufficient audit evidence and increase auditors' reliance on professional judgement, making standardized risk assessment procedures more difficult to apply consistently**.** Ulupui et al. (2024) assert that successful risk assessment largely depends on the auditor's understanding of the entity and the availability of reliable information. Without sufficient documentation, risk assessment may rely more heavily on assumptions and professional judgement than on adequate audit evidence, thereby reducing its effectiveness.

The results indicate that conceptually auditors have applied the audit risk assessment procedures in accordance with professional auditing standards, particularly in the understanding of the entity and the risk of material misstatement(Karla M. Johnstone, Audrey A. Gramling, 2019; Țîrcovnicu & Hațegan, 2023). This includes preliminary procedures to gain an understanding of the business, to identify significant accounts and to assess inherent and control risk. But in practice the implementation is not fully optimised. Auditors find it hard to get reliable and complete financial data because many small enterprises have manual and incomplete recording systems(Bérard & Claveau, 2017). One informant states : "We have a hard time tracking transactions sometimes because the records are incomplete and not kept in a systematic way." This restriction limits the ability of the auditor to carry out the risk identification process in its entirety. Ulupui et al.(2024) assert that successful risk assessment is largely dependent on the auditor's knowledge of the entity and availability of reliable information. Without sufficient documentation, risk assessment is often based on assumptions rather than good evidence and therefore less effective.

**Gaps in Audit Risk Assessment Practices**

A key finding of the study was that there are significant gaps between the auditing standards and their implementation in small enterprise audits. Obvious gaps exist in several areas: *The first* is that documentation of the audit planning and risk assessment procedures is frequently inadequate. Auditors are not always required by auditing standards (Irsanto et al., 2025) to document discussions about risk identification. *Second*, materiality determinations are not always rigors. In many cases auditors will make simplified judgements without doing formal calculations, which may affect the accuracy of audit conclusions(Susan, 2020). *Third,* the identification of specific risks like fraud risk and regulatory non-compliance is often limited by lack of supporting evidence. This results in a more limited assessment of risk of material misstatement(BRANDAS et al., 2013; Jones & Free, 2026). The results confirm that auditors are aware of auditing standards, but the application in practice is constrained by the limitations of small enterprises. This is in line with the previous research which indicates a constant divergence between the normative standards and the real audit practices (Țîrcovnicu & Hațegan, 2023).

**Challenges in Conducting Audit Risk Assessment**

The study identifies several major challenges that auditors face in conducting risk assessment in small enterprises: *First*, Weak internal control systems. Most small companies don't have segregation of duties, standard operating procedures and other formal internal controls. This makes it difficult for auditors to properly take control risk (Alayli, 2022). *Second*, Minimal Financial Paperwork. The auditor's ability to verify transactions and obtain sufficient audit evidence is limited because of insufficient and inconsistent financial records. Thus, inherent risk is often rated high by auditors. *Third*, Bad Accounting Skills. The business owners and staff usually do not have accounting knowledge, which results in errors in financial reporting, and increases the potential of material misstatement(Anggraeni et al., 2021). *Finally*, Manual Recording Systems. Manual bookkeeping leads to a more complex data tracing process and a higher risk of inaccuracies(Gustina, 2020). These challenges combine to create a high-risk audit environment t and require auditors to exercise more care and judgement.

**Audit Risk Level Analysis**

The results show (Figure 1) that all elements of audit risk in small enterprises are generally high. The inherent risk is high due to the nature of business and poor financial reporting practices. Internal controls are not effective or do not exist . High control risk exists . Therefore, the overall risk of material misstatement is also high.

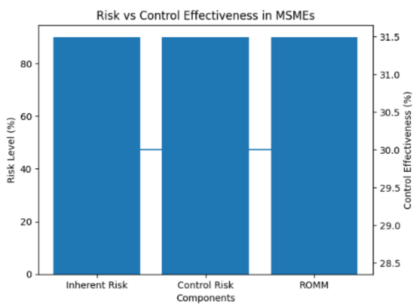


Figure 1. Risk Level Analysis in MSME Audits

An informant said emphatically: "Usually we take high risk from day one because there are very few internal controls". This condition implies an inverse relationship between the effectiveness of internal controls and the level of audit risk, such that weaker controls are associated with higher levels of audit risk. The inability to distinguish risk levels among audit areas complicates challenges in planning and conducting audits. This often leads to auditors employing generalised audit procedures instead of targeted risk-based approaches(Mansour et al., 2025).

**Discussion: Gaps and Challenges in Context**

This study further supports the proposition that a standardised risk based audit approach cannot be fully applied to small enterprises without adaptation. The gaps that have been identified in risk assessment practices highlight the limitations of the existing auditing frameworks when applied to entities with limited resources and informal systems.


Figure 2 Theoretical Framework

The Figure 2 . depicts a cause and effect flow regarding the auditing of small and medium sized enterprises (MSMEs). It starts with the intrinsic characteristics of MSMEs, which are limited resources, basic organizational structures and informal business practices(Gopinath et al., 2018; Țîrcovnicu & Hațegan, 2023). Such characteristics result in internal control weaknesses in many cases, with controls being poorly designed, insufficiently documented or inconsistently implemented(Alayli, 2022). These weaknesses, therefore, lead to an increase in the level of audit risk because the auditors are exposed to a higher possibility of errors or material misstatements in the financial reporting(Susan, 2020; Ulupui et al., 2024). Thus the chain of conditions ends up in ineffective risk assessment, making the audit process less reliable and efficient owing to poor data quality and weak control environments. Overall, the diagram shows that the fundamental nature of MSMEs can create a chain of problems that negatively impact the effectiveness of audit risk assessment.

The effectiveness of the risk assessment is related to the similarity of the audit methods and the type of auditee (Božović et al., 2025). In small entities, data and restrictions on internal controls reduce the use of traditional audit techniques. This implies more flexible and adaptive ways of auditing. Moreover, the problems found in this study indicate the necessity to improve the ability of auditors, including professional judgement and the ability to work in high-uncertainty environments. Regulators also have an important role to play in addressing these problems by providing specific guidelines for the audits of small enterprises. The study contributes to the literature by showing that the gaps and challenges in the audit risk assessment are not technical, but they are due to the structural characteristics of small enterprises. Therefore, the improvement of the quality of audits in this industry must be seen as a holistic process, where both contextual and methodological aspects are taken into account.

## 5. CONCLUSION

This study evaluates the application of audit risk assessment in small enterprises, focusing on the gaps and challenges encountered in practice. The findings indicate that, although audit risk assessment is conceptually consistent with professional auditing standards, its practical application remains suboptimal, particularly in audit documentation, materiality determination, and the identification of risks of material misstatement. Weak internal controls, limited financial documentation, low accounting competence, and reliance on manual recording systems increase inherent and control risks and constrain the effective application of standard risk assessment procedures. Limited reliable data and audit evidence also increase auditors' reliance on professional judgement, potentially introducing subjectivity and affecting audit quality.

The main contribution of this study is the identification of specific risk conditions and implementation gaps that require audit procedures to be adapted to the characteristics of small enterprises. Accordingly, a more adaptive audit methodology is recommended by prioritizing high-risk areas, applying flexible materiality considerations based on entity-specific risks, strengthening alternative audit procedures when documentation is limited, standardizing the documentation of professional judgement, and using technology-enabled audit tools where appropriate. The nature, timing, and extent of audit procedures should also be adjusted to the reliability of accounting records, strength of internal controls, and availability of audit evidence. These adaptations can reduce unnecessary procedures while directing greater audit effort toward areas with higher risks of material misstatement, thereby improving audit effectiveness and quality.

The findings also have implications for the refinement of risk-based auditing standards. Rather than replacing existing standards, more specific implementation guidance is needed to support their proportionate application to small enterprises. Such guidance should consider limited internal controls, less formal documentation, owner-managed decision-making, and greater reliance on professional judgement when determining materiality, identifying risks of material misstatement, and designing appropriate audit responses. Continuous professional development should further strengthen auditors' risk assessment and professional judgement in applying these adaptive procedures.

This study is limited by its focus on a single public accounting firm and its qualitative approach, which may restrict the generalizability of the findings. Future research should involve multiple public accounting firms and employ quantitative or mixed-method approaches to test the effectiveness of the proposed adaptive audit practices and explore technology-enabled audit models for small enterprises.

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