INTERNAL CONTROL
In SWEDISH SMALL and MEDIUM SIZE ENTERPRISES

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ABSTRACT

Small and medium size enterprises are currently the major part of economic activities throughout the world. Nowadays, they represent about 99% of all types of enterprises in Sweden, with providing high job opportunities to its labour force as these enterprises need focus in their development; the internal control mechanism is a means and a way of directing, monitoring and measuring the SMEs resources. It plays an important role in preventing and detecting fraud and protecting the physical and intangible resources as well as leading to high efficiency of the business operation. Therefore, focusing on this business area is a timely issue and a rewarding one since it contributes a lot for the majority of business enterprise involved in SMEs.

This study examines and describes the effectiveness of internal control systems in Swedish small and medium size enterprises. The study focuses on the main five components of internal control and their impact on achieving the company’s objectives. In so doing, the study creates a better understanding of effective internal control that may be applicable to the context of SMEs and establish theoretically the features of an effective internal control for sampled SMEs. To achieve this objective we formulate one research question: To what extent does the internal control system of SMEs comply with the principles of effective internal control? This is intended to look into how closely SMEs follow the virtues of effective internal control in their business operation.

Applying an inductive approach in qualitative interview, the study found out that, contrary to what is generally suggested, SMEs are aware of the importance of having a good internal control system. The findings of the research enabled the emergence of a theory grounded in the collected data. Indeed, the major features of an effective internal control system applicable for SMEs are found to be sound control environment, sound risk assessment process, sound operational control activities, effective information and communication system, effective monitoring and evaluation system. Therefore, the major findings of the research fit into the theoretical framework.

Key words: SMEs, internal control, control environment, risk management, control activities, information and communication, monitoring and evaluation
ACKNOWLEDGEMENTS

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CHAPTER ONE

1. GENERAL INTRODUCTION

This introductory chapter provides a general background to the research. It also presents the general objectives of the study and the research questions are also formulated under this chapter with the view to make the research focused on specific relevant issues. In what follows, definitions are given for major concepts frequently used in the study. The significance and delimitation of the research is also discussed and finally, a highlight on the organization of the research paper is provided.

1.1. Background information

Small enterprises and medium-sized enterprises are defined by their size, turnover or balance sheet total. In the European Union, small enterprises have between 10 and 49 employees and an annual turnover not exceeding EUR 7 million or an annual balance-sheet total not exceeding EUR 5 million. Medium-sized enterprises have fewer than 250 employees. Their annual turnover does not exceed EUR 40 million or their annual balance-sheet total should be less than EUR 27 million. In the case of Sweden, all enterprises with fewer than 250 employees are categorized as medium size enterprises and those with fewer than 50 employees are categorized as small (European Commission, 2003, p. 1).

SMEs constitute currently the major part of economic activities in the Sweden. Nowadays, they represent about 99% of all types of enterprises in Sweden and provide high job opportunities to its labour force (Nutek, 2004, p. 15). This business structure is not different from the EU business structure.

Internal control is a means by which resources of these SMEs are directed, monitored, and measured. It plays an important role in preventing and detecting fraud and protecting the physical and intangible resources; moreover it leads to high efficiency of the business operation. Therefore unless they have strong internal control system to monitor and run their businesses, the prospect of bankruptcy threatens each and every Swedish SME (Sampson, 1999, p. 4).

The focus of this research is to examine the effectiveness of internal control systems in small and medium size enterprises in Sweden. Therefore, focusing on this business area is a timely issue and a rewarding one since it contributes a lot for the majority of business enterprises involved in SMEs.

1.2. Research objective

The general objective of this research is to examine the effectiveness of internal control systems in small and medium size enterprises in Sweden. In so doing, the research create a better understanding of effective internal control that may be applicable to the context of
SMEs and establish empirically the features of effective internal control for SMEs in Sweden.

1.3. Research question

Since our research objective is set to study the effectiveness of internal control in Swedish SMEs, the main problem that this research paper intends to address can be formulated in the form of the following research question: *To what extent does the internal control system of SMEs comply with the principles of effective internal control?*

This question is believed to be central to the research as it guides all the way forward to the conclusion. Indeed, for a system of internal control to be effective, it needs to abide by certain standards of effective internal control. The research question intends to look into how closely SMEs follow the virtues of effective internal control in their business operations.

1.4. Definitions of main concepts

In what follows, a general definition of some main terms is given in order to restrict their respective meaning to the sense they are employed in this research on SMEs so that the research question is addressed adequately. A detailed discussion of these concepts is to be found in the review of literature in Chapter Three.

1.4.1. Internal control

Internal control means a system and a process established and operated within a small and medium sized enterprise for it to carry out its operation in a proper and efficient manner. Major examples of its objectives are ensuring compliance (abiding by laws and regulations), ensuring trust in financial reporting and increasing operational efficiency (COSO, 1992, p.2).

1.4.2. Internal auditor

By contrast to the external auditor, the internal auditor is an employee of the SME with the major task of advising management on whether its major operations have sound systems of risk management and internal controls (Putra, 2008, p. 1).

Internal audit’s role in evaluating internal controls is wide ranging because ‘everyone from the mailroom to the boardroom is involved in internal control’ (Institute of Internal Audit, 2008). The internal auditor’s work includes assessing the tone and risk management culture of the organization at one level through to evaluating and reporting on the effectiveness of the implementation of management policies at other SMEs (Institute of Internal Audit, 2005, p. 1).
1.4.3. SMEs

Small and medium sized enterprises are commercial business entities that are generally distinguished from large companies by their size and turn-over. Medium-sized enterprises have fewer than 250 employees and annual turnover not exceeding EUR 40 million. Small enterprises have fewer than 50 employees and an annual turnover not exceeding EUR 7 million (European Commission, 2003, p. 1).

1.4.4. Enterprise

Enterprise refers to a unit of economic organization or activity, especially a business organization (Merriam-Webster, 1977, p. 380)

1.5. Significance of the study

1.5.1. Why SMEs? Why Sweden?

One of the major driving factors in the choice of SMEs for this study is that the effectiveness of internal control tends to be more problematic for such type of businesses (Wai, 2008, p.1). Large enterprises and corporate companies have legal requirements to maintain an effective internal control and the nature and wider scale of their business operation generally drive them to acknowledge the need for an effective internal control. However, as literature on the issue points out, this tends not to be the case for SMEs. Therefore, the study chooses SMEs as major problem areas in this regard.

The choice to deal with Swedish SMEs is justified primarily by their relative physical accessibility to the researchers, given the fact that the study intends to collect primary data on which to base its analysis. In addition, as noted in the background information, Swedish national economy benefits a lot from business activities of SMEs which represent about 99% of all types of enterprises in Sweden and provide high job opportunities to its labour force. Therefore, the research question of this paper is of direct relevance to the context of Swedish business structure.

1.5.2. Why the study is important

Although the importance of an internal control system is widely acknowledged among large companies, an efficient system of internal control is typically said to be absent or not strong enough in most of SMEs in general (Wai, 2008, p.1).

This study highlights the importance of having a sound standardized internal control system in SMEs and its major roles. The research emphasizes on the fact that lack of proper understanding of the value of effective internal control in SMEs usually leads to inefficient system of internal control in SMEs. Therefore, by underlining to what extent a good system of internal control is vital for sound operations of SMEs and by examining application of effective internal control principles, this study is believed to contribute to the effort of implementing effective internal control systems in Swedish SMEs.
1.6. Delimitation of the study

This study primarily focuses on internal control practices of Swedish SMEs. Thus, its conclusions are not necessarily relevant for all countries of the European Union.

In addition, the research does not include the study of micro enterprises. The European Commission defines micro enterprises as employing fewer than 10 employees and an annual turnover not exceeding 2 million (European Commission, 2003, p. 1). The study is interested in small enterprises and medium enterprises only because these two types of business enterprises are the ones that play greater role in terms of their business activities.

Moreover, although small and medium enterprises have a number of interesting features to be studied, this research focuses on only one aspect: their system of internal control.

1.7. Organization of the study

The research is organized in such a way that the first chapter deals with the general introduction which presents a general background to the study, together with the research’s objectives and questions. It also defines major terms, presents the significance of the study, and delimits the boundaries of the research as well.

The second chapter deals with methodological issues whereby the philosophy, the strategy and the type of the research are presented.

The theoretical background to the study is rooted in the discussion of the third chapter with respect to issues such as a detailed definition, importance, components and principles of effective internal control, as well as a note on the roles and responsibilities involved in internal control.

The research design is discussed in the fourth chapter of the research paper including a discussion of the underlying research assumption and the approaches of the research. A description of the study’s units of analysis and sample characteristics is given together with a note on ethical considerations that are taken into account in the research process. The methods of data collection and the way these data are analyzed are discussed in the chapter, and the final section deals with the research criteria of reliability and validity.

Under chapter five, the major empirical findings are discussed and analyses of the findings are provided. The final part concludes the research paper and forwards some suggestions for further research on the subject.

Thus, in this general introductory chapter, efforts were so far made to provide an overall view of internal control of SMEs in Sweden. As it is noted, providing a definition for SMEs comes to categorizing these enterprises in terms of size, turnover or balance sheet total. SMEs are shown to play a dynamic role in the Swedish economic activities in terms
of their number and the employment opportunity they create. In addition, the issue of internal control in SMEs is briefly shown to be vital for the survival of SMEs to remain in the business. This chapter also put precisely what the general objectives of the study are and it forwarded research questions that guide the various activities throughout this research. The reason why this research is worth doing is also presented in relation to the fact that due understanding of the importance and the role of internal control in SMEs is vital for the smooth operations of these enterprises. As pointed out in this chapter, the focus of the research is clearly delimited from other tangent issues.

Having set this general introduction, we now proceed to the discussion of the research methodology in the following chapter.
CHAPTER TWO

2. RESEARCH METHODOLOGY

2.1. Introduction

In this second chapter, efforts will be made to identify the philosophy of the research and the assumptions that motivate the choice of such philosophy. From these positions, the research strategy will be specified as well as the type of research to be conducted. In specifying these elements of research methodology, effort is made to base selection of appropriate methodology that enables researchers to best address the research question.

2.2. Research Philosophy

Research philosophy consists of many assumptions about different perspectives of the world which in turn will influence the research strategy and the procedure of the research (Bryman, 2004, p. 11). In order to increase understanding of the importance of effective internal control and to attain the objective of examining adherence of SMEs to principles of effective internal control for SMEs (which corresponds actually to the research question), it is important to study the research philosophy. Differences in research philosophy depends on how differently knowledge and process is developed and based on these differences, three key philosophies are identified: Positivism, Interpretivism, and Realism (Bryman, 2004, p. 11-16).

In what follows, these positions will be discussed briefly in general terms and then the position that best fits our research will be selected and duly justified at the end of this section.

2.2.1. Positivism

As explained by Bryman (2004, p.11), the positivist philosophy advocates that only phenomena confirmed by the senses can genuinely be warranted as knowledge. For adherents of this position, the purpose of theory is to generate hypotheses that can be tested and will thereby allow explanations of laws to be assessed (Bryman, 2004, p.11). Furthermore, Zhu summarizes that positivism holds that an accurate and value-free knowledge of things are possible. It holds out the possibility that human beings and their actions and institutions can be studied as objectively as the natural world (Zhu, 2006, p. 1).

2.2.2. Interpretivism

On the other hand, interpretivism is a term given by contrast to the positivist tradition (Bryman, 2004, p.13). The philosophy behind this term is that the research required to respect differences between people and the objects of the world and therefore requires the researcher to grasp the subjective meaning of actions (Bryman, 2004, p.13).
As noted by Zhu, interpretivists attach importance to the meaning and tries to understand what is happening and are likely to argue that rich insights into this complex world are lost if complexity of social world is reduced entirely to a series of law-like generalizations (Zhu, 2006, p. 2).

2.2.3. Realism

As noted by Zhu, business and management research is often a mixture between positivist and interpretivist, reflecting the stance of realism (Zhu, 2006, p.2). Realism acknowledges a reality independent of the senses that is accessible to the researcher’s tools and theoretical speculations. It implies that the categories created by the researcher refer to real objects in the natural or social worlds (Bryman, 2004, p.12).

Realism holds that research activities involve trying to uncover the underlying mechanisms that generate observable events. It suggests that rather than testing theories against the ‘facts’, data is generated to evaluate theories against each other.

<table>
<thead>
<tr>
<th>Theory</th>
<th>Research design (most common)</th>
<th>Research methods (most common)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positivism</td>
<td>Social surveys</td>
<td>Structural interviews</td>
</tr>
<tr>
<td></td>
<td>Experimental</td>
<td>Structural observations</td>
</tr>
<tr>
<td></td>
<td>Comparative</td>
<td>Official statistics</td>
</tr>
<tr>
<td>Interpretivism</td>
<td>Ethnography</td>
<td>Unstructural interviews</td>
</tr>
<tr>
<td></td>
<td>Participant observation</td>
<td>Personal documents</td>
</tr>
<tr>
<td>Realism</td>
<td>Descriptive</td>
<td>Non-specific, but methods are theory-focused</td>
</tr>
<tr>
<td></td>
<td>Experimental</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Comparative</td>
<td></td>
</tr>
</tbody>
</table>

Pathirage, Amaratunga and Haigh, 2008, p. 6

2.2.4. Philosophy of this research

Among the above described philosophical position, this research finds it difficult to identify with the extreme positions of positivism and interpretivism. Instead, a mixture of both features is appealing to this study i.e. realism given the following justifications.

Realism seems to offer a better ground to answer the research question: To what extent does the internal control system of SMEs comply with the principles of effective internal control?

Since principles of effective internal control constitute a basis for common understanding and acceptable standard, we may take these principles as a ground for a certain objective rule. However, since each SMEs has some room to accommodate these principles into the specific operational conditions of its activities, a universal application to all SMEs is difficult to obtain. So the philosophy of this research tends more to be realism in that it adopts the interpretivist philosophy containing at the same time some element of positivist position.
2.3. Research strategy

Among the many interesting methodological issues, the major one is the research strategy which deals with the distinction between qualitative and quantitative research (Bryman, 2004, p.19-21). As it is noted in section 4.2, the research’s general orientation is qualitative in nature.

It employs an inductive approach focusing on describing and explaining the nature of internal control in SMEs in Sweden. This qualitative orientation effectively serves the purpose of the research in that it enables researchers to answer the research question by adequately showing the importance of having internal control in SMEs and examining to what extent this system of internal control is in line with principles of effective internal control.

2.4. Research types

There are various types of researches identified on the basis of their main purposes and how deep they go in their investigative power (Bryman, 2004). The major types are exploratory, descriptive, and explanatory.

As discussed by Bryman (2004, p. 26-32), descriptive research aims only to describe in detail, a situation or set of circumstance. Such research answers questions such as ‘how many?’, ‘who’, and ‘what is happening’, etc… The necessary means to a phenomenon are, by contrast, explained in explanatory type of research. It asks the question ‘why?’ - why a particular phenomenon has come to be as it is and tries to uncover its cause. It attempts to establish a causal factor behind the phenomenon in question. On the other hand, we speak of exploratory research, when the purpose of the research is to collect basic information on a certain unknown phenomenon or issue (Bryman, 2004, p. 26-32).

The research we are to undertake is both descriptive and explanatory type of research. This is because the study aims at not only providing descriptive information on the system of internal control in SMEs but it also intends to explain the extent this system is effective in relation to standard principles.

Therefore, broader issues of research methodology are identified in this chapter. It is shown that the research is based on the philosophical position of realism since it follows a certain mixture of both interpretivism and positivism. The research strategy is shown to be qualitative in nature. Since the research attempts descriptive analysis as well as explanation as to how significant effective internal control is for SMEs, the type of this research is shown to have a form of descriptive and explanatory nature.

After setting out such general methodological issues, the following chapter will draw a theoretical framework on the issue of effective internal control from the review of existing literature.
CHAPTER THREE

3. THEORETICAL FRAMEWORK

3.1. Introduction

In what follows, a review of literature is provided on the issue of internal control in Swedish SMEs. This review is done with the purpose of providing a theoretical framework that enables answering the research question in subsequent analysis of the research paper i.e. *To what extent does the internal control system of SMEs comply with the principles of effective internal control?*

In this section, what is exactly meant by internal control and SMEs will be made clear on the first section; then the importance of internal control as well as its major components is presented respectively. The binding principles of internal control are then discussed followed by a description of the role and responsibilities involved in internal control in SMEs.

As discussed in the final section of this review, discussions of the issue of internal control, in the literature, do not specifically focus on SMEs in general or Swedish SMEs in particular. Therefore, an argumentative presentation of different views in the matter becomes difficult in such cases. Therefore, the subsequent review will focus on setting a general theoretical background on which analysis of the research will be framed.

3.2. Definition

Authors of this thesis believe that a first step in addressing the research question is to give a working definition of what we mean by internal control as well as what we mean by SMEs. The need to define these concepts arises from the fact that the terms have a broad and multiple usages in the literature; and they may mean different things in different contexts. Therefore, what we intend to do in this section is to restrict their meaning to the closest possible to the sense they will be employed throughout the research paper in addressing the research question.

3.2.1. Defining internal control

- General Historical Notes

This historical note on the issue of internal control is meant to show how the issue developed in importance in the world. Some of these historical elements are important to appreciate the significance of the research question.

The literature shows that the practice of internal audit has existed for a long time. It has been recognized as a worldwide profession for over 60 years, with practitioners in over 165 countries (Institute of Internal Auditors, 2005, p. 1; AMF, 2005, p. 4). Internal control is the main focuses point of internal auditors, these professionals’ main objective is to
evaluate and upgrade the effectiveness and efficiency of internal control in the organization. Internal audit attained higher profile with the growing complexity of enterprises and the world they operate in, (Institute of internal Auditors, 2005, p. 1). Professional accounts and organizations have drafted most of the versions of the internal control definition (AMF, 2005, p. 3).

Credit institutions were mainly the target of earlier regulations on internal control. Other organizations were not subject to such requirements. So the later defined internal control mechanisms of their own and in their own way without having a standard reference or framework. (AMF, 2005, p. 4). Although the AMF Working Group notes this was specially the case of French enterprises, the condition of other Western countries was similar until the beginning of the 1990s. A landmark in the history of Western internal control system is the publication of a standard framework by the United States, followed by Canada and United Kingdom.

A review of literature on internal control system reveals that the most widely used reference framework is the American document published in 1992 entitled Internal Control Integrated Framework, more commonly referred to as COSO, an acronym of Committee of Sponsoring Organizations of the Treadway Commission, derived from the name of the committee which conceived the reference framework (Aldridge & Colbert, 1994, p. 21).

Inputs of COSO have evolved since then into various aspects of internal control. It is now recognized worldwide for providing guidance on critical aspects of organizational governance, business ethics, enterprise risk management, fraud, and financial reporting. (COSO, 1985, p.1).

Its objective is to present a framework which allows a common understanding of internal control among interested parties. Control criteria are specified and tools are suggested to assist management in evaluating internal control and in improving the control of the entity. Finally, the COSO Report offers guidelines for preparing reports on internal control for use by external parties (Aldridge & Colbert, 1994, p. 21)

- **COSO definition of internal control**

Since the approach to internal control recommended by COSO in its Internal Control Integrated Framework is widely used all over the world, this research adopts the definition of this framework to designate what we generally mean by internal control.

COSO defines internal control as “a process, affected by an entity’s board of directors, management and other personnel” (COSO, 1992, p. 2) This process is designed to provide reasonable assurance regarding the achievement of objectives in effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations (COSO, 1992, p. 2)
The above-quoted definition connotes certain fundamental concepts. The first one is that the ultimate goal of internal control is not the control per se. But mechanisms of the control are processes that attain other higher objectives. The second connotation is that internal control is not an abstract document but it is something that has practical relevance at every step of the company’s operations and by every employee at all levels of responsibility. The third concept is internal control does not provide a 100% guarantee but it offers relative shield to the management of the organization applying the control mechanisms. Internal control, as a fourth notion, is one of the mechanisms at the disposition of the management that enables objectives of the organization to be attained (COSO, 1992, p. 1).

The COSO framework expects the definition of internal control to fit the need of all companies of all size. However, the framework is not designed to be a one-size-fits-all type of framework. It has a broad room for a tailored definition and application with respect to enterprises’ specific needs (COSO, 2006, p. 1).

3.2.2. **Defining small and medium size enterprises**

In order to attempt to provide plausible answers to the research question, what we exactly mean by small and medium enterprises needs to be made clear. This section is meant to do so. Unless we set precise characteristics of SMEs that distinguish them from other types of enterprises, it would be impossible to examine their challenges toward effective internal control.

- **General Historical Notes**

The prevailing definition of SMEs has undergone a number of amendments through time. It has changed three times in the last fifteen years in response to various changes in the economic environment in which these enterprises operate.

The European Commission adopted a new definition of micro, small and medium-sized enterprises (SMEs) in order to enhance conducive business environment for SMEs. The public was consulted extensively so as to shape this new definition. It clearly sets out the levels which should be attained for a business entity to be categorized as micro, small and medium-sized enterprise (European Commission, 2003, p. 1)

The 2003 definition compared to that of 1996, has a higher level of financial ceilings in terms of turnover and / or total balance sheet. The increase is related to the higher productivity and inflation levels registered in 2003 (European Commission, 2003, p. 1).

To allow a smooth transition at EU and national level, the amended definition was made effective as of January 1st, 2005. As argued by the EC, this modernization of the SME definition will have “an impact on promoting growth, entrepreneurship, investments and innovation. It will favour co-operation and clustering of independent enterprises” (European Commission, 2003, p.1).
• Definition of SMEs by European Commission

The definition of Small and Medium size Enterprises adopted in this research is that of the European Commission since the Swedish government also applies this classification.

The European Commission currently defines SMEs as those companies with fewer than 250 employees which are independent from larger companies, with an annual turnover of less than €50 million and an annual balance sheet total not exceeding €43 million (European Commission, 2003). Table 3.2.2 presents the prevailing thresholds as well as the amended ones of 1996 for micro, small, and medium sized enterprises.

<table>
<thead>
<tr>
<th>Enterprise category</th>
<th>Headcount (unchanged)</th>
<th>Turnover (unchanged)</th>
<th>Or Balance Sheet (unchanged)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>&lt; 50</td>
<td>€= € 10 million (in 1996: 7 million)</td>
<td>€= € 10 million (in 1996: 5 million)</td>
</tr>
<tr>
<td>Micro</td>
<td>&lt; 10</td>
<td>€= € 2 million (previously not defined)</td>
<td>€= € 2 million (previously not defined)</td>
</tr>
</tbody>
</table>

European Commission, 2003, p. 2

More than 99% of the Swedish enterprises are classified as SMEs since they have less than 250 employees and also the SMEs sector’s turnover in Sweden accounts for 59% of the total turnover while their share of the total value added in the Swedish economy is 57% (Nutek, 2004, p.15). When it comes to investments, the SME sector accounts for 66% of the net investments so SMEs in Sweden play a major role for the economic and employment growth in the country and due to this and many other reasons, it is very important to look after their performance and create a good control system so that they can achieve their objectives and that they are kept away from getting bankrupt (Nutek, 2004, p.15; Katzeff, 2009, p. 64).

Appropriate establishment and operations of internal control becomes essential all the more that SMEs operate in an ever-changing business environment with varying forms of risks (European Commission, 2003, p. 3).

Therefore, the literature widely acknowledges that a proper definition of SMEs contributes a lot to guiding commercial, legal or other policies and measures that enhance the development of the sector to its fullest potential.

Problems specific to their size can only be addressed through appropriate policies in situations where there is a clear definition of which enterprises is an SME and which is not. Such is the importance of formulating a clear definition (European Commission, 2003, p. 3).
3.2.3. Relevant characteristics for internal control

3.3. Effective internal control in SMEs

What we have done so far is laying a solid ground for the theoretical framework upon which the research lies. Now that we have made clear what exactly we mean by internal control and SMEs, it is time to review the literature on theories around effective internal control. These theories will be used as a framework to guide our analysis after the data collection process. The section is important in laying the ground for answering the research question and attaining the research objective. Indeed, the objective of creating a better understanding of effective internal control that may be applicable to the context of SMEs is only possible by a review of literature on the general aspects of internal control. By the same token; we intend to establish empirically what the features of effective internal control are for Swedish SMEs based on the review of literature on the major components and principles of effective internal control.

Therefore, in this section, we explore the objectives of having an effective internal control system; and its major components and underlying principles as it is discussed in the literature. Note that these issues i.e. objectives, components and principles of effective internal control are discussed under this section because of the close relationship among these three concepts. One is actually followed by the other i.e. the objectives set out the rationale behind the establishment of effective internal control. Addressing these objectives necessarily requires identifying what the major components of internal control are. After identification of these components, it becomes vital to look into them in further detail. Such breakdown of these components into more specific workable, achievable points constitutes our discussion on principles of effective internal control.

The roles and responsibilities in internal control will also be reviewed and a note on the Swedish code of governance will be discussed as relevant to SMEs.

3.3.1. What we mean by Effective Internal Control

Effective internal control is a system of internal control whereby the designs, functions and programs of internal control achieve their intended results (Aldridge & Colbert, 1994, p. 21)

Although internal control systems operate at different levels of effectiveness, a system of internal control is said to be effective when it fulfills the following key attributes of an effective internal control system:

- Sound control environment
- Sound risk assessment process
- Sound operational control activities
- Effective information & communication system
- Effective monitoring & evaluation system (COSO, 1992, p. 1).
Therefore, these five interrelated components of internal control need to be present to conclude that internal control is effective.

### 3.3.2. The choice of COSO framework

In this research paper, we have adopted the internal control integrated framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This choice is motivated by several factors.

One of these factors is that the framework has acquired a wide acceptance worldwide. The success of the COSO model lies in its practicability and definition of internal control. The framework is used by business organizations of all size all over the world since the model provides a reliable and standard forum for discussing internal control (Applegate & Wills, 1999, p. 1; Office of the State Controller, 2005, p. 2). We consider that by adopting this framework in our study, we are adopting principles and components of internal control that have wider application and acceptance.

In addition, we found the COSO framework appealing to our study on SMEs because it is presented in such a way that promotes organizational circumstances to be adapted individually to its principles. (COSO, 2006, p.2). This implies that small and medium enterprises can accommodate the principles of effective internal control outlined by COSO with respect to their specific conditions. Note that, COSO has issued guidance that target smaller companies to ensure that their particular control needs are met (COSO, 2006, p.2).

Moreover, besides its applicability to SMEs, we consider the COSO framework is appropriate to our study because of its features that enable to structure internal control operations in SMEs (AMF, 2005, p. 8). By pursuing COSO principles, processes of internal control in SMEs are made to follow specific guidelines that ensure effectiveness. The following words of Applegate & Wills in *Struggling to incorporate the COSO recommendations into your audit process? Here’s one audit shops winning strategy* (1999, p. 8) illustrate the benefits of applying this framework from users’ perspective:

> “... we believe that concentrating on a single COSO objective during each audit will ultimately improve the efficiency and effectiveness of our projects. Our policy, which requires that all five COSO components be covered in all audits, has already improved the effectiveness of our audit work in cases where these components were not addressed in prior audit” (Applegate & Wills, 1999, p. 8)

In addition, one interesting feature of the COSO framework is that COSO identifies several control factors in defining each control component (COSO, 1992). This implies that the framework enables the measure the efficiency of the component itself since SMEs can use these factors as criteria for rating the effectiveness of controls.. Greater consistency in audit performance and to maximization of effectiveness of internal control is ensured by such requirement of each control component and factor to be addressed (COSO, 1992, p. 2).
Therefore, due to explanatory factors discussed so far, we consider that the COSO framework is most appropriate to our study of the effectiveness of internal control in SMEs. So we have adapted its framework as our theoretical framework for our analysis.

3.3.3. Objectives of effective internal control system

As we understand, the significance of implementing an effective internal control comes out of the objectives of doing so or, in other words, from what benefits it actually brings with it. Therefore, discussing the objectives of an effective system of internal control comes one step closer to addressing the research question of determining to what extent the internal control system of SMEs comply with the principles of effective internal control.

The literature on internal control commonly acknowledges that the three main objectives that an enterprise should follow in order to design an effective internal control system are Reliability of Financial Reporting, Efficiency and Effectiveness of Operations, and Compliance with Laws and Regulations. (COSO, 1992, p. 1).

What we mean by reliability of financial reporting is the preparation of reliable published financial statements. The report includes interim and condensed financial statements and selected financial data derived from such statements. Reliability refers to the quality of information, to what extent the information is free from error in reasonable terms. Such assurance is possible with the establishment of effective internal control system (Bushman, 2007, p.1).

i) Efficiency and Effectiveness of Operations

“Performance and profitability goals as well as safeguarding of resources are the major objectives to be attained by effective and efficient operations. This implies that operations are performed so as to attain their intended effect (COSO, 1992, p. 1). Such objectives can be assessed through biannual or quarterly performance audits (Bushman, 2007, p.2)

ii) Compliance with Laws and Regulations

Compliance with laws and regulations deals with those laws and regulations which the enterprise is subject to. First and foremost, the company must be aware of all laws and regulations to which it is subject such as generally accepted accounting principles (GAAP), EU rules and regulations, corporate governance rules, and other specific ones (Bushman, 2007, p. 3).

It is important to note here the word applicable. There are a wide variety of laws and regulations that affect different businesses. Some of these laws and regulations are very specific in regard to what departments or employees they may affect. Therefore, the system of internal control must be designed in such a way that it complies with the requirements of applicable laws (Bushman, 2007, p. 3).
3.3.4. Components of Effective Internal Control

In this important section, the review of literature will focus on providing the categories that will be used as distinct dimensions in the data analysis section. What we will do here is to explore the literature to bring about what is commonly said to be the general components or attributes of effective internal control. The section will deal with the major criteria that are mostly used to conclude whether a system of internal control is effective or not.

Since one of our research objectives is to establish empirically what the features of effective internal control are for SMEs in Sweden, we will depend heavily on this section to attain this goal.

True is the fact that the formality of any control system depends largely on the size of the enterprise, the complexity of its operations, and its risk profile. Less formal and structured internal control systems at SME can be as effective as more formal and structured internal control systems at larger and more complex company (COSO, 1992, p. 3).

However, in order to achieve the preceding three objectives and for the internal control system to be effective, it needs to fulfill the following key components of an effective internal control system: Sound control environment, Sound risk assessment process, Sound operational control activities, Effective information and communication system, Effective monitoring and evaluation system (COSO, 1992, 2-4).

The literature refers to the above five components of effective internal control in various terms. Some designate them as attributes or criteria. However, to be consistent, we continue to use the terminology adopted by the COSO Integrated Framework of Internal Control that is ‘components’ of effective internal control. These are discussed in further detail as follows.

i) Control Environment

As indicated in the Internal Control - Integrated Framework of COSO, the control environment sets the tone of a company or enterprise, influencing the control consciousness of its people (COSO, 1992, p. 2). It is the foundation for all other components of internal control, providing discipline and structure.

Control environment encompasses the ethical values of the staff, management’s philosophy and operating style, assignment of authority and responsibility, and finally the leadership and direction of the Board of Directors (COSO, 1992, p. 2).

An effective control environment is an environment where competent people understand their responsibilities, the limits to their authority, and are knowledgeable, mindful, and committed to doing what is right and doing it the right way. They are committed to following an organization's policies and procedures and its ethical and behavioral standards. The control environment encompasses technical competence and ethical
commitment; it is an intangible factor that is essential to effective internal control (Sampson, 1999, p. 5).

In its magazine *Tone at the Top*, published exclusively for senior management, boards of directors, and audit committees, the Institute of Internal Auditors underline that a strong tone at the top plays a pivotal role because the control environment represents an organization’s first line of defense to mitigate the risks of financial reporting errors. Researches prove that a commitment to strong internal control by the top management is often translated into a better performance.

However, not only at the top management level but building a strong consciousness of control mechanisms throughout the organization’s culture is one of the ways to ensure effective control environment in the enterprise (Institute of Internal Auditors, 2005, p. 2).

  ii) Risk assessment

Risk assessment is a vital exercise for all-size companies since every entity faces a variety of risks from external and internal sources that must be assessed. A requirement for a sound risk assessment is the identification of clear objectives.

Operations of the enterprise can be put in danger and its objectives remain unattained by uncontrolled risk-taking. This is why the management must assess all risks. Risk assessments are considered effective if they help determine what the risks are, what control are needed, and how they should be managed (COSO, 1992, p. 3)

It is important that risk identification be comprehensive, at the department level and at the activity or process level, for operations, financial reporting, and compliance objectives described under Section 3.3.1.

Risk assessment of COSO expects that after risks have been identified, a risk analysis is performed to prioritize those risks. A complete risk assessment encompasses the assessment of the likelihood of risk occurring as well as the estimation of quantitative and qualitative costs of the potential risk. In addition, also included is the determination of how to manage the risk (COSO, 1992, p. 3).

Setting priorities is one of the ways that enable organization to focus on risks with reasonable likelihood of occurrence and higher impacts. (Sampson, 1999, p. 9) Although smaller companies are more likely to have a more informal, less structured risk assessment process, the basic concepts of this internal control component should exist in every organization as recommended by the Institute of Internal Auditors (IAA) in its discussion of ‘Putting COSO’s Theory into Practice’ (Institute of Internal Auditors, 2005, p.1).

In order to achieve goals and objectives, management needs to effectively balance risks and controls. In conditions where risks and control are well-balanced, a reasonable assurance can be reached. However, in case of imbalances, the problems outlined in Table 2 may arise.
Table 3 Imbalances between risks and controls

<table>
<thead>
<tr>
<th>Excessive Risks</th>
<th>Excessive Controls</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss of Assets, Donor or Grants</td>
<td>Increased Bureaucracy</td>
</tr>
<tr>
<td>Poor Business Decisions</td>
<td>Reduced Productivity</td>
</tr>
<tr>
<td>Noncompliance</td>
<td>Increased Complexity</td>
</tr>
<tr>
<td>Increased Regulations</td>
<td>Increased Cycle Time</td>
</tr>
<tr>
<td>Public Scandals</td>
<td>Increase of No-Value Activities</td>
</tr>
</tbody>
</table>

Sampson, 1999, p.3

iii) Control activities

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the company's objectives. Control activities occur throughout the organization, at all levels and in all functions – be it in small or large companies.

Major aspects of control activities in small businesses are higher concentration of decision making authority, wider breadth of control, and more direct ways of communication. (Sampson, 1999, p. 10)

According to the purpose or intention of the type of control desired, there is a need to differentiate between preventive and detective controls. The former seeks to prevent undesirable events from occurring. Such types of controls deter losses and they include proactive measures. Examples of preventive controls are separation of duties, proper authorization, adequate documentation, and physical control over assets (Dan Sampson, 1999, p. 9).

Detective controls, on the other hand, attempt to identify undesirable acts. Such controls make it evident that a certain loss has occurred but they do not prevent a loss from occurring. These types of control activities include reviews, analyses, variance analyses, reconciliations, physical inventories, and audits.

As the literature reveals, the two types of controls are not mutually exclusive, but both are complementary essential activities ensuring effective internal control. Preventive controls are essential for their proactive nature and their emphasis on quality. However, detective controls play a critical role providing evidence that the preventive controls are functioning and preventing losses.

Elements of control activities include approvals, authorizations, and verifications. These are part of the preventive type of control activities in that employees perform their duties within limited parameters. Operations requiring approval of supervisors are duly treated by the later so that the policies of the enterprise are adhered to (Sampson, 1999, p. 11)

Related to this point, another preventive element is segregation of duties. In cases where such control activities are operating efficiently, employees are provided with clear duties
and responsibilities. Personnel involved in authorization are segregated from those responsible for inventory and those involved in recording transactions. Such segregation of duties is one aspect of an effective internal control system (Sampson, 1999, p. 13).

Reconciliation activities are part of detective control activity that is performed by employees so that differences and incompatibilities are identified among a set of data or transactions. Not only identification but also measures to correct such imbalances are involved in the reconciliation activities (Sampson, 1999, p. 12).

Another element of detective control activities is the reviews of performances. In such cases, performances are compared to a pre-defined benchmark and inconsistencies are reported accordingly.

Not all elements of control activities can be categorized as either preventive or detective. Some elements exhibit both features. This is the case of security of assets and controls over information systems. Indeed, by restricting access to certain assets to a limited number of employees has both a preventive and a detective purpose. The same is true with controls over information systems that address both general controls as well as application controls (Sampson, 1999, p. 14-16).

Therefore, we conclude that for an internal control system to be effective, consistent application of control activities should be taken into account.

iv) **Information and Communication Systems**

For an internal control to be an effective one, pertinent information must be identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities (COSO, 1992, p. 3).

Reports are produced by the information systems. Thus, operational, financial, and compliance-related information contained in such reports enable to ensure effective control over the business.

Effective communication is central to effective internal control. Employees are expected to participate in the internal control activities as much as they are kept informed of what is expected of them, and how their specific duty fits into the grand picture. (COSO, 1999, p. 3). Therefore, controls are standardized by the use of information technology and effective communication system (Institute of Internal Auditors, 2005, p. 16).

v) **Monitoring and Evaluation System**

The quality of internal control needs to be assessed overtime through monitoring mechanisms such as on-going monitoring and separate evaluations. The purpose of such activities is to ensure that internal control is well designed and duly-applied. Monitoring is the glue that links the 5 components of effective internal control. Monitoring activities are relevant to all aspects of these components (COSO, 1992, p. 3). In cases where there is a
lack of separate evaluations in small businesses, highly effective on-going monitoring comes into picture to compensate for the lack (Institute of Internal Auditors, 2005, )

As noted under 3.3.1., internal control is effective if the objectives of designing such control system are achieved. In other words, as noted in the COSO framework, this is the case where management and interested stakeholders have reasonable assurance on the achievement of operational objectives, reliability of financial statements, and compliance to relevant laws and regulations.

Ongoing monitoring activities include various management and supervisory activities that evaluate and improve the design, execution, and effectiveness of internal control. Separate evaluations, on the other hand, such as self-assessments and internal audits, are periodic evaluations of internal control components resulting in a formal report on internal control (COSO, 1992).

Therefore, each of the above described component of effective internal control is narrowly linked to each other to form an integrated whole that we referred to as integrated framework under 3.3.2. Changes in business environment trigger changes in the framework as an entity. Hence, internal control exists in operations of an SME for fundamental business reasons (COSO, 1999, p. 3).

The internal control definition--with its underlying fundamental concepts of a process, effected by people, providing reasonable assurance--together with the categorization of objectives and the components and criteria for effectiveness, and the associated discussions, constitute this internal control framework (COSO, 1992, p. 4).

### 3.3.3 Principles of Effective Internal Control

This section is a detailed elaboration of the previous one which deals with components of effective internal control. As important as it is to clearly identify the components of effective internal control, it is equally important to set out the principles that guide an effective system of internal control. Our research objective will not be fully achieved without clearly identifying these principles.

This section enables the researchers to place a firm ground for the theoretical background that is expected to frame the research. These principles are actually the major elements of the theory that will be used to answer the research question. Indeed to determine the significance of having effective internal control system in Swedish SMEs, we need to have a clear theoretical ground for generally accepted principles of effective internal control. These principles are also important for us so that the research meets the objective of identifying the challenges that may prevent SMEs from adopting effective system of internal control. This section is, of course, important in creating a better understanding of effective internal control that may be applicable to the context of SMEs and establish theoretically what the features of effective internal control are for SMEs in Sweden.
It is important to note from the outset that this research adopts the key principles of effective internal control outlined by COSO’s framework. As discussed under 2.1, this framework is used in this research since it is the most widely used one and that its framework is found to have features that are applicable to the context of SMEs. COSO’s streamlines 20 fundamental principles associated with the five key components of internal control i.e. control environment, risk assessment, control activities, information and communication, and monitoring.

The COSO report on the framework of internal control systematically defines the principles associated with each of these components, examines their attributes, lists a variety of approaches that smaller companies can take to achieve them, and includes real-world examples of effective ways to evidence their effectiveness.

Although it draws examples for smaller businesses, the principles apply to all types of organizations.

These principles are not mere checklists. Instead, each and every principle is essential to ensure sound implementation of the corresponding internal control component (Rittenberg, Martens, & Landes, 2007, p. 4)

These principles included in the guidance require judgments as to the most effective way to implement the controls. Thus, they are not rigid attributes but they can be less formal for smaller organizations and for larger organizations where communication is more indirect, they can be more formal. (Rittenberg et al., 2007, p.4)

Therefore, the following principles constitute essential elements to achieve each of the five components of effective internal control as they appear in the COSO framework.
### Table 4 Principles of Effective Internal Control

<table>
<thead>
<tr>
<th>Component</th>
<th>Corresponding Principles</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Control Environment</strong></td>
<td><strong>Integrity and ethical values.</strong> Sound integrity and ethical values, particularly of top management, are developed and understood and set the standard of conduct for financial reporting.</td>
</tr>
<tr>
<td></td>
<td><strong>Board of directors.</strong> The board of directors understands and exercises oversight responsibility for financial reporting and related internal control.</td>
</tr>
<tr>
<td></td>
<td><strong>Management’s philosophy and operating style.</strong> Management’s philosophy and operating style support achieving effective internal control over financial reporting.</td>
</tr>
<tr>
<td></td>
<td><strong>Organizational structure.</strong> The company’s organizational structure supports effective internal control over financial reporting.</td>
</tr>
<tr>
<td></td>
<td><strong>Financial reporting competencies.</strong> The company retains individuals competent in financial reporting and related oversight roles.</td>
</tr>
<tr>
<td></td>
<td><strong>Authority and responsibility.</strong> Management and employees are assigned appropriate levels of authority and responsibility to facilitate effective internal control over financial reporting.</td>
</tr>
<tr>
<td></td>
<td><strong>Human resources.</strong> Human resource policies and practices are designed and implemented to facilitate effective internal control over financial reporting.</td>
</tr>
<tr>
<td><strong>Risk Assessment</strong></td>
<td><strong>Financial reporting objectives.</strong> Management specifies financial reporting objectives with sufficient clarity and criteria to enable the identification of risks to reliable financial reporting.</td>
</tr>
<tr>
<td></td>
<td><strong>Financial reporting risks.</strong> The company identifies and analyzes risks to the achievement of financial reporting objectives as a basis for determining how the risks should be managed.</td>
</tr>
<tr>
<td></td>
<td><strong>Fraud risk.</strong> The potential for material misstatement due to fraud is explicitly considered in assessing risks to the achievement of financial reporting objectives.</td>
</tr>
<tr>
<td><strong>Control Activities</strong></td>
<td><strong>Integration with risk assessment.</strong> Actions are taken to address risks to the achievement of financial reporting objectives.</td>
</tr>
<tr>
<td></td>
<td><strong>Selection and development of control activities.</strong> Control activities are selected and developed considering their cost and potential effectiveness in mitigating risks to the achievement of financial reporting objectives.</td>
</tr>
<tr>
<td></td>
<td><strong>Policies and procedures.</strong> Policies related to reliable financial reporting are established and communicated throughout the company, with corresponding procedures resulting in the implementation of management directives.</td>
</tr>
</tbody>
</table>
Information technology.
Information technology controls, where applicable, are designed and implemented to support the achievement of financial reporting objectives.

Financial reporting information.
Pertinent information is identified, captured and used at all levels of the company and distributed in a form and time frame that supports the achievement of financial reporting objectives.

Internal control information.
Information used to execute other control components is identified, captured and distributed in a form and time frame that enables personnel to carry out internal control responsibilities.

Internal communication.
Communications enable and support understanding and execution of internal control objectives, processes and individual responsibilities at all levels of the organization.

External communication.
Matters affecting the achievement of financial reporting objectives are communicated with outside parties.

Ongoing and separate evaluations.
Ongoing or separate evaluations enable management to determine whether internal control over financial reporting is functioning.

Reporting deficiencies.
Internal control deficiencies are identified and communicated in a timely manner to parties responsible for taking corrective action, and to management and the board as appropriate.

With an understanding that these principles correspond to the five components of effective internal control outlined by the COSO framework, we will use these principles in a condensed manner to be summarized in the five components throughout this research study i.e. control environment, risk assessment, control activities, information and communication, and monitoring and evaluation.

3.4 Roles and Responsibilities in Internal control

Under this section, we will discuss the roles and responsibilities of the various stakeholders in SMEs involved in the system of internal control. This aspect of internal control is dealt separately here since the theory on internal control underlines the importance of having a very clear distinction of roles and responsibilities in such enterprises. This section will be used to back up the selection of sample interviewees in the data collection process from various positions including managers, auditors, accountants, and the like. This part of the theoretical framework is expected to provide a basis to identify the major challenges of SMEs in implementing a proper system of internal control; and in so doing to target the research question.

No one in the organization is exempted from a responsibility for internal control. All employees, with varying degrees, are involved in it - whether they are participating in the
control system per se, or produce information to be used in the control system. The role-of the corporate governance participants including the Management, the Board of Directors, and Auditors is discussed briefly in what follows.

Management:

The Chief Executive Officer (CEO) plays a forefront role in designing and implementing effective internal control. In the case of small enterprises, the leadership of the chief executive – often an owner-manager is usually more direct. However, in large and medium companies, the CEO gives direction to senior managers and reviews how they control the business, thereby leading more indirectly.

The Management holds the responsibility to decide on how much risk is acceptable to the company. In so doing, it spells out the level of effectiveness and efficiency of internal control system. (Cheney, 2008, p.1)

Board of Directors:

Board of Directors play an important role in internal control system by providing governance and corporate strategic leadership. They are involved in resource allocation, business plan decisions, enhancement of capability in various departments, and the like. they also appoint management which provides direction to effective internal control.

Auditors:

By auditor, we refer to both internal and external auditors. They are highly involved in ensuring effectiveness of the internal control system. The design and implementation of control mechanisms are assessed by such auditors. Their assessment is eventually to be translated into recommendations on how to improve the system of internal control (Cheney, 2008, p.2)

Therefore, the Management, the Board of Directors, and Auditors are the main participants in designing and implementing effective internal control in most organizations including SMEs.

3.5 Internal Control in the Swedish Code of Corporate Governance

One of the arguments to include such section in the research paper is the belief that a proper understanding of the legal framework under which SMEs operate enhances understanding of their business environment and operations. The principles that this research intends to draw for SMEs needs to be in line with the general legal framework of relevance to SMEs. Therefore, this section enables researchers to delimit the theoretical framework on which the analysis will be based so that the conclusions to draw fit into the Swedish legal framework.
The Swedish corporate governance code was published in December 2004. It contains a number of rules and regulations regarding corporate governance, including internal control. Since the focus of this thesis is on internal control, we will not give a detailed description of the entire code. The two paragraphs in the Swedish Code of Corporate Governance that deal with internal control are paragraph 3.7 Internal control and Internal Auditing and paragraph 5.2 Report on Internal Controls.

The article clearly states that the Board is responsible for the company’s internal control. The Board is to ensure that the company has a sound system of internal controls and keep itself informed of and assess how well it functions. (The Code Group, 2005, p.31)

The Swedish Code of Corporate Governance, in paragraph 3.7, requires that the board submits an annual report. The report is expected to include the organization of the internal control system on specifically financial reporting and its efficiency during the most recent financial year.

The Swedish Code also requires the evaluation of the need for a separate internal audit function in companies that do not have any. We found that this is indicative of how important it is to have a special internal audit function as the company’s businesses evolve over time.

The paragraph 5.2 entitled Report on Internal Controls, requires that companies’ annual report must include a report on internal control and auditors’ review of it. The fact that internal control reports are made part of the annual report of companies, including SSMEs reveals the importance the Swedish legal framework attaches to a sound internal control system.

3.6 Studies on SMEs

3.6.1 Studies on internal control in SMEs

- Search results

The Google search engine was used with to generate relevant literature to the issue on hand. However, we sadly report that the search results obtained by browsing the search engine are not relevant to the desired level. One important limitation of these results is that the articles are for online sale and ecommerce is not yet introduced to Ethiopia. So the range of search results available to the researchers was limited.

What we can say from the review of literature so far done is that, although SMEs have been subject of research in various instances, there is a paucity of researches that specifically deal with the internal control system of Swedish SMEs.
### Table 5 Internet Search results

<table>
<thead>
<tr>
<th>Search engine</th>
<th>Key words</th>
<th>Entries*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Google</td>
<td>• internal control, SME</td>
<td>880</td>
</tr>
<tr>
<td></td>
<td>• Swedish SME</td>
<td>638</td>
</tr>
<tr>
<td>Yahoo!</td>
<td>• SME, internal control</td>
<td>820</td>
</tr>
<tr>
<td>Sage online publication</td>
<td>• SME, internal control</td>
<td>3</td>
</tr>
</tbody>
</table>

* These entries were mostly found to be irrelevant to the interest of this study.

- **Relevant characteristics for internal control**

Notwithstanding the definition discussed under 3.2.2, we single out here the main characteristics of SMEs that are relevant to their internal control.

The issue of internal control is most relevant to small and medium size enterprises for a number of reasons. One such reason is related to their size. Indeed, SMEs in general and small enterprises in particular hire a limited number of employees. Hence, a clear division of labour that segregates duties and responsibilities are mostly absent. Such a lack of clear segregation of duties opens a room for fraudulent action by employees. As noted by Higson (2002, p. 9), because of the higher level of trust, the control environment in an SME is often less defined therefore there may be more scope for fraudulent activity.

Therefore, SMEs benefit a lot from implementing internal control activities because of their vulnerable condition arising from their size of operation.

In addition, SMEs are not required by law to undergo external auditing. This implies that a clean record and smooth operation of the SMEs activity depends largely on what control can be done internally. Therefore, a strong internal control has a significant value for the clean operation of the SMEs.

- **Focus on internal control**

The review of literature reveals that small and medium sized enterprises have been subject of interest to various stakeholders in Sweden such as policy makers, legislative bodies, business entities, academicians of various fields, and so on. As noted above, one can conclude that research outputs on SMEs in Sweden focus on a limited range of topics - the topic of internal control being the least referred theme. When the issue of internal control comes into picture, it is viewed from the standpoint of larger firms.

The study that is the closest to the topic covered in this research is most probably that of Chavan and Lamba. Note that still their studies are not focused on Swedish SME. Their research output is entitled ‘An International Perspective on Internal Controls in Small and Medium Enterprises’. The paper, published in the journal Business Review, 2007 reports the results of an empirical examination of cultural influences on judgments of Anglo-
American and Asian SME managers in relation to whistle blowing as an internal control mechanism. Australia serves as a proxy for the cluster of countries comprising the U.S., UK and Canada, while India and Malaysia represent the Asian cluster (Chavan & Lamba, 2007).

The study draws on cultural characteristics and differences among these countries to formulate hypotheses that Australian managers are both more likely and more accepting of engaging in whistle blowing as an internal control mechanism than Malaysian and Indian managers. Data was gathered through a survey questionnaire administered to samples of SME managers that have significant operations in all three countries. The questionnaire comprised two whistle-blowing scenarios, and used both single-attribute and multidimensional attribute measures of managers’ judgements. The results support the hypotheses about differences in Australian compared to Indian and Malaysian managers’ judgments (Chavan & Lamba, 2007, p.1).

The findings of this study suggest that enterprises that aim to improve effectiveness in their control systems or achieve similar levels of reliability across divisions in various countries need to implement control systems that are compatible with cultural values. Specifically, the results suggest that compared to India and Malaysia, whistle blowing as an internal control mechanism is likely to be more effective in Australia (Chavan & Lamba, 2007, p. 56).

Therefore, one can conclude that the issue of internal control in the case of Swedish SMEs is an important topic that calls for more research. The most prevalent topics i.e. internalization of SMEs and finance-related issues are highlighted in what follows.

3.6.2 Finance-related studies

The issue of financing of SMEs is a central issue in the literature. The economic and social importance of the small and medium enterprise (SME) sector is well recognized in academic and policy literature. It is also recognized that these actors in the economy may be underserved, especially in terms of finance. This has led to significant debate on the best methods to serve this sector (Biggs, 2008, p.1). As noted by Cressy, Gandemo and Olofsson (1996, p. 12), major constraints for expansion of financial resources to SMEs are related to the following characteristics of SMEs

• SMEs rarely have a long history or successful track record that potential investors can rely on in making an investment;
• Larger companies (particularly those quoted on a stock exchange) are required to prepare and publish much more detailed financial information – which can actually assist the finance-raising process;
• Banks are particularly nervous of smaller businesses due to a perception that they represent a greater credit risk.
• SMEs will need to give a business plan, list of the company assets, details of the experience of directors and managers and demonstrate how they can give providers of finance some security for amounts provided.
3.6.3 Internationalization of SMEs

As recognized by Kadocsa, one of the major challenges of SMEs is global competitiveness (Kadocsa, 2006, p.1). This study made a survey of 100 SMEs in Hungary and conducted interviews with sampled stakeholders. Our review of this study found that the author identified several internal and external factors that influence competitiveness of SMEs as indicated in Table 6. However, it is to be noted that the study mainly focuses on SMEs in commercial and service sector without including agricultural SMEs. Moreover, the study concentrates around family-based SMEs without including SME of similar sizes but not organized around a family.

<table>
<thead>
<tr>
<th>External factors</th>
<th>Internal factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment</td>
<td>Marketing</td>
</tr>
<tr>
<td>Productivity</td>
<td>Innovation</td>
</tr>
<tr>
<td>Capital supply opportunities</td>
<td>Productivity</td>
</tr>
<tr>
<td>Globalization</td>
<td>Knowledge-based development</td>
</tr>
<tr>
<td>EU</td>
<td>Capital supply</td>
</tr>
<tr>
<td>Business relations</td>
<td>Management, organization, structure</td>
</tr>
<tr>
<td>Alliances</td>
<td>Cost-efficiency</td>
</tr>
<tr>
<td>Networks</td>
<td>Compliance</td>
</tr>
</tbody>
</table>

Adapted from Kadocsa, 2006, p. 4

Agndal, in his doctoral thesis, reports a study of the internationalization processes of 16 industrial SMEs located in Jönköping, Sweden (Agndal, 2004). More specifically, he identifies changes in international strategies, suggests reasons why changes are undertaken and discusses how the context of the internationalization process affects these changes. However, the researchers have a reservation over the application of such analysis to small enterprises. The study mainly addresses the internationalization process of medium industrial firms.

To sum it up all, an overview of the existing literature reveals that the working definition adopted in this research of internal control is the one forwarded by the Internal Control Integrated Framework of COSO. In addition, small and medium size enterprises are categorized according to their size in terms of the number of their employees. According to the definition of the European Commission, this research paper calls medium enterprises those that employ fewer than 250 employees; and small enterprises those with fewer than 50 employees.

The literature suggests the need for effective of internal control for SMEs. It is considered to be an efficient tool for management of risks for the SME. Lack of an effective internal control system has been shown to be one important cause for fraud and, in extreme cases, bankruptcy. The literature review casts no doubt on the preeminence of an effective system of internal control for a small and medium size enterprise.
The objectives of effective internal control are evident in the literature. They are Reliability of Financial Reporting, Efficiency and Effectiveness of Operations, and Compliance with Laws and Regulations. The major components that are found in the various internal control systems and that enable effective achievement of these objectives come out of the review of the relevant literature. These are Control environment, Risk assessment, Control activities, Information and communication systems, and finally Monitoring. In the same manner, the principles of internal control those guides SMEs as well as other forms of business organizations are found to stem from these components.

The code of Swedish Corporate Governance is also found to be an interesting part of the literature review in that it shows the rules and regulations that bind operations of SMEs in Sweden.

Therefore, the issues raised in these various sections constitute a sum for the theoretical framework which the research will heavily depend on in the subsequent processes of data collection and data analysis. In what follows, the research design will be discussed in further detail based on the theoretical frame of reference developed so far in this chapter.
CHAPTER FOUR

3 RESEARCH DESIGN

4.1 Introduction

Research design is employed in the paper to refer to a framework for the collection and analysis of data (Bryman, 2004, p.27). Therefore, before discussing the various research methods on collection and analysis of data, we need to set a framework that guides the choice among the various methods. This will therefore be the focus of this section.

4.2 Research Assumption

Under this section, the ontological and epistemological assumptions that are the basis for the research’s methodology is presented. These assumptions are considered important in the research since they help researchers to set the appropriate research design that enables the research question to be addressed adequately in the research process (Bryman, 2004, p. 27).

The research assumes the existence of multiple forms of internal control depending on the type of enterprise. It acknowledges that there is no one single form of internal control system that fits to all types of SMEs, but that, enterprises benefits more from a system of internal control that is tailored to their size and scale of operation. Although forms of internal control are multiple, the research’s ontological assumption is that the nature of internal control in SMEs can be perceived in constructionism that internal control can be achieved by the interaction among stakeholders (Bryman, 2004, p. 16-18).

On the other hand, an epistemological assumption that lies in this research is interpretivism in that norms and subjective position of the researchers and research community are vital elements in the study (Bryman, 2004, p. 13-16). Therefore, the researchers are hereby expected, in answering the specific research questions, to grasp the subjective meaning of the research’s results and enrich analysis of these results through subjective interpretation.

4.3 Research Approach

There are mainly two research approaches depending on the relationship between theory and observation: the deductive and inductive approach.

The process of deduction is based on a theory on which a hypothesis is based. Data collection step leads to findings which are used to reject or confirm a hypothesis. The final outcome is the revision of the theory (Bryman, 2004, p. 9).

The inductive approach begins with empirical observation, and generalizations are made on the basis of these observations to form a theory (Bryman, 2004, p. 10).
The approach that is adopted in this research is an inductive one. Generalizations about the system of internal control of SMEs are done on the basis of empirical observations with qualitative orientation. However, unlike generalizations in the positivist sense, this study intends to forward context-specific generalizations.

4.4 Ethical Considerations

Writers of this thesis acknowledge that the issue of internal control is a sensitive issue that requires respondents to reveal their own personal experience and how things are done in their enterprise.

Therefore, in order to get meaningful data, the objective of the research is made clear to all interviewees so that they feel at ease to respond freely. Researchers made sure that interviewees understand that inputs of the interview will not be used for any other purpose than the cause of the research. All interviewees were asked of their consent to participate in the research.

4.5 Empirical Observation

In this section, the data collection techniques and that of data analysis will be discussed since these are the basis for a sound empirical observation.

4.5.1 Methods of data collection

i) Semi-structured interview

The data collection method used in the research is the qualitative interview method. This is considered most appropriate to the nature of this research since it enables description of the nature of internal control in SMEs as well as explanation of the extent to which internal control is important in operations of SMEs. The method also enables to perceive how respondents frame and understand internal control in SMEs. Moreover, the extent to which internal control in SMEs complies with principles of effective internal control is expected to be more evident from data collected through such semi-structured interview.

During data collection, the researchers made use of semi-structured interviews. Prior appointments were made for the interview to create a convenient time and place to the participant. The interviews were conducted in the respective working places of participants and this is believed to make the participant feel at ease to respond naturally to our questions. With semi-structured interviews, the researchers have a list of questions or interview guides that the interviewee responded.

ii) Reason for selecting Semi-structured interview

Since the data collection methods selected for this study is qualitative interview method which is among the most popular method in doing research, even though there are three kinds of interview (structured, unstructured and semi structured interviews), the
researchers selected semi-structured which seems most practical and appropriate for this paper which focuses more on the description and explaining of the perceived nature of internal control in the small and medium enterprises.

By using semi-structured interview method, the researchers were able to eliminate eventual misinterpretations of the questions. This was possible by giving additional explanation on the research questions so as the interviewee provides reasonable and appropriate answers.

Related to this point, the semi-structured interview method enabled us to establish personal contact with the interviewees. This was important in this research because of the nature of the research questions. Indeed, internal control is a sensitive issue which individuals are not ready to discuss about. Those who are responsible to ensure that control mechanisms are implemented in the enterprise are not usually willing to reveal how such mechanisms actually work for fear that the enterprise is exposed to fraudulent actions. Face-to-face interview enables to reduce such risk of non-response. Individuals feel obliged to answer ‘awkward’ questions which they would have left unanswered in case of questionnaires.

On the other hand, the method enables formulation of longer and complex questions. Subtle issues such as the independence of auditors and managers, fraud detection mechanisms and the like require posing a number of interrelated questions through interview method.

In addition, the semi-structured interview method is lenient on the length of time required for interviews (Bryman, 2004, p. 327). Therefore, by adopting this method, we were able to ensure completeness of the interview process.

iii) Unit of Analysis and Sample characteristics

The sampling method used for the selection of the sample interviewees is purposive sampling. Efforts were made to include small enterprises as well as medium-sized enterprises in the sample so that challenges of both types of enterprises are addressed in the research. Therefore, three small enterprises and four medium ones are interviewed – the distinction being made using the SME threshold defined by the European Commission as presented under Table 2. These enterprises are involved in different lines of businesses ranging from restaurants, supermarkets to vehicle spare part sale. We believe that this heterogeneity of businesses adds relevance to the data collected from each enterprise and at the same time enable the eventual emergence of a theory that reflects the variety of cases in the real world of business.

The individuals selected for interview are those who have the most involvement in the financial activities of the SMEs. We were able to interview managers of the respective enterprises. We believe that these interviewees are better placed to provide us with accurate and all-rounded information about operations of the business entity. Although we tried to include relevant employees in our sample, we did not obtain positive response except for staff of one of the medium enterprise interviewed for the purpose.
Therefore, the researchers believe that having access to a variety of enterprises and to the most adequate interviewees for this study –i.e. the Managers- in terms of immediate exposure to information certainly raises the expectations for the results and provides imminent value for a proper treatment of the research question.

4.5.2 Methods of Data Analysis

i) Introduction

As acknowledged by Bryman (2004, 398), analysis of qualitative data is not a straightforward exercise since there are no clear-cut rules like that of quantitative data analysis. Therefore, a careful selection of methods of analysis determines the quality of interpretation and analysis. Therefore, in this section, the methods of analysis as well as the steps to be followed are highlighted.

ii) Methods of Analysis

Among the various approaches of qualitative data analysis, the one that is considered most appropriate for this research is the grounded theory approach. This method of analysis enables the researchers to derive a theory on the importance of effective internal control for SMEs based on the data systematically gathered and analyzed through the appropriate research process (Bryman, 2004, p. 401).

For this research, data are analyzed in an iterative process, moving from the data collected, to the theoretical background and to the emerging theory. As mentioned above, after the realization of the semi-structured interviews, transcripts of the interviews will immediately be made in order to gather and ensure the richness of the data obtained.

We have found it appropriate to adapt a form of grounded theory to this study on several grounds. Grounded theory has the goal of generating concepts that explain the research question (Bryman, 2004, p. 401) and since this study has an explanatory purpose, we consider the method is appropriate to adequately answer the research question. In addition, our research deals with a practical issue; therefore a theory grounded in experience suits the purpose of our research.

We find it appropriate here to qualify our use of the grounded theory as a method of analysis. We found it necessary to adapt a form of grounded theory convenient to our research as compared to the original theory developed by the first users.

Indeed, Glaser & Strauss (1967 in Bryman 2004, p. 401) emphasis that the researcher should have “no preconceived ideas” when collecting and analyzing data. However, we share the concern of George Allan (2003, p. 8) that there should be some agenda for research by interview and that the time and resource constraints that we are facing prohibit unfocused investigation’. If we were to follow the intentions of the original grounded theory, no preconceived ideas about effective internal control systems would be allowed in the analysis. As questioned by Bulmer (1979) in Bryman (2004, p. 406), it is not clear
‘whether researchers can suspend their awareness of relevant theories or concepts until a quite late stage in the process of analysis.’

Therefore, we understand that there are a certain set of desirable features of effective internal control systems in business entities. Based on this conceptual scheme, we find it appropriate to adapt a form of grounded theory that permits us to include the advantage of building on formerly achieved knowledge and theoretical background on the issue of internal control (Bryman, 2004).

What exactly we have adapted from the theory is made explicit in the following section.

### iii) Steps of Analysis

**a) Theoretical aspects**

In this section, a description of steps in ground theory analysis is provided in general terms. The steps that we have specifically followed using an adaptive form of this theory are discussed with examples in the next section.

Grounded theory was first envisaged through the work of two sociologists, Barney Glaser and Anselm Strauss. Their collaboration in research on dying hospital patients led them to write the book *Awareness of Dying* published in 1967. In this research they developed the constant comparative method later known as Grounded Theory (Hunter, Hari, Egbu and Kelly J, 2005, p. 57). Although it was developed in the field of sociology, the method is now widely used in the context of business researches as well (Allan, 2003, p. 1).

Grounded theory is defined by Strauss & Corbin (1998, p. 12 in Bryman 2004, p. 401) as a theory that is derived from data, systematically gathered and analyzed through the research process. One of the key features of this method is that data collection, analysis, and eventual theory stand in close relationship to one another. The insights that grounded theory reveals is the contextual explanations rather than descriptions what is going on (Ng and Hase, 2008, p. 155).

It is worth noting that the two founders of grounded theory (Glaser and Strauss) have come to have a divergent inclination on some issue, which had led to the split in the methodology relevant to the grounded theory. According to Kelle (2005, p. 15), "the controversy between Glaser and Strauss boils down to the question of"

- whether the researcher uses a well defined "coding paradigm" and always looks systematically for "causal conditions," "phenomena/context, intervening conditions, action strategies" and "consequences" in the data, or
- whether theoretical codes are employed as they emerge in the same way as substantive codes emerge, but drawing on a huge fund of "coding families."

It is to be noted that both strategies have their pros and cons. Given the scope of this research, we have not considered to choose from any of the two versions but opted to stick to the original conception of the theory.
Accordingly, in grounded theory, the researcher begins with a general research question. Then relevant people and/or incidents are theoretically sampled from which the relevant data are collected. Data are coded, which may at the level of open coding generate concepts. Through a constant comparison of indicators and concepts, categories are generated. Then relationships between categories are explored in such a way that hypotheses about connections between categories emerge. Then specification of substantive theory emanates from the data collected based on the principle of theoretical saturation and testing of hypotheses. The substantive theory is finally explored using grounded theory processes so that formal theory may be generated (Bryman, 2004, p. 403).

b) Analysis implementation

Data analysis, in this research, is part and parcel of the entire research process meaning that the data collection, the data analysis and the eventual induction of a general statement on effective internal control in SMEs come all together in close association with each other.

In this research, we followed basically four stages of analysis that correspond to the activities related to generation of Codes, Concepts, Categories, and Theory respectively.

<table>
<thead>
<tr>
<th>Stage</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Codes</td>
<td>Identifying anchors that allow the key points of the data to be gathered</td>
</tr>
<tr>
<td>Concepts</td>
<td>Collections of codes of similar content that allows the data to be grouped</td>
</tr>
<tr>
<td>Categories</td>
<td>Broad groups of similar concepts that are used to generate a theory</td>
</tr>
<tr>
<td>Theory</td>
<td>A collection of explanations that explain the subject of the research</td>
</tr>
</tbody>
</table>

Allan, 2003, p. 2

After transcription of the interview, our analysis started with identifying key points important to the investigation in the transcripts. These points were highlighted in italic font and given an identifier (P) attributed sequentially starting at the first interview and continuing on through subsequent interviews.

In order to highlight the specific attributes of small enterprises and medium enterprises, we differentiated between these two by designating Pm those key points identified in interviews of medium enterprises while those of small ones is marked Ps.

As indicated in Ethical Considerations, the anonymity of these enterprises is guaranteed. Therefore, key points related to the interviews of the first medium sized enterprise is identified as Pm1, the second Pm2, Pm3 for the third one and finally Pm4 for the last one. By the same token, identifiers for the small ones are marked as Ps1, Ps2, and Ps3.
In so doing, it is possible to trace back through the interview transcriptions to the actual content and context of each key point.

To give an example of the process, transcripts of three different interviews of small enterprises are the following:

- ‘We have a computer system in our supermarket which record every stuff in the supermarket with the selling prices and when each stuff is sold the computer will record automatically the sale; at the end of each day total sales recorded by the computer and the actual cash collected will reconcile or balance’.

- ‘Our computer system will control the entire inventory we have in the supermarket, when we purchase the stuffs we put all the information of the stuffs like the no. of unit and different identity in the computer system therefore each month the computer provide report about the in and out of the stuffs therefore we can easily control it.’

- ‘The computer system also provide monthly report about all items IN and OUT, the remaining balance in the shop, and any oversold items and unsold item for long period also report by the computer program.’

Table 8 Examples of codes and concepts from the data in case of small enterprises

<table>
<thead>
<tr>
<th>Id</th>
<th>Code</th>
<th>Concept</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ps1</td>
<td>computer recording total sales at the end of each day and reconciling or balancing the actual cash collected</td>
<td>the use of computer system in balancing and reconciling daily transactions</td>
</tr>
<tr>
<td>Ps2</td>
<td>controlling the entire inventory is possible with the computer because specifications of the stuff are uploaded in advance</td>
<td>the use of computer system in controlling the inventory</td>
</tr>
<tr>
<td>Ps3</td>
<td>the computer software provides each month information on what is in and out of the stuffs</td>
<td>the use of computer software in producing monthly reports</td>
</tr>
<tr>
<td>Ps3(a)</td>
<td>controlling oversold items or items unsold for long time</td>
<td>the use of computer system to control the quality of inventory</td>
</tr>
</tbody>
</table>

This process of coding yields concepts, which are grouped and turned into categories. Therefore, by grouping, examining, comparing and conceptualizing the data from the interview transcript, we finally have a set of categories. In the above example, the category that emerges from this process is, as depicted in Figure 1, the fact that ‘information Technology is a mechanism for effective internal control.’

the use of computer system
in balancing and reconciling daily transactions

the use of computer system in controlling the inventory

use of computer software in producing monthly reports

the use of computer system to control the quality of inventory

Figure 1: Diagrammatical emergence of the category “Information Technology as a mechanism for effective internal control”

Thus, this process is repeated for each key point identified in the transcript and for all sample cases of small and medium sized enterprises. The categories that come out of this process are linked to each other and the connection between the various concepts enables the emergence of the grounded theory.

The grounded theory as a method of business research is criticized in that the theory that is grounded in specific data is not applicable for a wider scale generalization (Allan, 2003, p. 8-9; Georgieva and Allan, 2008, p.49; Ng and Hase, 2008, p. 162). It is to be noted that in this study, the aim is to generate a theory that is anchored in the data collected and analysed so as a specific contextual generation of a theory is possible. We have not conceived the emerging theory to be generalized in the positivistic sense but rather a *grounded* theory is the focus of this research.

Therefore, in this chapter, efforts were made to specify the underlying assumptions of the research which are the basis for identifying the appropriate research design, strategy and approach. In doing so, appropriate ethical considerations are taken into account. With respect to empirical observations, we have also highlighted the data collection and data analysis methods with examples to illustrate the various steps involved in the process. In what follows, a summary of major findings and discussion of empirical results will be provided.

4.6 Research Criteria

4.6.1. Introduction
A discussion on methodological issues will be incomplete without discussing the issue of credibility. Credibility is the criteria in judging the quality of any research study taking into account the amount of evidence used.

In the case of qualitative study which is the case here, to determine the value of the evidence is to determine the quality or sustainability of the investigation (Spencer, Ritchie, Lewis, & Dillon, 2003, p. 3). To meet these criteria, certain test of measurement in terms of reliability and validity must be fulfilled to achieve the goal of the study. Although these measurement criteria are more often used for quantitative studies, their respective relevance for qualitative research is now well acknowledged and assimilated in qualitative researches (Bryman, 2004, 272).

4.6.2 Reliability

External reliability refers to the degree to which a study can be replicated (Bryman, 2004, p. 273). It is true that, in qualitative research such as ours, it is difficult to obtain an exact replication of a study since it is not possible to entirely ‘freeze a social setting and the circumstances of an initial study to make it replicable’ (Bryman, 2004, p. 272). In addition, the grounded theory expects researchers to have no ‘preconceived ideas when collecting and analyzing data’ (Allan, 2003, p. 8). As insightfully noted by Allan (2003, p. 8-9), time and other resource constraints prohibit unfocused investigation. Therefore, the research’s reliability is best served if such ideas are clearly made explicit in the research.

Indeed, we have made throughout the research, conscious efforts to meet the criteria of reliability. We identified the possible threats of bias in our interview and attempted to address them in various ways. We collected our data through semi-structured interview whereby we had only general guiding questions. These questions were asked in a clear manner and further explanations were given when requested by the interviewee. This enabled interviewees to answer freely and address as many aspects of the issue as they thought appropriate. So, in this manner, we avoided displaying our tendencies in the data collection process.

We also avoided long and multiple complicated questions since these may lead to confusion. In doing this, we have minimized possible biases in the formulation of the guiding questions.

In addition, we have presented the methods of data analysis in clear terms so that our interpretation is restricted to what the data actually tells us. The steps of analysis are described with examples so that anyone who is interested in replicating the analysis may be able to do so. Therefore, we consider that that our research meets the criteria of external validity both in its data collection and data processing stages.

On the other hand, internal reliability refers to whether members of the research team agree about what they see and hear. In our case, the research questions have been elaborated with the effort of both of us and interviews were held by the two of us. We explained our research questions to interviewees and both of us intervened when there was a need to clarify some items. We also held discussion of our perceptions after interviews. Therefore,
we consider our study is internally reliable since it meets the criteria of inter-observer consistency (Bryman, 2004, p. 273).

4.6.3 Validity

Validity is the measure of the correctness or precision about research findings which can best be explained using two distinct concepts. The first concept is the internal validity and the second is the external validity.

Internal validity gauges how close the researcher’s observation are to the theoretical ideas he/she develops. In our case, we have used grounded theory as a method of data analysis. Therefore, inherently, our observations are grounds for developing the theory as discussed under Chapter Five.

We consider our study to be externally valid in that it has solid ground for its conclusion to be generalized across a wider range (Bryman, 2004, p. 273). We have taken samples from small as well as medium size enterprises so that our research questions address the concerns of both entities. In doing so, we are able to generate a grounded theory that is based on the empirical context.
CHAPTER FIVE

EMPIRICAL FINDINGS AND DATA ANALYSIS

This chapter, in its first section, presents general highlights on empirical issues and the findings obtained from the conducted interviews with managers and employee of small and medium sized enterprises. We conducted our interviews in enterprises which are involved in different type business activities in Sweden. The second section holds a discussion and analysis of these findings in relation to the theoretical framework set out in Chapter Three. The data analysis is arranged based on the main components of effective internal control covered in the theoretical framework with the summarized interviewee questions to address the research objective.

5.1. General highlights on the empirical study

We selected purposefully four medium size and three small size enterprises. Such selection enabled us to look into the varying experiences of both small and medium size enterprises. As a first attempt to reach out such enterprises, we browsed the concerned websites in an effort to obtain contact details. However, since all information was displayed in Swedish, we could not make use of their information. We rather opted to look for details and addresses of SMEs through snowball system whereby acquaintances of the researchers were used to get into contact with SMEs’ personnel. The SME selected in this manner was invited to recommend another one in Umea town. On the other hand, some of the SMEs were contacted by the researchers on the spot without prior contact. Those who were willing to participate in the research were included in the sample of SMEs to be studied as described in Table 9.

Table 9 Characteristics of Sample SMEs

<table>
<thead>
<tr>
<th>Line of business</th>
<th>Ent. 1</th>
<th>Ent. 2</th>
<th>Ent. 3</th>
<th>Ent. 4</th>
<th>Ent. 5</th>
<th>Ent. 6</th>
<th>Ent. 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service delivering</td>
<td>Service delivering</td>
<td>Service delivering</td>
<td>Service delivering</td>
<td>Service delivering</td>
<td>Service delivering</td>
<td>Service deliverying</td>
<td>Factory (Spare part production)</td>
</tr>
<tr>
<td>(Supermarket)</td>
<td>(Dressing house)</td>
<td>(Restaurant)</td>
<td>(Super-market)</td>
<td>(Restaurant)</td>
<td>(Restaurant)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No of employees</td>
<td>70</td>
<td>40</td>
<td>35</td>
<td>65</td>
<td>55</td>
<td>45</td>
<td>240</td>
</tr>
<tr>
<td>Position of interviewee</td>
<td>Manager</td>
<td>Manager</td>
<td>Manager</td>
<td>Manager</td>
<td>Manager</td>
<td>Manager</td>
<td>Controller</td>
</tr>
</tbody>
</table>

Efforts were done to ensure the willingness of SMEs personnel in the study. Those who were unwilling to be included in the research were ignored. Informed consent was obtained in all the seven cases that were included as sample SME.

The interview was scheduled to the convenience of the interviewees. All the interviews were held in the working place of the interviewee. We believe such venue encouraged
interviewees to feel at ease and avoid any intimidation of unknown surrounding. The medium of communication was English and interview schedules lasted for an average of one hour and half to two hours. The data collection was done during the month of April. The interview was transcribed in English to ease the analysis of the collected data.

5.2. Major findings

5.2.1. Awareness on internal control

One of the major findings of the interview is that managers of small as well as medium sized enterprises are aware of the importance of internal control to their operations – although the degree of awareness varies from one SME to the other. Such awareness is noticeable in the words of one of the interviewees:

‘... at the end of each day, all the remaining stuffs or unsold items are counted and their balance is checked by the manager from what the computer shows; .... and all the collection of cash is also reconciled during this time with the computer total sales report’ (interviewee code s2).

Such description of control activities on daily and monthly basis is common in transcripts of the various interviews. Details of such activities are covered in subsequent sections; what is to be emphasized at this stage is that managers in the sample interview stress their being conscious of their responsibility to ensure a proper follow-up of daily transactions- whatever the mechanism.

5.2.2. Use of computer system

When asked if they use computer software to facilitate their daily operations, the managers unanimously stressed how heavily they depended on the application of computer software.

What came up as an interesting issue here is that they said to use the computer system not only because it facilitates daily transactions but also as a tool to control the smooth flow of daily operations. Interestingly, when asked if they have an internal auditor, the majority made it a point that they use the computer system to ‘audit’ or cross-check transactions. As well summarized by one of the interviewee, the computer software is widely used for various activities such as control of inventories, cross-checking of entries and cash collected as well as various daily and monthly reports:

‘... we use computer system to control every inventory and all daily collection. This makes the internal control more reliable. We control our employee based on the computer system to some extent i.e. we can control the sales items and the cash collection daily. We can control the unsold items, oversold items, undersold items and items which expired based on the computer system’ (interviewee code m2).
By adopting the computer software for their transactions, the enterprises are actually adopting the embedded control mechanisms that are built-in within the computer program. When asked if managers have an accounting manual to be guided with, they asserted that they have no such manual since they use the computer software.

5.2.3. Levels of authority and responsibilities

Given the small number of employees in small enterprises, one would assume that division of roles and responsibilities is inexistent. However, what our findings reveals is that small enterprises have their own mechanisms to place check and balance on financial transactions.

‘All the financial activities of the restaurant like sales and purchase transactions are recorded by the manager of the restaurant, and sent on daily basis to the main office in Stockholm, the financial reports are prepared there at consolidated form. The correctness of all the sales and purchase and also cash collection report prepared by the manager of the restaurant is checked and approved by district manager twice a month regularly’ (interviewee code s2).

As explained by interviewee code s2, although the manager is the only responsible person for the financial activities within the enterprise, his transactions are not left unchecked. Control mechanisms such as checking documents and entries are done at a higher level of the management.

In the case of medium-sized enterprises, a higher degree of division of tasks is noticed among employees. Although none of the four enterprises have a functioning internal control staff, they all acknowledge the fact that

‘depositing, reconciling, and recording of the enterprise’s receipts/collections are done by someone other than the custodian of the petty cash and/or change funds’ (interviewee code m1, m2, m3, and m4).

One of these enterprises, which actually employs the largest human power in the sample SMEs (a total of 240 staff), adds to the above point that bank accounts are reconciled by an employee who does not sign checks, handle or record cash.

In addition, when asked if they consider division of responsibility as one aspect of internal control, the managers responded affirmatively.

Therefore, be it at the small enterprise level or a medium one, the concern to ensure a good internal control is evident in such effort to assign appropriate levels of authority and responsibility to management as well as employees of these enterprises.
5.2.4. **Risk mitigation**

The small well as the medium sized enterprises are aware of the risks involved in their business activities. Daily reconciliation and other control activities described above have the ultimate goal of mitigating risk.

The three guiding questions addressed to medium sized enterprises related to the risk factor were the following:

- **To what extent does the enterprise identifies and analyzes risks arising from internal and external sources?**
- **Does the enterprise establish clear budget and financial objectives?**
- **To what extent do you consider that the potential for material misstatement due to fraud is explicitly considered in assessing risks?**

These guiding questions lead to the fact that the concept of risk mitigation is present in these enterprises in that the internal and external sources of risks are identified and analyzed. Efforts are also made to determine ways of managing these risks. One of the interviewee describes this in the following terms:

‘To address and integrate the risk, the daily collection of cash is reconciled with the computer total sales report;

- every 15 days the sales report is cheeked by external auditor;
- every monthly report prepared by the accountant is checked by the external auditor and
- every month all the IN and OUT of inventory is also checked by the manager and external auditor’ (interviewee m2)

However, not all managers consider the task of analyzing risk to be their responsibility. One manager of medium enterprise states that

‘... it is not my responsibility to provide sufficient clarity and criteria to the risks to reliable financial reporting; it is the head office main branch that assesses the risk to reliable to FS’ (interviewee m1).

The interviewees also note that they have the practice of ensuring each year that they have a clearly established budget and financial objectives – including ‘total sales and purchases’. Such planning is considered to be one mechanism of managing risks by the managers.
One manager admits the challenge of mitigating risks due to fraud, though it occurs rarely.

‘We can control the unsold items, oversold items, undersold items and items which are expired based on the computer system. But we cannot control the items stolen by employee sometimes we face this kind of problem but it is rare’ (interviewee m2).

SMEs also identify external risks related to credit sales. According to one official of sales division in the case of SME code m4, the company puts forward various mechanisms to mitigate the risk of non-payment of credit sales including thorough screening of customers, reserving the privilege of credit sales for few trusted clients, strict follow-up of pending payments, working in close network with area representatives in various parts of the country, and so on.

On the other hand, managers (m1, m2, and m4) are generally aware of the potential for material misstatement due to fraud and that this fact is explicitly considered in assessing risks to the extent of resorting to an external auditor. To quote the words of interviewee m2 as an example:

‘Because we use computerized system of controlling and beside that we check the activities of the supermarket by external auditor, the material misstatement of financial report are assessed effectively to achieve the objective of financial reporting.’

5.2.5. HR Policies and codes of conduct

Although the enterprises do not call it a full-fledged human resource policy as such, they insist that they have a general code of conduct that reflects the general orientation of the enterprise and that serves as a control mechanism. One manager of medium enterprise describes this in the following simple terms:

‘We have clear responsibilities and right for each employee depending on the position he or she is assigned. For example,

- sales persons should politely communicate with customers, should give receipt to the buyer, should give the necessary service.
- Others who work on store will assist the customer at any time when they require any support politely.
- The sales persons should balance their collection before they go home daily.'
• The entire employee should wear the uniform; when there is new information we will provide meeting and make sure they know it’ (interviewee code m2).

This same interviewee emphasizes, on other instance, the more informal nature of assigning responsibilities to employees and that this actually enables more flexibility between tasks and thereby ensuring optimal use of resources.

'We don’t have written job description for each employee, but we give oral order for all employee based on the market condition. When we have a lot of customers, we use all of our sales persons otherwise we give them other jobs to utilize our labour force effectively. I (the manager) work with the employees therefore can assign them in the necessary place based on the situation’ (interviewee m2).

As to the training policy of the enterprise, the majority do not consider there is a need for regular trainings. They consider ‘the work doesn’t need that much training’ (interviewee m1). This fact is more qualified with the following words of interviewee m2:

• ‘Our employees work to satisfy customer in providing the proper service which do not require as much training,

• Our sales persons are familiar with the collection machine since we give short training when they start their job.

• Our accountant is familiar with the computer software application and since our system does not change regularly, training is not as such necessary’.

Therefore, more than a formal human resource policy in strict terms, small and medium sized enterprises put more emphasis on the systematic way of ensuring internal control. It is what the following manager concludes:

‘Even though there are no human resource policies and practices designed as a regular framework, the way the organization works and implements facilitate the effective internal control over financial reporting like the systematic way of controlling through computer and control by manager, accountant and so on’ (interviewee m1).

5.2.6. Communication

Related to the fact that there are certain levels of authority and responsibilities within the sample SMEs, we were interested to find out that officials make conscious efforts to reconcile their separate records properly and resolve differences.
Area managers / district managers ensure accuracy of financial reports as often as every 15 days in most of the cases. Internal and external communication is generally considered important for the enterprise. The following terms of interviewee code m1, make it explicit:

- ‘Information is used to execute control in the organization that the person can handle to carry out the internal control responsibility like, the way the cashier and the accountant identified control makes the control very strong’.

- ‘internal communication enables and makes faster the execution of internal control objectives and it is true also in our company’

- The company communicates with outside parties like external auditors and government body like twice a year so that the financial reporting can be reliable and free from any misstatements’.

5.2.7. Evaluations

Since efforts to ensure good internal control system is not a one-time activity, it was interesting to observe that managers of sample SMEs take appropriate follow-up action for identified problems or weaknesses in internal controls – including matters communicated by the auditors. Employees also undergo regular evaluations of job performance is most of the cases.

One major indicator that ensures proper internal control for SMEs is the well-functioning of the systems designed to effect internal control. This issue is expressed in the following terms by interview code m2:

- ‘We always reconcile daily collection with what the computer system report of total sales and deposit it, therefore if this system works effectively we believe the internal control over financial reporting is functioning properly’.

The under-quoted words of interviewee m1 stress the importance of continual assessment of internal control activities for the enterprise:

- ‘Our company uses ongoing evaluation over financial reporting by determining the internal control effectiveness, mostly I (the manager)and the main office evaluate the functioning of internal control over financial reporting’.

- ‘Twice a year the management with the board identified the internal control strength and deficiencies and take corrective actions as appropriate for the deficiency and also they discuss about how to make improvement’.
Based on these findings of the research, we move on to the discussion and analysis of these empirical findings.

5.3. Analysis

In this section, the empirical findings obtained are summarized in schematic form to underline their relation with each other and analyzed in relation to the theoretical framework. To be noted is that analysis of the collected data is done following the steps of analysis illustrated under 4.5.2.

5.3.1. Awareness of SMEs on internal control

Based on the interview data, awareness on the merits of effective internal control system comes as a basis determining all the other activities of the SME related to internal control.

The result from this study balances the conclusions drawn by Lau Y. Wai, (2008, p. 15) on the perception of SMEs on the importance of internal auditing. Indeed, his study found that an efficient system of internal control is typically said to be absent or not strong enough in most of SMEs in general. However, the empirical findings of this research emphasize that SMEs are well aware of the importance of effective internal control and work consciously to bring about such a system in their respective enterprises.

5.3.2. Control environment

As grounded in the data collected, the overall environment of control relies on a proper distinction of levels of authority and responsibility, earmarking of standard codes of conduct that ensure integrity and ethical values among management and employees and mitigation of avoidable risks as presented below.

![Figure 2: Control Environment](image)

Ensuring a proper control environment is identified by the COSO Internal Control Integrated Framework as one attribute of effective internal control. It is to be recalled that the theoretical background of this study is anchored on the COSO Integrated framework of Internal Control. The findings of this study reveal that this attribute is also central in the case of SMEs.
5.3.3. **Control activities**

Control activities are made more effective if transactions of the SME are facilitated by a computer system. Such system enables control over the inventory, reconciliation of daily transactions, and accurate reporting of financial activities. Integration with risk assessment, establishment of policies and corresponding procedures are also found to constitute major elements in the overall control activities grounded in the collected data. These activities are also highlighted by the COSO framework as key attributes of effective internal control.

![Figure 3: Control Activities](image)

5.3.4. **Risk management**

One of the major rationales for having an effective internal control in SMEs is found to be the management of risk. SMEs are seen to identify and analyze risks arising from internal and external sources. SMEs also mitigate risks by establishing clear budget and financial objectives. In doing so, SMEs minimize the potential for material misstatement due to fraud.

![Figure 4: Risk Management](image)

Therefore, these findings of the research share the concern of the theoretical framework on the importance of managing risks.
5.3.5. **Information and Communication**

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Figure 5: Information and Communication

Smooth flow of information and external as well as internal communication is shown in the results to be one mechanism of ensuring effective internal control in the case of SMEs.

5.3.6. **Monitoring and Evaluations**

Activities and mechanisms of internal control undergo an on-going evaluation. In addition, it is found that internal control deficiencies are identified and communicated in a timely manner to parties responsible for taking corrective action. This logic is also embraced by the COSO Integrated Framework of Internal control.

Therefore, grouping findings of the study in this manner shows that the salient features of effective internal control that come out of the data collected, correspond to the components of internal control identified in the theoretical background.

These components are control environment, control activities, risk management, information and communication and finally monitoring and evaluations.
CHAPTER SIX

6. CONCLUSION

6.1. Introduction

In this final chapter, a brief summary of the main findings will be presented. We recognize that the research faces certain limitations and these will be discussed in this chapter. Taking such limitations into account and based on the theoretical and empirical findings, we will try to suggest some directions for future research areas.

6.2 Summary of main findings

Based on this adaptive form of ground theory, one of the research’s main empirical findings is the fact that sample SMEs are aware of the importance of maintaining an effective internal control system in their activities. This perception is believed to be a positive input for all forms of effort to enhance internal control systems in SMEs. Although the degree of awareness varies in depth from one SME to the other, the study found out that there is a basic understanding of the virtues of a good internal control system. This perception is gauged by the extent to which the components of effective internal control are present in the SMEs. Conclusions on the details of these components are given in what follows.

- Sound control environment

Based on the sample SMEs, we found out that their control environment can be said to be sound. This fact is grounded in the data collected. Indeed, in each of the sample SMEs, the levels of authority and responsibility are properly segregated. In addition, we found out that there are efforts to establish standard codes of conduct. Although the degree to which these codes are formalized differs from one SME to the other, the rationale for introducing such codes remains the same in the sample SMEs i.e. to ensure integrity and ethical values among management and employees of the SME.

Therefore, the sample SMEs have a sound control environment that is conducive for an effective internal control system.

- Sound risk assessment process

Risk assessment activities in sample SMEs are found to include sound processes of risk mitigation. Data collected through the interview reveals that all sample SMEs are cautiously involved in reconciliation of transactions. This activity is done on daily basis and cross-checking control activities are done with the ultimate goal of mitigating risk. Sample SMEs are found to identify and analyze not only risks arising from internal sources but risks emanating from external ones are addressed as well such as risks of non-payment of credit sales by customers.
Sales report, inventories and others are checked by external auditors to ensure reliability of financial reports and minimize the potential for material misstatements due to fraud. SMEs are also involved in ensuring budgetary and financial objectives are clearly established. Indeed, sample SMEs make sure each year that total sales and purchases are planned adequately so that such planning serves as one mechanism of managing risks by SMEs managers.

Therefore, as it can be seen, SMEs are involved not only in identifying risks but efforts are also there to manage and mitigate such risks. Thus, management of risk is found to be an essential attributes of an effective internal control in SMEs.

- **Sound operational control activities**

One of the features of an effective internal control system is the prevalence of sound operational activities. The sample SMEs heavily depend on the application of computer software for facilitating their daily transactions. Daily entries are kept in the computer. Above the duty of facilitating daily entries, sample SMEs make use of computers as a tool to control the smooth flow of daily operations. They made it a point that they use the computer system to ‘audit’ or cross-check not only transactions but inventories as well. Accurate reporting of financial activities are also possible by using such system. By adopting the computer software for their transactions, the enterprises are actually adopting the embedded control mechanisms that are built-in within the computer program. Therefore, one can tell that the sample SMEs fulfill the attributes of sound operational control activities.

- **Effective information and communication system**

Effective communication system is said to prevail in sample SMEs since officials at different levels of authority and responsibilities make conscious efforts to reconcile their separate records properly and resolve differences. Accuracy of financial reports is ensured by Area managers / District managers of SMEs on a regular basis. Communication is also maintained with external stakeholders in terms of communicating appropriate financial reports.

These features, thus, allowed us to conclude that internal and external communication and information system is said to be effective in sample SMEs.

- **Effective monitoring & evaluation system**

It was found out that appropriate follow-up action for identified problems or weaknesses in internal controls is taken by managers of sample SMEs – including matters communicated by the auditors. Indeed, regular discussion is held by the management and the board of sample SMEs to identify strength and deficiencies of internal control and take corrective actions as appropriate for the deficiency and also they discuss about how to make improvements. In addition, the job performance of employees is evaluated regularly in most of the sample cases.
Therefore, one major indicator that ensures effective internal control for SMEs is the prevalence of an effective monitoring and evaluation system which is shown to be the case of sample SMEs.

By way of conclusion, it can be said that although the level of awareness differs from one SME to the other, SMEs are conscious of the significance of effective internal control. This perception is evaluated against the five components of an effective internal control system.

The above findings of the research are found to be in line with the theoretical background which is based on the COSO Integrated Framework of Internal Control. Indeed, the study backs up the fact that the major components of effective internal control identified in the general theory are also equally valid in the case of SMEs. Thus, these sample SMEs are said to have an internal control system that complies with the principles of effective internal control.

Therefore, the theoretical and empirical findings of the research made it possible for us to address the research question adequately since they reveal the extent to which the practice of internal control in SMEs comply with the principles of effective internal control system.

6.3 Limitations of the study

The results of this research are subject to several limitations as it is the case in such similar research works.

The size of the sample interviews is one limitation. As mentioned earlier, in spite of our relentless efforts to contact as many managers and employees of SMEs as possible, we succeeded in conducting seven interviews only. One reason for this is the fact that managers find it difficult to avail themselves for interview due to workload. However, efforts were made to extract as extensive information as possible from the existing sample interviews so that the findings of the research emerge from the data collected.

The language constraint is also another limitation on the clear understanding during communication. In addition, a number of vital statistics and other important resources relevant to the case of Sweden are published in Swedish, although some have been translated into English. Moreover, the researchers found it difficult to obtain published journals and books on issues of relevance to this study (particularly internal control in SMEs) because of resource constraints and lack of infrastructure such as e-commerce.

The limited time available to carry out the research is considered a limitation to this study since as wide as the scope of this topic is, researchers were sometimes constrained to move on to meet submission deadlines even when not completely satisfied with results obtained.
The final limitation is concerned with the definition of internal control itself. A review of literature on definitions of internal control gives not only what we mean by internal control but also give highlights on what we do not mean by the term internal control.

Internal control can provide only reasonable assurance - not absolute assurance - regarding the achievement of an organization's objectives. Effective internal control helps an organization achieve its objectives; it does not ensure success. There are several reasons why internal control cannot provide absolute assurance that objectives will be achieved: cost/benefit realities, collusion among employees, and external events beyond an organization's control are some of the reasons why internal control does not provide absolute assurance (Sampson, 1999, p. 4).

6.4 Possible future research directions

We can notice from findings of the research that even if SMEs are currently the major part of economic activities in Sweden and that they represent about 99% of all types of enterprises in Sweden, providing high job opportunities to its labor force; the back bone of this business activities that is internal control system of SMEs has not yet gained the proper focus proportionate to its value by researchers and other publishing institutes in Sweden.

Therefore, the issue is still an area that requires further empirical and theoretical studies whose results can have practical relevance for the improvement of the internal control system in Swedish SMEs.
REFERENCE


APPENDIX

Guiding Questions for the Interview

Definition of Internal control: A process design to provide reasonable assurance regarding the enterprise objective achievement.

Section 1. General Questions

1-What is the name of your company or business sector?

2-How many permanent and temporary employees do your firm have?

3-What is your current position and how many years have you been working in this position?

4. How much capital does your firm have?

Section 2. Questions related to Internal Control

2.1 Control environment

1. Does your organization has established policies regarding such matters as acceptable business practices, conflicts of interest and codes of conduct? If yes, are employees informed about it?

2. To what extent do you consider your enterprise is committed to competence? Do the personnel have adequate training? the required qualification, etc?

3. Does the enterprise have an audit committee? If yes, to what extent does this committee have the resources and authority required to discharge its duty and responsibilities?

4. Does your company have a clearly set management philosophy and operating style including clear statement of vision, mission, and objectives?

5. Do you consider that the organizational structure of your company is appropriate for its size and complexity of its operations?

6. To what extent are the lines of authority and responsibility clearly defined? Are there written job descriptions for each employee delineating specific duties, reporting relationships and constraints?

7. To what extent do you consider that human resource policies and practices are designed and implemented to facilitate effective internal control over financial reporting?
2.2 Risk Assessment

8. To what extent does the management specify financial reporting objectives with sufficient clarity and criteria to enable the identification of risks to reliable financial reporting?

9. To what extent does the company identify and analyze risks to the achievement of financial reporting objectives as a basis for determining how the risks should be managed?

10. To what extent do you consider that the potential for material misstatement due to fraud is explicitly considered in assessing risks to the achievement of financial reporting objectives?

2.3 Control Activities

11. Does the company take actions to address and integrate the issue of risks to the achievement of financial reporting objectives?

12. To what extent are control activities selected and developed considering their cost and potential effectiveness in mitigating risks to the achievement of financial reporting objectives?

13. To what extent policies related to reliable financial reporting are established and communicated throughout the company, with corresponding procedures resulting in the implementation of management directives?

14. Are information technology controls designed and implemented to support the achievement of financial reporting objectives in your company?

2.4 Information and Communication

15. To what extent is pertinent information identified, captured and used at all levels of the company and distributed in a form and time frame that supports the achievement of financial reporting objectives?

16. To what extent do you consider that information used to execute other control components is identified, captured and distributed in a form and time frame that enables personnel to carry out internal control responsibilities?

17. Internal communications enable and support understanding and execution of internal control objectives, processes and individual responsibilities at all levels of the organization. Do you consider that this is the case in your company?

18. How effectively does the company communicate with outside parties on relevant matters that affect the achievement of financial reporting objectives?
2.5 Monitoring

19. To what extent your company makes ongoing or separate evaluations in order to determine whether internal control over financial reporting is functioning.

20. To what extent are internal control deficiencies identified and communicated in a timely manner to parties responsible for taking corrective action, and to management and the board as appropriate?