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Importance of Internal Audit and Internal Control in an organization – Case Study

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International Business Degree Thesis
Bachelor of Business Administration
2017

DEGREE THESIS	
Arcada	
Degree Programme:	International Business
Identification number:	15474
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Title:	Importance of Internal Audit and Internal Control in an organization - Case Study
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Commissioned by:	

Abstract:

This research is a descriptive case study of a company. It presents concepts of the internal audit and internal control based on an example of a Finnish company. The research examines the role and importance that internal audit and internal controls have in an organization.

The main research question is "What is the role and importance of internal audit and internal control in an organization" Additional sub-questions relating to the case company that will allow for better understanding of both concepts and the case company are:
"How internal audit and internal control are implemented in the case company?"; "How the implementation of internal audit and internal control influences the case company?"; "What are the internal audit and internal control regulations that the case company must comply with?"

To answer the main and sub-research questions, this thesis has a theoretical part about both research concepts. The theory is mainly based on the internal auditing and internal control literature. Data concerning the case company is collected by interviews and secondary sources in the form of annual reviews, financial statements and the company's website. It is later analyzed through a theoretical prism.

The findings of this research show that both the theory and the case company assume internal audit and internal control as important. The role of both concepts is allowing the organization to achieve its goals and objectives, through more effective organizational operations, risk management, and decision making.

Keywords:	internal audit, internal control, risk management, business objectives
Number of pages:	48
Language:	English
Date of acceptance:	

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1 INTRODUCTION

Nowadays businesses operate in the fast, competitive and ever-changing environment. Their success is based on the ability to adapt to the environmental changes, to fulfill organizational objectives and to manage risks as the business landscape evolves every day.

"Companies that were once leaders in their sector, including Kodak, Blackberry, Sears, and Macy's, have suffered massive declines in value and sector status. Whole industries, like taxi cabs, travel, and retail, have seen massive business model shifts with the arrival of game-changing players like Uber and Amazon." (Leech, 2017) In addition, to purely strategical risks, companies must be aware of a wide range of financial and reputational risks. (Alma, 2016)

At the beginning of 2000's major corporate and accounting scandals resulted in collapses of companies like Enron, WorldCom, Ahold and Parmalat (Lakis and Giriunas, 2012, p. 146). They shook investors' confidence and resulted in the tightened law in the form of Sarbanes-Oxley Act of 2002 and many other regulations, recommendations, and legislation around the world. However, tightened regulations are not impermeable as the recent fraud cases such as following proves: ABB in South Korea of $100 million; Konecranes in one of its subsidiaries of 17 million € in 2015; alleged bribery cases of Caverion in Germany and of Shindler in China or internal audit scandal of Toshiba. (Revill, 2017 & Business Insurance, 2015 & Caverion.com, 2016 & France-Presse, 2015 & Bhattacharyya, 2015) Such cases result in damaged reputation, financial losses and loss of trust for the management of the company.

In order to assure shareholders and to manage those risks, companies increased their interest in internal control and internal audit. "Internal Audit's objectivity, perspective, and skills can assist stakeholders and provide valuable insight". (McDonnell, Kinsella and Healy, 2017, p.1) "Internal control is recognized as a key corporate governance mechanism and disclosure of information about internal control systems is viewed as a significant component in the process of restoring public trust in corporate probity in the wake of financial scandal." (Spira & Gowthorpe, 2008, p.5).

The introduction of COSO Framework and Sarbanes-Oxley Act law fueled rapid development and growth of organizational importance of those two concepts. It makes them an important and interesting research subject, which can be expected to evolve continuously in the future.

Presentation of the case study will allow for deeper and more holistic understanding of those concepts based on a real life example. Furthermore, the case company will provide information how internal audit and internal control are used in a Finnish global company. The case company is not required to follow the Sarbanes-Oxley Act of 2002 by law. Therefore it constitutes a unique situation not widely presented in the literature of the subject.

1.1 Research aim & questions

The main aim of this thesis is a presentation of internal audit and internal control concepts, based on a real life example. Appropriate interpretation and implementation of those concepts are vital for the companies, but the question of its benefits and importance to an organization remains. An example of global company KONE is presented. Implementation of internal audit and internal controls at KONE is analyzed through the prism of theory, regulations and actual outcomes. The research examines the role and importance which internal audit and internal controls have in an organization.

The main research question in this study is:
What is the role and importance of internal audit and internal control in an organization?

Additional sub-questions relating to the case company allow for better understanding of both the concept and the case company:

- How internal audit and internal control are implemented?
- How the implementation of internal audit and internal control influences the case company?
- What are the internal audit and internal control regulations that the case company must comply with?

Answers to the research questions expose advantages of both concepts, their role, and benefits. Some attention is given to possible regulations and the position of both concepts in an organizational structure.

1.2 Limitations

This study is limited by the time constraints and possibilities of conducting the research by one person. Therefore, the scope of this thesis is limited to the theory behind internal audit and internal control concepts. Additionally, an example of how they are applied in the company that operates in a global setting will be given.

As this thesis analyzes a real life example of only one case company, generalizations cannot be made. Therefore, this research does not discuss, whether the implementation and results of the internal audit and internal controls at KONE are comparable, to those used by other companies.

The study is also limited by confidentiality needs of the case company KONE. It was wished by KONE to keep the interview information confidential. Therefore, research results and other instances where sensitive information was used, are moved into appendices and will not be available publicly.

1.3 Research process

“Discovery favors the prepared mind”(cp. Strauss & Corbin, 1998, p.47). This quote of Pasteur is part of “theoretical sensitivity” that was described by Strauss and Corbin (1998). It is a concept used in grounded theory, which allows separating the researcher’s personal experiences and previous knowledge from her research.

In this research “theoretical sensitivity” is adapted as part of the grounded theory to fit a case study. Liusvaara (2008) argues that “theoretical sensitivity’s” application in the case study is critical, because case study is “examined through the background philosophies”. This allows the researcher’s previous experiences and knowledge to be kept separate.

Below figure is an adaptation of "theoretical sensitivity" in the research process. It represents a framework which this thesis is based on.

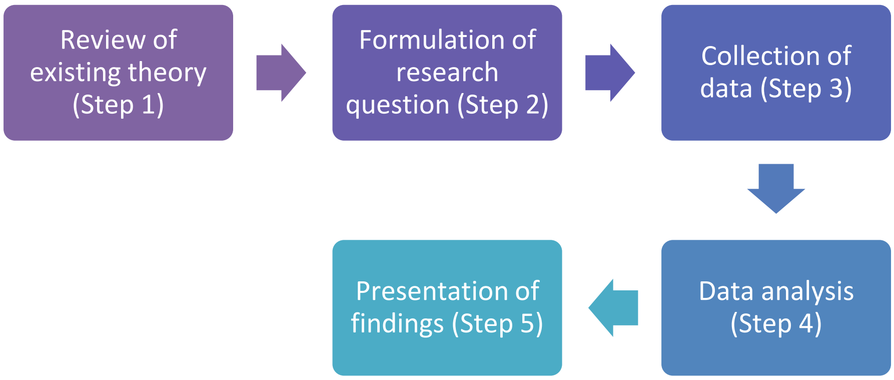

Figure 1 Author's adaptation of research process based on the works of Strauss and Corbin (1998, pp.41-47)

The above figure follows works of Strauss and Corbin's (1998, pp.41-47) "Theoretical sensitivity". It suggests that the "research question" (step 2) should be born as a result of careful "review of existing theory" on the topic (step 1). It is to ensure that knowledge of the researcher is updated and not misinterpreted by her experience.

Researcher's knowledge obtained from the literature and experience are the first parts of "theoretical sensitivity". After that, next to follow are "data collection" (step 3) and "data analysis" (step 4).

This process altogether creates a research situation where the researcher has "attribute of having insight, the ability to give meaning to data, the capacity to understand, and capability to separate pertinent from that which isn't" (Strauss & Crobin, 1998, p.42). Therefore, it leads to the final step of research (step 5) the "presentation of findings".

1.4 Definitions

Assurance service – a service where the internal auditor engages in „systematic process of objectively obtaining and evaluating the evidence" (Theiia.org, 2016 *a*)

Audit charter - A document approved by those charged with governance that defines the purpose, authority and responsibility of the internal audit activity (Theiia.org, 2016 *a*)

Consulting service - „advisory in nature, and are generally performed at the specific request of an engagement client. The nature and scope of the consulting engagement are subject to agreement with the engagement client." (Theiia.org, 2016 *a*)

1.5 Structure of Thesis

This study is structured in six chapters. The first chapter is introductory in nature. The background of the study is presented together with the aim and research questions with its limitations. The research process is presented as well.

The second chapter explains the methodology used in this research. A literature review of the theory of internal audit and internal control is in chapter three. The fourth chapter presents the case company KONE, its main numbers and history. The use of internal audit and internal control in KONE are explained.

Chapter five discusses the findings and observations made by the researcher which are later concluded in chapter six. Chapter six has a short explanation of the limitation of research and possible future studies.

2 METHODOLOGY

In this chapter, the methodology implemented in this research is explained. The author briefly explains the method that was used to obtain research material, analyzing it and interpreting it.

2.1 Material

The theoretical chapter of this thesis is based on secondary data sources. Information about internal audit and internal control concepts are based on books, published textbooks, journals and articles on the topic.

The chapter about the case company KONE is a mix of primary and secondary data. Primary data is obtained through interview. Secondary data includes materials published by KONE on their website or in printed publications.

Primary data is collected from two separate semi-structured interviews with Pekka Piuhola, the Head of Internal Controls at KONE. The before-mentioned method was chosen to allow freer exploration of the topic by the interviewer. Surfacing of different subjects concerning internal audit and internal controls during the interview was to be expected.

2.2 Approach

This thesis was approached from the perspective of qualitative research as it is exploratory and analytical. In the words of Saldana et.al (2011, p.3) qualitative research is "an umbrella term for a wide variety of approaches and methods for the study (…). The information or data collected and analyzed is primarily (but not exclusively) nonquantitative in character (…)". It is also descriptive research that will focus on questions such as "how", "what", "where" and "when" (Greener & Martelli, 2015 p. 47).

The aim of this research is to examine concepts of internal audit and internal control based on real life example of KONE. Saldana et. al (2011, pp.4-21) presents 14 different types of qualitative research such as ethnography, grounded theory, phenomenology, case study, content analysis, mixed methods research, narrative inquiry, poetic inquiry, arts-based research, autoethnography, evaluation research, action research, investigation journalism and critical inquiry.

Due to explanatory nature of this research, a case study approach has been chosen. It allows for deeper examination of the topic, and it focuses on "a single unit for analysis – one person, one group, one event, one organization" (Saldana et. al 2011, p.8). Moreover, "case study in and of itself is valued as a unit that permits in-depth examination". (Saldana et. al 2011, p.8). Bryman & Bell (2007, p. 725) write that "case study entails the detailed and intensive analysis of a single case" which in this case is KONE. Additionally, Saldana et.al (2011, p.8) argues that case study is not to "develop an argument for how single case represents or reflects comparable individuals or sites". Which is, in fact, the limitation for this research.

Deductive Qualitative Analysis approach is used as this research is designed to test the theories against observations (the theory of internal audit and internal control against observations of the case study).

2.3 Data collection

The interview is used as a data collection method in both quantitative and qualitative research. However, "Interview is probably the most widely employed method in qualitative research." (Bryman & Bell, 2007, p. 472) An interview was chosen as data collection method by the author, because it meets the needs, time frame and limitations of this study.

Three types of interviews are categorized in publications about conducting research: structured, semi-structured and unstructured (Bryman & Bell, 2007, pp.210, 474; Greener, 2008, p.89):

- Structured interview has pre-planned set of questions and answers, to ensure that each respondent has the same interview stimulus
- Semi-structured interview is based on pre-planned interview guide which contains specific topics that should be covered by the interviewer. It is not limited by them and allows for deviation from the study guide, both in questions and answers
- Unstructured interview is guided mostly by the main topics prepared by the interviewer. It mimics a conversation where interviewer allows for free response. It is followed by questions derived from the answers which are of interest to the interviewer

The semi-structured interview has been chosen for this research. Pre-planned interview guide allows obtaining information needed to answer research questions. In the same time, it will not limit exploration of topics of the subject, which is necessary in the case study.

2.4 Data analysis

Qualitative Data Analysis (QDA) "is the range of processes and procedures whereby we move from the qualitative data that have been collected into some form of explanation, understanding or interpretation of the people and situations we are investigating." (Skinner, Edwards and Corbett, 2014, p.70)

This research is deductive in approach. The data was collected in an interview to assess the functionality of existing theories of internal audit and internal controls in real life setting. As this thesis is guided by the research questions, the analysis is in the explanatory form. It is suggested to follow these steps to prepare data for analyses (see Miles and Gilbert 2005, pp. 152-156):

- Prepare a transcription - Data analysis starts from data preparation. In this research data was collected in the form of an interview. Therefore data preparation started from the transcription summary of the digital recording
- Read the whole set of data - Carefully studying the transcription/notes is necessary for the researcher to obtain a holistic picture of the studied phenomenon
- Write memos - Any insights or observations should be dutifully noted as they are the "first relevancies" and essential analysis of the data
- Edit the data - Omit "obvious redundancies, repetitions, and unimportant digressions." (see Miles and Gilbert 2005, p. 153)

To analyze the findings the author used combined methods of "primary and secondary data comparisons" and "search for missing information" based on the work of Dudovskiy. (2016)

First method "primary and secondary data comparisons" is used to compare findings of the interview with results of the literature review. (Dudovskiy, 2016) Similarity and differences between secondary and primary data are discussed to increase understanding of concepts and the case study.

Second method "search for missing information" is a discussion about issues that were not mentioned during the interview, even though they have been expected. (Dudovskiy, 2016) Discussion about these aspects is included in this research to explore contradictions between reality and theories. Additionally, the need for possible future research may arise.

2.5 Expected results

The design of this research and analysis is expected to produce information about concepts of internal control and internal audit and their use in real life. The chosen methodology is appropriate for the subject of this study because it allows for deeper understanding of the topic.

A case study in connection with Qualitative Data Analysis and literature review allows for interpretation of theories against real-life example. As a result, the author of this research is able to understand those concepts holistically and consequently answer research questions. It is the expected result of this research.

Moreover, after the research, the writer will have perspective on the topic from the theoretical point of view and application of those concepts in a successful company. Additionally, the author, will be able to interpret new information on the subject in the future.

3 THEORY

In this chapter, the theory behind the concepts of internal audit and internal control is presented. The writer focuses on the role of internal audit and internal control in an organization. Differences between these two concepts and their perceived benefits are discussed. Additionally, a brief history of internal audit and internal controls is presented.

3.1 Internal Audit

3.1.1 Definition

In 1999 Institute of Internal Auditors (IIA) (Na.theiia.org, 2017) has defined internal auditing as:

"(…) an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."

Another definition of internal auditing is presented by Soltani. It states that internal audit is “an appraisal activity established within a company as a service. Its functions include examining, evaluating and monitoring the adequacy and effectiveness of the accounting and internal control systems” (Soltani, 2007, p. 621).

ASQ (American Society for Quality) describes internal auditing as a “first party audit”. It “is performed within an organization to measure its strengths and weaknesses against its own procedures or methods and/or against external standards adopted by (voluntary) or imposed on (mandatory) the organization. A first-party audit is an internal audit conducted by auditors who are employed by the organization being audited but who have no vested interest in the audit results of the area being audited” (Russell, 2013, p.5).

3.1.2 Internal audit and its role in an organization

Internal audit is designed to help the organization to reach its objectives. Fulfillment of organizational objectives defines the company’s achieved success. Business objectives are organizational goals and what the company wants to achieve. If they are coherent and can be measured, they are in fact evaluation criteria of the organization’s success. The organization states its objectives in a mission and vision statements. Mission statement conveys what the organization is and what it wants to achieve today. Vision statement communicates aspirations to what it intends to achieve in the future. (Reding et.al, 2013)

Business objectives’ categorization is a matter of discussion and believes. COSO (Committee of Sponsoring Organizations of the Treadway Commission) categorizes them as follows (Reding et.al, 2013):

- Strategic objectives are about what managements do and plan (strategy) in order to create value for the organization’s stakeholders
- Operations objectives focuses on organization’s operations in order to increase effectiveness and efficiency
- Reporting objectives are about reporting internal and external information and the level of its reliability
- Compliance objectives concentrate on existing laws and regulations and their implementation in the organization

According to Reding et.al (2013), business objectives are measures of success for the organization, but for an internal auditor, they provide foundations for engagement objectives. Engagement objectives are goals of an internal auditor that are to be achieved within the organization. Internal auditor's mission is to help the organization to achieve its objectives. Therefore, the proper and thorough definition of engagement objectives within given organization is vital.

Another vital point for the fulfillment of organizational objectives and sustainable success is effective risk management, control and governance process. The role of the internal auditor is to evaluate and improve those processes (Reding et.al, 2013):

- Governance process is an achievement of the organization's objectives by authorization, directions and overseeing management by the board of directors
- Risk management is a process of understanding and dealing with uncertainties by the management of the organization. Uncertainties are all risks and opportunities that could affect (negatively or positively) organization's ability to achieve its objectives
- Control is a process of mitigating risk to the level that can be accepted by the management of the organization

Overall, the board of directors conducts (lead and guide) the governance process, while management conducts risk management and control processes. The board of directors and management's cooperation is essential to efficient implementation of all processes. Internal auditor's role is to evaluate, improve and guide through those processes. Therefore, internal auditing is also a vital point of the equation. (Reding et.al, 2013)

According to Pickett (2005, p.8), Internal auditors are able to assist top management with the following:

- Monitoring activities that top management cannot monitor itself
- Identifying opportunities and minimizing risks of failure
- Validating reports to senior management
- Protecting senior management in technical analysis that is beyond their knowledge

- Providing information for the decision-making process
- Reviewing for the future as well as for the past
- Helping line managers manage by pointing to violation of procedures and management principles

The main role of internal auditing is to add value to the organization by performing assurance and consulting activities. They need to be operational, tactical, strategic and improve operations. However, the interpretation of this role is wide. Primary duties of assistance with risk management, control, and governance processes will add a different value to the organization. In reality, it is depending on the specific needs of organizations and the sector they are operating. (Reding et.al, 2013)

Pickett (2010, p. 335) notes that examples may be following: for organizations in the scandal-ridden industry value adding auditing service will be compliance reviews. For organizations in quickly growing sectors, value adding will be consulting advice on programs and projects. For organizations in developing countries it may be building controls and preventing fraud or corruption. For global organizations it may be management of the risks and logistics of coordinating information with the head office and so on.

Pitt (2014, p.5) provides yet another categorization of internal audit's role based on the type of organization (public or corporate sector) rather than organization's environment as Pickett suggested it. For public sector, internal audit's role will be focused on "efficient and effective expenditure of public money" (Pitt, 2014, p.5). In the corporate setting, internal audit's role will be measured by and will be focused on his ability to satisfy stakeholders and ensure profit.

To decide the scope and to interpret the role of auditing needed, the auditor will refer to audit charter. The internal auditor will also need professional standards, mission, vision and success criteria. They should be based on the sector in which the company is operating.

Determining value adding auditing services should be based on the definition of internal auditing by The Institute of Internal Auditors. It should also answer the questions suggested by Pickett (2010, p. 337): „How can we (auditors ref. Pickett) best contribute to risk management, control, and governance services through both our assurance and consulting roles?”.

Additionally, it is suggested by Pitt (2014, p. 13) that understanding strategic priorities will give insight to the internal auditor of where value can be added. Moreover, the internal auditor should “strive to meet stakeholder expectations by embedding performance measurement processes focused on the most efficient and effective use of limited resources” (Pitt, 2014, p.13).

As Guidance Task Force points out, most audits provide value to the organization already when they facilitate communication with management about control structure and its effectiveness. (Reding et.al, 2013) However, the most important function of internal audit is to be independent.

The subservient internal audit is a source of significant risk to the company. It may result in fraud, monetary loss, devastate reputation and brand or result in the company’s collapse. Therefore, it is “essential for the internal audit function to have independent authority and reporting lines and have adequate access to the audit committee. Internal audit functions should be well funded, staffed, and trained, with appropriate specialized skills depending on the nature, size, and complexity of the operating environment of an organization.” (Ohja, 2012) Internal auditing services provide value altogether if they are maintained in the high quality. Compliance with professional standards of internal auditing is a way to provide it.

3.1.3 History of Internal Audit

„The profession of auditing in general, and internal auditing, in particular, is ancient” (Pickett, 2010, p.8) It was „father of modern internal auditing” Lawrence Sawyer who said that word auditing comes from ancient Rome. Ancient officials were performing public and oral verification of records that was called „hearing of accounts”. This event was later described by the term „audit”. It derived from Latin „auditus” which means „a hearing”. (Pickett, 2010, p. 8)

The roots of internal auditing are long and profound, traced to centuries B.C. However, the birth of modern day internal auditing is perceived by many to happen with the formation of The Institute of Internal Auditors (IIA). It was established in 1941 in the United States, with first 24 members. (Reding et al., 2013) IIA’s fast growth, worldwide expansion, continuous research, and development fueled growth in internal audit profession.

Internal audit function started mainly as protection against fraud and asset loss. Organizations grew in size and complexity which led to their decentralization. Management needed to internally evaluate accounting information that was used for making decisions. They also needed to control efficiency of work and to ensure that no deceitful actions took place. (Ramamoorti, 2003, p.3)

First companies that realized the potential of internal auditing beyond audit of financial statements were railroad, defense, and retail industries. Quickly, internal auditing became a mean to verify all transactions and to summarize business and its activities. In this way internal audit provided further insights and ensured integrity and objectivity. (Ramamoorti, 2003, p.3)

Therefore internal audit’s role changed from typical clerical function to a management practice. It described internal audit as „the activity which independently applies consistent procedures and inspection standards in order to assess the relevance and performance of all or part of the actions within the organization, in reference to standards” (Autissier, 1998, p.3).

Establishment of IIA confirms this transformation in the internal audit function. One of the first IIA charter members Robert B. Milne describes the reason behind the establishment of The Institute of Internal Auditors as follows: “The Institute is the outgrowth of the belief on the part of internal auditors that an organization was needed in the structure of American business to develop the true professional status of internal auditing. Although its roots are in accountancy, its key purpose lies in the area of management control. It comprises a complete intracompany financial and operational review” (Ramamoorti, 2003, p.4).

Even though, in the early years after the establishment of IIA, internal auditing was still connected with external audit. Internal auditors have still been assisting in the review of the financial statements, but the profession was developing. It can be said that it was finally established as serious and fully equipped profession in 70’s. In 1974 first Certified Internal Auditor exam was held. (Theiia.org, 2013)

Since 1978 all American listed companies are required to have auditing boards with three to five independent members. (Autissier, 1998, p.4) By that time internal audit function has also grown to include “operational” orientation that is “control which functions by examining and evaluating the adequacy and effectiveness of other controls” (Ramamoorti, 2003, p.6). Additionally, internal audit’s importance in organizational hierarchy rose as its success was depending on the relationship between the audit committee and those in charge of the organization. (Ramamoorti, 2003, p.7)

By 1990’s internal auditors have been performing financial, operational, management and compliance audit with risk and control based approach. Moreover, internal auditing function has become “industry based” with internal auditors working within the industry that they specialize in. In 1999, to include all these changes and expanding roles and obligations, The Institute of Internal Auditors implemented a new definition of internal auditing in the form that is known today (Na.theiia.org, 2017):

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

Through 2000’s and the beginning of 2010’s internal auditing evolved around tightened regulations and increased need for regulatory compliance. It was focusing more on risk management, improvement of business operations and IT and battle with corruption. This was mainly due to global economic downturn and many corporate scandals that resulted in new laws and regulations.

Continuous and rapid development of internal auditing over the years has been fueled by globalization, technological development, e-commerce and growing complexity of organizational structures. (Reding et al., 2013) In the same time, The Institute of Internal

Auditors expanded into 170 countries and territories with over 180 000 members worldwide (Na.theiia.org, 2016 *b*). It continuously conducts research and develops practices that allow internal audit to adjust and respond to ever-changing needs of organizations.

3.2 Internal Control

3.2.1 Definition

There are many definitions of internal control. Lakis and Giurinas (2008, p.146) write that the concept of the word "control" itself holds many definitions and meanings. They entail different goals, values, and achievements that will be implemented in organizations. Therefore, it can be expected that the concept of internal control can be defined in various ways. It can be understood differently each time depending on situation.

In 2008, Hightower (p. 27) defined internal controls as "program of activities established to catch and monitor a potential exposure that could result in a significant error, omission, misstatement, or a fraud".

"Turnbull Report" from 1999 was created by London's stock exchange. It was later revised and updated by Turnbull Review Group established by Financial Reporting Council (FRC). They define internal control as follows (Chambers and Rand, 2010, p.129):

> "An internal control system encompasses the policies, processes, tasks, behaviors and other aspects of a company that taken together:
>
> -facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company's objectives. This includes the safeguarding of assets from inappropriate use of from loss and fraud, and ensuring that liabilities are identified and managed;
>
> -help ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information within and outside the organization;
>
> -help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business."

However, most common definition is by Committee of Sponsoring Organizations of the Treadway Commission (COSO). The committee is a joined initiative of five organizations which are American Accounting Association, the American Institute of Certified Public Accountants, Financial Executives International, Institute of Internal Auditors, and the

Institute of Management Accountants. It is dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence (Coso.org, 2017).

COSO's Internal Control-Integrated Framework is widely recognized internationally, and part of its recommendations was used in Sarbanes-Oxley Act in 2002. According to Hightower (2008, p.7), every internal control manual refers to those two.

COSO defined internal control as "process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance" (Everson et al., 2013, p.3).

Although many definitions of internal control exist, internal control is mostly "concerned with authority management tools that help to control processes and achieve enterprise goals". (Lakis and Giriunas, 2008, p.149)

3.2.2 Internal control and its role in organization

The most holistic view on the role of the internal control in organization or enterprise is presented by the internal control framework. It connects definition and main components of internal control. In this research, the role of internal control is represented by the Internal Control Framework developed by COSO. COSO Framework is the most widely recognized and implemented. Moreover, it is also well developed, being published already in the year 1992 and recently updated in 2013. Therefore, it gives comprehensive knowledge on the subject.

Other known frameworks exist: CoCo (Criteria of Control) by the Canadian Institute of Chartered Accountants (CPA Canada); The Turnbull Report by The Financial Reporting Council in UK and J-SOX by Business Accounting Council of the Japanese Financial Services Agency. They are not so popular worldwide and tend to be mostly implemented in their countries of origin. (Graham, 2015, p.2; Schell, n.d.; Lexology.com, 2008) However, their objectives and framework for internal control are typically similar.

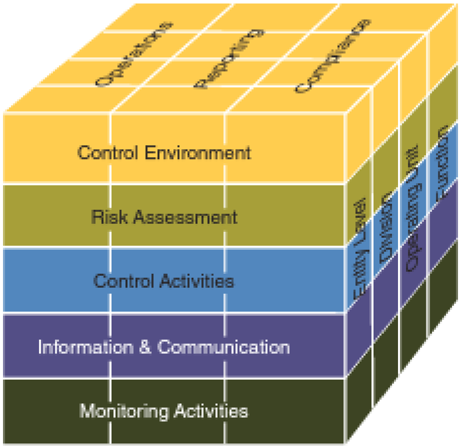

Figure 2 COSO Framework Cube.(Graham, 2015, p.4)

Figure 2 shows the 2013 updated COSO Framework. It is depicted in the form of cube, to represent the fact that components are affecting each other and "the entity either on an entity-wide basis or specifically on a divisional, regional or product line basis" (Graham, 2015, p.5).

As it is visible in Figure 2, internal control has five main components shown in the rows (Control Environment, Risk Assessment, Control Activities, Information & Communication and Monitoring Activities). They compose the "effective" internal control and allow for achieving entity's goals by the fulfillment of objectives. Objectives are shown in vertical columns (Operations, Reporting and Compliance). They have an impact on the organizational structure level of the entity (Entry Level, Division, Operating Unit and Function) shown by the third dimension of the cube.

As it is stated in COSO definition, internal control is a process that assures achievement of objectives:

- Operational – Efficient and Effective Operations
- Reporting - Reliable Financial Reporting
- Compliance – with Laws and Regulations

Five main components, application which creates control (Graham, 2015, p.5; Rutgers Accounting Web, 2015):

- Control environment - what kind of message the management sends to its employees about the importance of internal control?
- Risk assessment - management performs risk assessment; they put the effort where their greatest risk is; risks for which internal controls are set up must be reliable to the risks and everyday problems of employees
- Control Activities - actual controls that are in place, for example, segregation of duties, authorization and transactions
- Information and Communication - how are the results and to whom are the results communicated in the organization? How the departments communicate between each other? Is it internal communication (within organization) and also external? (to shareholders)
- Monitoring - how are the controls monitored by management; regular monitoring to uncover issues and ensure that the problem is communicated and solutions are found; an answer to dynamically changing environment

Together, with the third dimension of the cube, components, and objectives of the COSO Framework create an opportunity for effective internal control implementation. "Business environment and management policy are also effective in creating control environment. Risks identified in terms of an entity's strategic, financial and operational objectives have a significant role in determining the design of control activities. Information, communication and monitoring also help to assess and review the efficiency of control activities." (Uzun, 2009, p.3).

The role of internal control is to help the organization achieve specific goals or objectives. COSO Framework's role is to drive internal controls and to allow the realization of these goals using improved organizational performance and governance. Therefore it is vital that all structures comply with internal control principles. Principles must also be relevant to the organization. Only in this way the value-adding internal control is created.

Key benefits of implementing internal control are increased efficiency of operations and management of risks. However, management will also be supported by (Uzun, 2009, pp.4-6):

- application of standardized procedures, rules, and regulations;
- securing entity's current assets;
- providing reliable financial reporting;
- ensuring compliance with laws and regulations;
- elimination of income or resource losses;
- goal-oriented and accurate decision making;
- identification and prevention of fraud

Inadequate internal control systems would be an impediment that slows down the company. It is important that during the development of internal controls, it is responding to specific and main risks. It must also be cost efficient and comprehensive, as well as consistent and well understood by all employees (Mosher, 2009).

Internal control is part of basic instruments of enterprise control that allows companies to achieve an advantage over others in their industry. According to Lakis and Giriunas (2012, p.142), only effective internal control can give potential to achieving goals and tasks. It does so by risk control and the ability to perceive and eliminate threats. Internal control is a source of security in the ever-changing business environment rather than just financial control. Therefore, it should be well implemented, monitored and constantly updated in an organization.

3.2.3 History of Internal Controls

Internal control is tracked back to "The Earliest Times – The Babylonian and Egyptian Eras" (Lee, 1971, p.151). There is evidence of application of internal control also found in Roman and Greek empires, Dark Ages, Middle Ages and in Sixteenth and Seventeenth Century. (Lee, 1971, pp. 151-157). According to Hackett and Mobley (1976, p.2) between 1500 and 1850, internal control was used through the development of double-entry accounting. This continued to be used only as control system for cash transactions until 1905.

Industrial Revolution and ever-growing size of corporations made its mark especially in the period between 1905 and 1933. Then it became evident that the extent of auditing and testing being done in accounting systems needed to be based on "evaluation of the effectiveness of the system of internal control" (Hackett & Mobley, 1976, p.3). 1929 stock market crash was factored by bad financial reporting practices and a poor quality of audits. The perceived legal liability of the auditors who reviewed systems of internal control of clients, sustained rapid development of internal control. (Hackett & Mobley, 1976, pp.3-5)

In 1940 the word "control" was introduced to what was previously called "internal check". (Hackett & Mobley, 1976, p.5) This decade also witnessed the development of first internal control definition by the American Institute of Certificated Accountants (AICPA) in 1949. Internal control was defined as "a plan and other coordinated means and ways by the enterprise to keep safe its assets, check the covertness and reliability of data, to increase its effectiveness and to ensure the settled management politics" (Lakis and Giriunas, 2012, p. 146).

After 1949, internal control has been updated constantly. Another breakthrough came with the political turmoil of Watergate and the subsequent adoption of 1977 Foreign Corrupt Practices Act (FCPA). It affected the financial management of companies responsible for internal accounting controls. As Moeller (2011) summarizes it "FCPA was a strong set of corporate governance rules, and because of the FCPA, many boards of directors and their audit committees began to actively review the internal controls in their enterprises".

However, despite the adoption of FCPA, there was no unified definition of internal control at the time. Despite the expectations of many, there were no additional regulations afterwards. FCPA raised awareness for the need of good internal control among enterprises. However, there was no knowledge of what good internal controls actually meant. There were no standards concerning the application, reporting or quality of internal controls in companies.

To answer the problem AICPA released a series of Statements on Auditing Standards (SAS) on internal control audit standards in the first half on 1980's. It standardized the terminology and defined internal control concepts. In the same time, The National Commission on Fraudulent Reporting (called later Treadway Commission) was working on and issued a report that identified “factors that allowed fraudulent financial reporting” (Moeller, 2013, p.52). Those factors were a reason behind enterprise failures, high inflation and high-interest rates that dominated US economy in 1970’s and 1980’s.

The same report gave recommendations to “management, boards of directors, the public accounting profession, and others” (Moeller, 2013, p.52) on elements of internal control. They also identified the lack of consistent definition of internal control as a threat. Therefore Committee of Sponsoring Organizations (COSO) which oversees Treadway Commission set out to find the definition of internal controls.

As result, in 1990 COSO released a draft of COSO Framework, which was adjusted and re-released as Internal Control-Integrated Framework in 1992. It became a recognized standard for effective internal control. (Moeller, 2013, pp.52-53; Hightower, 2008, p.7) The framework was re-released again in 2013, to capsulate changes in business and operating environments.

In 2002, Sarbanes-Oxley Act (SOX) was released as a response to the major corporate and accounting scandals. They resulted in collapses of companies like Enron, WorldCom, Ahold, Parmalat (Lakis and Giriunas, 2012, p.146) and shook investors’ confidence. Creation of this act brought the regulation of financial practice and corporate governance. It had a major impact on businesses worldwide. Moreover, Section 404 of the law mandates the use of COSO framework in annual evaluations of internal controls implemented in companies.

According to Hightower (2008, p.7) “Every internal control manual today, refers to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework and the Sarbanes-Oxley Act (SOX).”

3.3 Internal Audit and Internal Control in an organization

Internal audit and internal control may seem similar at the first look. Both departments work towards improvements of processes and fulfilling the organization’s goals and objectives. Internal audit assists to manage risks, and internal control performs audits. “They both use auditing techniques and analytical tools to assess and evaluate the business environment" (Hightower, 2008, p. 27). Even historically, internal audit and internal control have been developing similarly and have been mainly connected with checking of accounts.

Although, the final goal is same, internal audit and internal control are different regarding the functional level. They also differ in the degree of independence, responsibility and reporting level in the organizational structure. They have different frequencies and reach of their activities.

Internal audit is "a function, while internal control is a system", it means that "internal audit assesses the effectiveness of controls put in place to mitigate risks."(Manoukian, 2016). Therefore, internal audit is not responsible for identifying risks or putting controls in place. However, internal audit can assist in this process by its consulting activities. It assesses the viability of solutions and processes that internal control has developed. It is a role of internal control to identify risks relevant to operations and development of reliable controls.

"Internal controls differs from internal audit in that it is not just about assessing and evaluating a company's compliance posture in an oversight capacity, but the internal control function needs to be a proactive participant in defining, documenting, communicating, educating, testing, and supporting the company's operational and financial goals and objectives." (Hightower, 2008, p.27)

One of the most important and biggest differences between those two concepts is in the organizational structure. Internal audit is independent of the organization's management, usually reporting to the Board of Directors or Audit Committee. Internal audit is also responsibility of Internal Auditor.

On the other hand, internal control is developed in cooperation with and for the operational management. Therefore the operational management is responsible for the adequate implementation and use of the controls on an everyday basis. (Manoukian, 2016) Another difference is in frequency. As said before internal controls are used on an everyday basis in all departments it has been developed for. Internal audit is performed at various times, and in different departments at the time.

Roles of internal audit and internal control are well presented by the concept of "Three Lines of Defense Model". This model is a representation of how different specialties and teams can effectively and efficiently cooperate for the risk management.

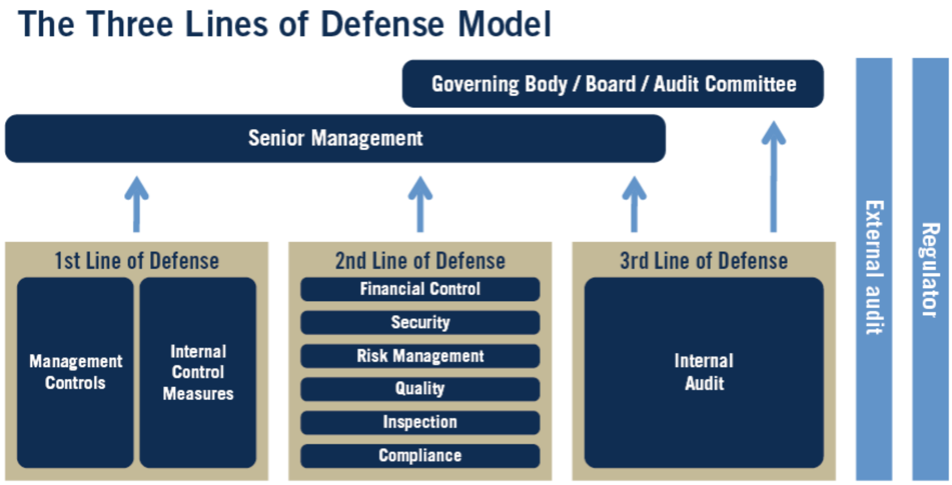

Figure 3 The Three Lines of Defense Model. (IIA, 2013, p.2)

Figure 3 presents a model of defense against risk. It recognizes three lines or groups of specialties. They all have different responsibilities in the organization's risk management and control. All distinctive groups also serve and report to various stakeholders.

In the first line of defense, there are Management Controls and Internal Control Measures. They refer to the operational management of the organization. Operational management owns risks, manages risks and implements internal controls processes for everyday use. It is a natural first line of defense. Internal control and risk management activities are designed for operational systems and processes of the organization. (Sun, 2013; IIA, 2013)

In the second line of defense, there are Financial Control, Security, Risk Management, Quality, Inspection, and Compliance. It is composed of multiple functions, which are established by management. They ensure that the first line of defense is well designed, in the right place and functioning well. They also oversee risks and permanent controls. They are management functions by nature, but they already have some degree of independence from the first line. (Sun, 2013; IIA, 2013)

In the third line of defense, there is Internal Audit. Internal audit provides the most comprehensive assurance about controls, risk management and governance based on the highest level of objectivity and independence. (Sun, 2013; IIA, 2013)

The first and second lines of defense are reporting to the Senior Management, while Internal Audit is reporting to the governing body. Internal audit function will also provide recommendations to the Senior Management to improve inaccurate processes or to fix errors. Internal Audit is also more independent than the second line of defense and even more than the first line of defense. In this way, it is fostering professionalism and honest reporting on the state of processes in an organization.

In the model, External Auditors and Regulators are added. They represent other forces that will have an influence on governance and controls used in an organization. They play a major role by setting the requirements especially in heavily regulated industries such as financial service or insurance. (IIA, 2013, p.6) They represent laws, regulations, and recommendations that will affect both internal audit and internal control.

4 CASE COMPANY – KONE

KONE Corporation is a Finnish, public limited company based in Helsinki, Finland. KONE Corporation and its subsidiaries form the consolidated KONE Group ("KONE" or "the Group"). KONE is one of the leading companies that "provides its customers with industry-leading elevators, escalators, automatic doors and integrated solutions to improve the customer experience in and between buildings. In addition, KONE offers maintenance and modernization services for existing equipment". (KONE, 2017, p.23)

This chapter focuses on the case company KONE. It presents the history and global expansion of KONE, the mission, and vision and also its operational structure and key numbers.

4.1 Short history

KONE was established on October 27th in 1910 in Helsinki. First, it was operating as a machine shop with refurbished motors. At the time it was also an importer and installer of elevators for the Swedish company – Graham Brothers. During World War I, KONE's revenue and staff number grew by producing brass shells and castings for the Russian army. After, the war in 1918, KONE made and installed first elevators made from their own components in Helsinki. Yearly production yielded four elevators at the time. (Kone.com, n.d.)

In 1924 KONE was bought by Harald Herlin. That year marked the beginning of the family owned global company. By the time of World War II, KONE produced their 3000th elevator and expanded its operations to crane production. To fulfill the war demand, KONE also converted part of its operations to manufacture ammunition and wood gas generators for vehicles. (Kone.com, n.d.)

After the war, KONE had produced elevators and cranes that were used to pay the Soviet Union as part of the war reparations. In the 1950's Finnish economy started recovering after the war. KONE kept its export to the Soviet Union after the war reparations were paid-off. By the end of 1960's the company experienced modernization of its processes and logo and expansion and leadership of the Northern Europe market. There was also the third generation of Herlin family in the leadership position as Pekka Herlin took over the presidency from his father, Heikki Herlin. (Kone.com, n.d.)

By 1980's KONE was "a conglomerate with a presence in several geographic markets. It had divisions for elevators and escalators, cranes, electronic medical technology, wood handling for the pulp and paper industry, high-pressure hydraulic piping systems, and shipboard cargo access solutions" (Kone.com, n.d.). 1990's and first decade of 2000's KONE had seen development of few leading industry innovations and a global expansion. (Kone.com, n.d.)

In 1996, the fourth generation of Herlin family in the person of Antti Herlin had joined the company. Later in 2003, he became the Chairman of KONE after his father passed away. In 2010, KONE celebrated 100-years anniversary in 1000 locations around the world. In 2015, KONE elevators were used by over one billion people. (Kone.com, n.d.)

4.2 KONE Today

Nowadays KONE Group is operating in over 60 countries (see Figure 4). It has authorized distributors and agents in almost 100 countries, accounting for around 400 000 customers all over the globe. To serve its clients, KONE employs over 50 000 employees. (KONE, 2017, p.2)

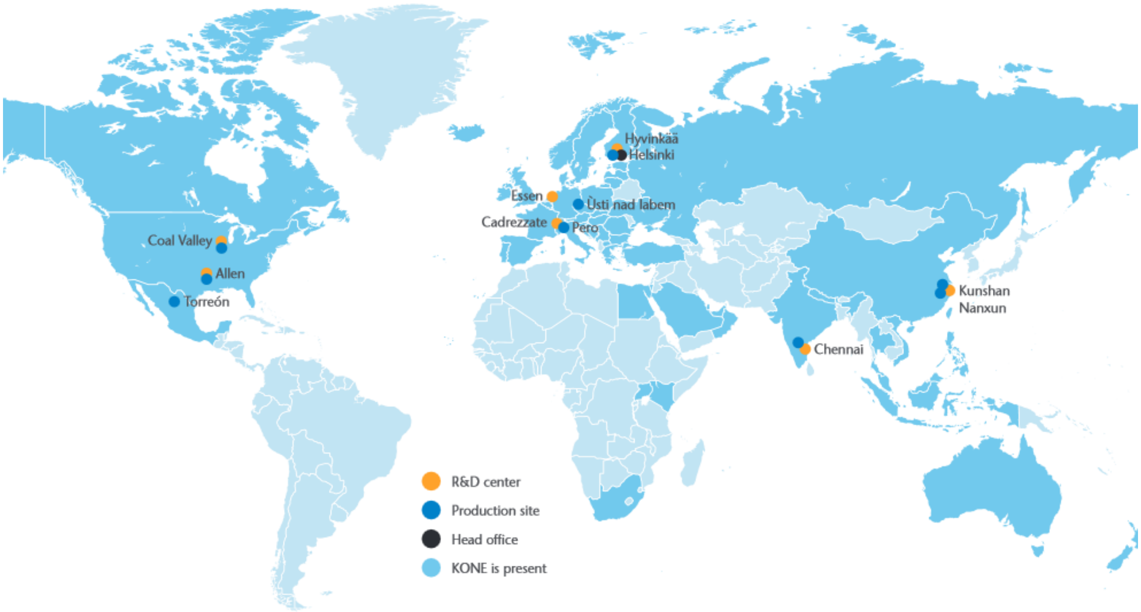

Figure 4 KONE Group's Global Operations at Glance (KONE, 2017, p.2)

KONE's business model is based on "Solutions throughout the lifecycle of buildings" to provide customers with solutions for the entire lifespan of the building. (KONE, 2017, p.5)

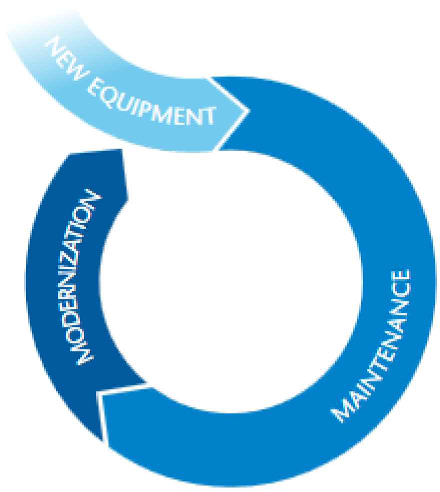

Figure 5 KONE's Business Model- Solutions throughout the lifecycle of buildings. (KONE, 2017, p.5)

To provide value and to satisfy its business model KONE Group is divided into two main business lines: New Equipment Business and Service Business. New Equipment business takes care of the projects, where new equipment (elevators, escalators, auto walks, automatic doors and integrated access control systems) is installed on construction sites. Service Business takes care of maintenance of already installed equipment and modernization solutions for aging equipment. In its maintenance base, KONE has over 1,1 million pieces of equipment at the moment. (KONE, 2017, p.5)

KONE has steadily grown through the years. Last year's Annual Review of KONE Group stated sales revenue of 8,784 MEUR (growth of 1,6% comparing to 2015 and of 76,15% comparing 2010). 55% was in New Equipment business, 31% in Maintenance business and 14% in Modernization business. 41% of sales comes from the Asia-Pacific region, 40% from Europe, Middle East and Africa and 19% from Americas. (KONE, 2017, p.3 & Kone.com, 2017)

KONE's vision and mission are concerned around "People Flow". It means how people move between and in buildings. KONE's mission is to improve "People flow" in urban settings, making it reliable and pleasurable and overall making cities better places to live. KONE's vision is to provide the best "People Flow" experience and to provide efficient and easy customer experience while serving buildings' lifecycle. (KONE, 2017, p.11)

This year KONE implemented new strategic phase called “Winning with Customers”. It focuses on customer’s needs and brings new solutions and services by collaborative innovation and competencies. (KONE, 2017, p.4) Megatrends affecting KONE growth are rapid urbanization, technological advancement, aging population and aging existing equipment, and environmental need for eco-solutions.

4.3 Organizational Structure

(Confidential information is in Appendix 2.)

4.4 Regulations

KONE’s stock is listed on the NASDAQ OMX Helsinki Oy and therefore it abides by the rules and regulations of Helsinki Stock Exchange. “The duties and responsibilities of KONE Corporation’s various governing bodies are determined by Finnish law and KONE’s corporate governance principles.“ (KONE, 2017, p.76)

KONE complies with the Finnish Corporate Governance Code 2015 published by the Securities Market Association, and which is “applicable to all companies that are listed on Nasdaq Helsinki Ltd” (Rannikko et al., 2015, p.9). Its goal is to unify reporting standards in Finland and to increase transparency of organizations. In this way it provides protection to shareholders through accountability of top management.

KONE complies with the Governance Code with few exceptions to recommendations:

- 16 (Independence of the company of the members of the audit committee),
- 17 (Independence of the company of the members of the remuneration committee)
- 18a (Independence of the company of the members of the nomination committee)” (KONE, 2017, p. 76)

Companies that comply with the Finnish Corporate Governance Code are expected by regulation to adhere to “Comply or Explain” principle. This principle expects companies to follow all recommendations of the code. Departure from the recommendation should be well reasoned. Also, by the principle of “Comply or Explain” they should be well reported and explained by the company. (Rannikko et al., 2015, p.10)

KONE’s departure from the recommendations is dictated by the company’s ownership structure. Antti Herlin owns 62% of voting rights and 22% of the shares in the company. Due to the risk connected with the immense decision power, KONE justifies “the main shareholder serving as either Chairman or Member of the Board of Directors and of its Committees and, in this capacity, overseeing the shareholders’ interests” (KONE, 2017, p.76). Explanation statement is included on KONE’s website, in its Financial Statements and Annual Reviews.

KONE also complies with IFRS standards issued by The International Accounting Standards Board as adopted by the European Union. (KONE, 2017, p.23)

(Confidential information is in Appendix 3)

4.5 Internal Audit in KONE

Use of internal audit in Finnish Corporate Governance Code of 2015 is defined in Recommendation 16 and 27.

Recommendation 16 refers to the establishment of Audit Committee to “deal with matters relating to the company’s financial reporting and control” (Rannikko et al., 2015, p.34). Audit Committee should be, but does not have to be established in the company. If the nature of business or its size does not require it, Audit Committee does not have to be created. However, in such situation, the duties of Audit Committee should be dispersed among the board of directors or another governing body. (Rannikko et al., 2015, p.34)

Recommendation 27 refers to the responsibility of the company to “define the organization of the company’s internal audit.” (Rannikko et al., 2015, p.49). The role of internal audit is mainly defined as one of the assurance. Corporate Governance Code defines “the purpose of the internal audit is to evaluate, among other things, the appropriateness and success of the company’s internal control system and risk management as well as the management and corporate governance processes” (Rannikko et al., 2015, p.49).

The consulting role of internal audit in the Corporate Governance Code is not defined per se. It can be found in “internal audit supports the development of the organization” (Rannikko et al., 2015, p.49). It can mean also consulting service if needed. Recommendation 27 highlights that internal audit development as a separate function in an organization depends on its size and the nature of business operations. However, internal audit and its most important principles should be stated in the Corporate Governance Statement of the company. (Rannikko et al., 2015, p.49)

(Confidential information is in Appendix 4)

“The Internal Audit Department is responsible for auditing both the internal control system and the management of business risks ”, and they regularly control and “steer” internal control processes and procedures (KONE, 2017, p. 77).

(Confidential information is in Appendix 4)

4.6 Internal Control in KONE

Use of internal control in Finnish Corporate Governance Code of 2015 is defined in Recommendation 25 and is mentioned in Recommendation 27.

Recommendation 25 states that companies must “define the operating principles for internal control” and to “ensure that the company’s objectives relating to matters such as the company’s strategy, operations, practices, and especially financial reporting, are achieved” (Rannikko et al., 2015, p.48). Internal control principles should also ensure that the company is complying with laws and regulations. The development of internal control principles should depend on the needs, size and business operations of the company. Operating principles of internal control should be then stated in the company’s Corporate Governance Statement. (Rannikko et al., 2015, p.48)

Recommendation 25 also states that internal control principles should be defined by the board of directors. Board of directors should also be responsible for monitoring the functioning of internal controls. This recommendation is compatible with the Recommendation 27, which states that the role of internal audit is to evaluate internal control system.

Therefore, the board of directors has a chance to monitor internal control through the function of internal audit, if one exists in the company. (Rannikko et al., 2015, pp.48-49)

KONE's Board of the Audit Committee monitors the functioning of internal control system and "assesses the adequacy and appropriateness of KONE's internal control and risk management" (KONE, 2017, p.76). (Confidential information is in Appendix 5)

According to KONE (2017, p.77), the goal of internal control system is to "ensure that the Group's operations are efficient and profitable, that its business risk management is adequate and appropriate, and that the information created is reliable. The control system also makes it possible to oversee that the determined operating principles, given instructions and possible related party transactions are followed."

KONE has a well-developed internal control structure for internal control procedures applied during financial reporting process. It is harmonized and unified framework to provide "processes, tools, and instructions to cover managerial and external financial reporting" (KONE, 2017, p.77).

(Confidential information is in Appendix 5)

5 DISCUSSION

After the literature review, it was expected to see the existence of both internal audit and internal control departments in KONE and they have those two departments indeed. (Confidential information in Appendix 6)

Both internal audit and internal control are somewhat regulated by the Finnish Corporate Governance Code of 2015. However, recommendations focus more on the fact that the internal audit and internal control should be implemented. It does not focus on the specifics of its implementation. Finnish Governance Code of 2015, does not specify any activities beside the overall role of those two concepts and that the use of concepts should be reported in Corporate Governance Statement issued by the company.

Only the duties of Audit Committee are more described. It is due to compliance with legislation about the listed companies from Decree of Ministry of Finance. (Rannikko et al., 2015, p.34) Such thing can be considered a lax form of regulation in comparison to

SOX law. In Sarbanes-Oxley Act “compliance remains dynamic and complicated to master for most companies” and it can also be considered costly (see Sheridan, 2015).

Nonetheless, Finnish Corporate Governance Code of 2015, cannot be too easily dismissed as vague. It is argued by Fredriksson and Lindahl (2009, p.50) that “it cannot be coincidental that a report recommending governance policies for listed Finnish companies was published shortly following SOX”. Indeed, the first Finnish Corporate Governance Code recommendations were issued in 2003. Therefore it can be concluded that “the Finnish stock exchange regulators were free to adopt provisions they felt were beneficial, and ignore others” (Fredriksson & Lindahl, 2009, p.37).

Internal control has received much attention in the recent three decades. Development of the COSO Framework has made internal control easier to grasp and implement. Events of the beginning of 2000’s and succeeding adoption of Sarbanes-Oxley Act of 2002 have resulted in adopting of COSO Framework in many public and privately owned companies. They have also increased overall discussion in the literature, as it was found during this research.

(Confidential information in Appendix 6)

The importance of internal audit in KONE has been rooted in the organization system much longer than internal control. It goes back to 1995 when KONE uncovered irregularities in its Italian subsidiary. Faultily reporting non-existent work value and receivables, which had been going on for an extended time period, had a substantial effect on KONE’s 1995 results. They were described as “poor”, and it forced KONE to correct its Consolidated Balance Sheet and Consolidated Financial Statements of 1992, 1993 and 1994. (KONE, 1996)

Together with the ongoing recession in many markets at the time, KONE anticipated that its profitability would be affected until 1998. (KONE, 1996) To help the situation KONE underwent structural changes in Italian organization and strengthened the internal auditing standards. However, as reported in the Annual Review of 1997, the situation required more extensive corrective measures and it seriously burdened the financial results of KONE. (KONE, 1998) If there had been strong internal auditing standards in place to begin with, the situation could have been avoided or discovered much earlier, decreasing its impact on financial results.

Notably, KONE does not apply Recommendation 16 (Independence of the company of the members of the audit committee) of Finnish Governance Code 2015. The recommendation states that “The majority of the members of an audit committee must be independent of the company and at least one member shall be independent of the company’s significant shareholders” (Rannikko et al., 2015, p. 34).

The Audit Committee of KONE comprises of four members, “Jussi Herlin (Chairman), Anne Brunila (independent member), Antti Herlin and Ravi Kant (independent member)“ (KONE, 2017, p.78). Therefore, KONE complies with the rule that at least one member should be independent. However, it is only 50% of Audit Committee instead of the majority. Jussi Herlin is also a Vice Chairman of the Board of Directors and owns the shares of the company. Antti Herlin is a full-time Chairman of the Board of Directors and owns 22% of shares.

(Confidential information in Appendix 6)

KONE has been a family company almost since the beginning of its existence. Jussi Herlin is now the fifth generation of Herlin family to work in KONE and a part of its management. The company has been passed from father to son for generations, which also strongly implies that it will happen again. Jussi’s Herlin is already involved in many of KONE’s boards (KONE, n.d & KONE, 2017, p.80). Hence, it is the best interest of the Herlin family to keep appropriate levels of independence between boards and to develop the company for the long-term. Indeed, trust in the Herlin family’s ability to successfully run the company placed KONE at first place as The Most Reputable Corporation in Finland (t-media.fi, 2016).

6 CONCLUSION

This study has focused on the role and importance of internal audit and internal control in an organization. A case study of the company KONE aimed to provide an example and answer questions of how those concepts are implemented and regulated in the company and how they influence the company's operations.

Based on the results of this research, it is easy to conclude that internal control influences KONE's operations on an everyday basis. Properly developed internal control can positively influence business operations, risk management, and decision making on all levels of the organization. KONE's attention to the development process and its careful implementation are the best indications of it's importance to the whole organization.

Operations of internal audit in KONE and influence of the concept may be harder to grasp at first. It provides value to the company by its level of autonomy and the possibility to independently assess business operations. However, it also needs to be considered through the prism of the following fact. To have most efficiency, internal control must also be "controlled and steered" by internal audit to ensure its proper functioning. Internal audit influences an organization positively by service assurance and supervision of internal control processes. Meanwhile internal control leads to changes and creates controls.

When used daily, internal controls improve and allow for efficient operations, risk management, and decision making. The role and benefit of both concepts are to secure more effective and risk-respondent operations of the company. It also increases the assurance of fulfillment of the business' objectives and goals. Consequently, it also provides the satisfaction of shareholders. Therefore it leads to the conclusion that internal control and internal audit both are positively influencing KONE's operations.

KONE shows that for both concepts to work properly, they must be at the core of the leadership's, management's and employees' beliefs in its benefits. They cannot be overly bureaucratic. Specifically, internal control must be developed to respond the company's needs and to fit its culture. Positive and "helpful" perception of the concepts among employees ensures greater results.

Finnish regulation, in the form of Finnish Corporate Governance Code 2015, has allowed KONE to develop both concepts freely. (Confidential information in Appendix 7)

The literature review has also confirmed that internal audit and internal control are important in an organization. They both focus and allow for more efficient organizational operations, however through different means. It is core role to both concepts to allow the organization to achieve its goals and objectives. They are both parts of the bigger picture.

Internal audit makes sure that internal controls are developed well so that through internal control, processes are effective. Both are also vital parts of the “Three lines of defense” model. Internal audit and internal control allow for better risk management as they have different levels of independence. This creates a higher level of assurance that operations, risk and decision making are managed well.

In conclusion, the importance of internal audit and internal control is reflected in a way that both of concepts affect an organization. The example of case company and literature review both reveal, that the role of internal audit and internal control is to be part of risk management system. Together they also allow for the company to achieve its business goals, through more efficient operations.

Moreover, an example of KONE and the literature review also conclude that both concepts are affected by the following. Different regulations, laws, models and application, and because of that they look different in different companies and settings. The author of this research acknowledges that due to this fact, generalizations about internal audit and internal control used in companies cannot be made, unless bigger research is performed.

Possible generalizations made in the research were not to imply that the situation would be repetitive in different settings, and it should not be taken as such. Any possible generalization’s intent was to present knowledge derived from KONE’s example or literature review. It can serve as a base for a hypothesis in possible future research.

Future repetition of this research on a wider scale is recommended. Participation of larger amount of companies would allow for an understanding of results of this study in broader context. It would also allow for better understanding of using internal audit and internal control’s functions. In relation to future research, the cost of implementation of internal audit and internal control should be explored. In such studies, the focus should be on the tangible influence of those concepts on company’s profitability.

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APPENDIX 1: ORGANIZATIONAL STRUCTURE OF KONE GROUP

Appendix not supplied for confidentiality reasons.

APPENDIX 2: CONFIDENTIAL INFORMATION FROM CHAPTER 4.3

Appendix not supplied for confidentiality reasons.

APPENDIX 3: CONFIDENTIAL INFORMATION FROM CHAPTER 4.4

Appendix not supplied for confidentiality reasons.

APPENDIX 4: CONFIDENTIAL INFORMATION FROM CHAPTER 4.5

Appendix not supplied for confidentiality reasons.

APPENDIX 5: CONFIDENTIAL INFORMATION FROM CHAPTER 4.6

Appendix not supplied for confidentiality reasons.

APPENDIX 6: CONFIDENTIAL INFORMATION FROM CHAPTER 5

Appendix not supplied for confidentiality reasons.

APPENDIX 7: CONFIDENTIAL INFORMATION FROM CHAPTER 6

Appendix not supplied for confidentiality reasons.

APPENDIX 8: INTERVIEW SUMMARY

Appendix not supplied for confidentiality reasons.

APPENDIX 9: INTERVIEW GUIDE

Appendix not supplied for confidentiality reasons.