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Effects of outsourcing transactional processes

A multiple cases study of Swedish SMEs on risks found within the internal control

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Preface

First of all we would like to thank our supervisor, Bertrand Pauget, for all his support and guidance during this whole process. We are also thankful for the opinions and feedback that our opponents has contributed with. Lastly, we would like to deeply thank the participants in this study, without you this work would not have been possible.

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Abstract

Background
Today’s competitive market forces companies to focus on their core processes. As a result, the number of outsourcing arrangements has grown and especially transactional processes outsourcing, which is clearly evident in Sweden. The lack of expertise and resources that characterizes SMEs makes outsourcing of transactional processes many times a necessity. However, little attention has been given the possible internal control risks associated with outsourcing (Christ et al. 2015). Moreover, frameworks such as the COSO-framework has also neglected to provide guidelines as to how companies should handle outsourcing arrangements. Although the COSO-framework argues that it can be applied to all companies, no matter the size, organizational structure or the choices management makes (COSO 2013).

Aim
The aim of this study is to identify and analyze internal control risks within Swedish SMEs when outsourcing transactional processes. Moreover, the study will try to provide recommendations to the COSO-framework about how outsourcing arrangements should be handled in order to maintain an effective internal control.

Method
The study uses a qualitative method where a multiple cases study is conducted. The study consists of three case companies where a total of four participants were interviewed through semi-structured interviews, where all participants has a managerial position at their respective company.

Conclusion
The findings within the study indicates that outsourcing transactional processes has made the case companies more effective. Moreover, the performance and relational risks identified within the case companies align with previous research where multiple risks were identified. The authors also highlights the possibility of a new risk when outsourcing transactional processes. Furthermore, the authors suggest that the COSO-framework should be modified such that the outsourcing company is a part of the control environment within companies.

Key words
Outsourcing transactional processes, internal control, COSO-framework, risks, SME
Table of contents

1. INTRODUCTION ........................................................................................................... 8
   1.1. BACKGROUND ........................................................................................................... 8
   1.2. PROBLEMATIZATION ................................................................................................. 10
   1.3. AIM .............................................................................................................................. 11
   1.4. RESEARCH QUESTIONS ............................................................................................. 12

2. THEORETICAL FRAMEWORK ............................................................................... 13
   2.1. OUTSOURCING ........................................................................................................... 13
   2.2. INTERNAL CONTROL .................................................................................................. 14
   2.3. RISKS IN OUTSOURCING ........................................................................................... 15
       2.3.1. Relational risk ...................................................................................................... 16
       2.3.2. Performance risk ................................................................................................. 17
   2.4. THE COSO-FRAMEWORK ......................................................................................... 18
       2.4.1. Control environment .......................................................................................... 19
       2.4.2. Risk assessment ................................................................................................ 20
       2.4.3. Control activities ................................................................................................ 20
       2.4.4. Information and communication ....................................................................... 20
       2.4.5. Monitoring activities ......................................................................................... 21

3. METHODOLOGY ............................................................................................................ 22
   3.1. QUALITATIVE METHOD .............................................................................................. 22
   3.2. MULTIPLE CASES STUDY ......................................................................................... 23
   3.3. CASE A ....................................................................................................................... 24
   3.4. CASE B ....................................................................................................................... 25
   3.5. CASE C ....................................................................................................................... 25
   3.6. PRIMARY DATA ......................................................................................................... 26
   3.7. SECONDARY DATA .................................................................................................... 27
   3.8. DATA ANALYSIS ...................................................................................................... 28
       3.8.1. Within-case analysis .......................................................................................... 28
       3.8.2. Software program .............................................................................................. 28
       3.8.3. Cross-cases analysis ......................................................................................... 29
   3.9. TRUSTWORTHINESS ................................................................................................. 29
       3.9.1. Credibility ......................................................................................................... 29
       3.9.2. Transferability ................................................................................................... 30
       3.9.3. Dependability .................................................................................................... 31
       3.9.4. Confirmability ................................................................................................... 32

4. FINDINGS ...................................................................................................................... 33
   4.1. EFFECTS OF OUTSOURCING ................................................................................ 33
       4.1.1. The importance of internal control ..................................................................... 33
       4.1.2. The outsourcing companies impact ..................................................................... 34
       4.1.3. Problems when outsourcing ............................................................................. 35
   4.2. MITIGATING POTENTIAL RISKS .......................................................................... 36
       4.2.1. Control Mechanisms ......................................................................................... 36
5. **DISCUSSION** ................................................................................................................. 39

5.1. **THE EFFECT ON THE INTERNAL CONTROL WHEN OUTSOURCING TRANSACTIONAL PROCESSES** ........................................................................ 39

5.2. **IDENTIFYING AND MITIGATING RISKS WITHIN THE INTERNAL CONTROL** .................................................................................................................. 42

5.3. **MODIFIED COSO-FRAMEWORK FOR SWEDISH SMEs** ................................. 44

6. **CONCLUSIONS** ......................................................................................................... 46

6.1. **FINDINGS OF THE STUDY** ...................................................................................... 46

6.2. **CONTRIBUTIONS WITH THE STUDY** .................................................................. 47

6.3. **LIMITATIONS AND FUTURE RESEARCH** .......................................................... 47

REFERENCES....................................................................................................................... 49

APPENDIX – INTERVIEW GUIDE...................................................................................... 52
1. Introduction

In this chapter, the background and research-gap of the study is presented. Moreover, the purpose of the study and three related research questions is further presented.

1.1. Background

Today’s markets are often characterized as highly competitive where many companies struggle to gain an advantage over its competitors. The increased competition that companies are facing is forcing managers and companies to focus much more on their core processes in order to offer a more superior product or service compared to its competitors (Arwinge 2014; Höglund & Sundvik 2016). The redistribution of resources often results in processes that are deemed as non-core are outsourced to a third-party actor. Outsourcing is when a company expands their organizational boundaries and delegate parts of their operations to another company (Arwinge 2014; Wikland 2012). One of the processes that many managers and companies deem as non-core and that more often than others are outsourced is that of routinized work such as accounting and payroll, also known as transactional processes (Christ et al. 2015; Höglund & Sundvik 2016). Practitioners and researchers alike have all encouraged outsourcing as a favorable business model which is evident around the world where a large number of companies today chooses to outsource parts of their transactional processes (Christ et al. 2015; Ernst & Young 2013; KPMG 2016).

However, one of the more prominent outsourcing countries, especially amongst the Nordic countries is that of Sweden (Deloitte 2015; Visma 2014). A study performed by Deloitte (2015) shows Sweden as the country in Scandinavia that most often chooses to outsource and compared to 2010, the number of outsourcing arrangements has increased by four times (Deloitte 2015). Moreover, further studies portray Sweden as a leading country within outsourcing where around 30 % of companies chooses to outsource some part of their administrational work, whether this is payroll, accounting, recruitment or IT (Visma 2014).

The reasoning as to why companies, in general, choose to outsource and the positive effects it provides has throughout the years gained a lot of attention from researchers and practitioners, where lower costs and access to professional expertise are highlighted as the main reasons and benefits of outsourcing (Höglund & Sundvik 2016; Janvrin et al. 2012; Lewin & Peeters 2006). However, amongst small and medium-sized companies (SMEs), the benefits of
outsourcing arrangements are not always the underlying drivers for choosing to outsource. The lack of expertise and resources that characterizes SMEs makes outsourcing of especially transactional processes many times a necessity (Höglund & Sundvik 2016; Niemi et al. 2012). A company is considered to be an SME if the staff headcount is less than 250 combined with a turnover of less than 50 million euro or a total balance sheet of less than 43 million euro (European Commission 2018). Although outsourcing can positively influence a company, one aspect that is often neglected when the decision to outsource the transactional processes is made is the resulting adverse effects on the control structure within the company. When choosing to outsource, the control structure within the company no longer only includes the company itself, it further incorporates control over the service organization as well (Christ et al. 2015). Since the outsourced company provides the information which managers use to supervise and control parts of their operations and their outsourcing arrangement, they might be subject to risks due to the fundamental information potentially being compromised (Arwinge 2014; Christ et al. 2015; Höglund & Sundvik 2016). A study conducted by Ernst and Young (2013) highlights that when Swedish companies choose to outsource, they are potentially facing risks such as loss of control, negative impact on financial reporting quality and loss of knowledge (Ernst & Young 2013). Thus, the necessity for SMEs to outsource transactional processes and to expand the organizational borders (Höglund & Sundvik 2016) can negatively affect managerial activities such as communication, planning and controlling (Christ et al. 2015) and company objectives such as strategy formulation and goal-setting (Arwinge 2014).

However, to increase overall efficiency and avoid financial penalties and other regulatory and societal actions that might result from transactional processes being outsourced, companies must implement and maintain an effective internal control system (COSO 2013). The internal control system is one of the key features, if not the foundation, of a company's control system (Arwinge 2014; Pfister & Hartmann 2011). When implemented correctly, it provides managers and companies with the tools necessary to more easily comply with laws, create more reliable financial information and achieve efficient overall operations (COSO 2013). By providing legitimate and timely information, the internal control assures managers that the basis on which decisions are made are reliable, that valuations of assets are correct and daily duties are performed on schedule (Arwinge 2014). Thus, internal control is an essential part of companies and for managers in their decision-making process to ensure quality in their decision (Arwinge 2014). To achieve an effective internal control system, the Committee
of Sponsoring Organizations of the Treadway Commission (COSO) has created a framework which companies can use in their work of creating and maintaining the internal control (COSO 2013). After being recognized by the authorities in the United States during the implementation of the Sarbanes Oxley Act (SOX) in 2002 (Janvrin et al. 2012), the framework offered by COSO has been globally recognized as one of the most influential and most adopted frameworks around the world (Wikland 2012). In Sweden, the recognition and increased interest for the COSO-framework resulted in many different changes such as regulatory changes for listed companies, a separate corporate governance code and other recommendations for an effective internal control (Wikland 2012).

1.2. Problematization

Outsourcing the transactional processes is today many times seen as a necessity and thus a rather common business practice amongst SMEs (Höglund & Sundvik 2016) and is forecasted to increase even more in the future (Deloitte 2015; KPMG 2016). However, the possible negative implications that the internal control, companies, and managers across multiple markets faces has been given limited attention from both the accounting literature and professional organizations (Christ et al. 2015; Höglund & Sundvik 2016). The implications on the internal control for outsourcing the transactional processes is mainly anecdotal evidence within previous research and mostly driven by marketing from consultants within the area (Christ et al. 2015; Deloitte 2015; Ernst & Young 2013; KPMG 2016; Visma 2014). Thus, there is a research gap with regards to the internal control risks that Swedish SMEs are facing when outsourcing the transactional processes. The main objective of previous studies which links outsourcing to that of internal control has primarily focused on the reason why companies choose to outsource and the possible benefits of that choice (Christ et al. 2015; Höglund & Sundvik 2016). Moreover, risks such as interdependence between the outsourcer and the service company and level of expertise with outsourcing arrangements (Tjader et al. 2014) that are identified and associated with other types of outsourcing such as manufacturing and IT cannot simply be translated to outsourcing of transactional processes due to the vast differences between the outsourcing arrangements (Christ et al. 2015). Thus, in order to support managers and especially SMEs across multiple markets with maintaining and creating outsourcing arrangements one must identify the specific risks that the internal control faces when the transactional processes are outsourced.
Furthermore, in order to support managers and SMEs, it is important that the framework on which they base their internal control is up to date and applicable to their operations. The most used and recognized framework that regulators, authorities and organizations use in order to recommend and create an effective internal control system is the COSO-framework (Arwinge 2015). COSO (2013) argues that their model of an effective internal control is applicable to all companies, no matter the size, market or organizational structure (COSO 2013; Janvrin et al. 2012). Although COSO (2013) argues that their framework can be applied to any entity, no matter the organizational structure or what choices management makes directly or through external actors, the framework has been largely criticized due to the lack of support for outsourcing arrangements (Janvrin et al. 2012). Today, no clear guidelines or principles are offered within the framework for how to maintain an effective internal control when choosing to outsource the transactional processes (Janvrin et al. 2012). This poses a problem for both managers and companies alike due to the positive trajectory of more outsourcing (Deloitte 2015; KPMG 2016) and popularity of the framework across multiple markets and countries. Thus, in order to identify and mitigate possible risks with outsourcing the transactional processes, it is important to update and further add recommendations to the existing COSO-framework of internal control.

1.3. Aim

The foundation and most important part of a company’s overall control system is the internal control. However, little to no evidence has been presented with regards to how the internal control is affected and what risks occur when companies outsource their transactional processes. Thus, this study aims to identify and analyze the internal control risks within Swedish SMEs when outsourcing transactional processes. Moreover, the most commonly used and recognized framework for creating an effective internal control is the COSO-framework. Since there is a lack of clear guidelines within the framework as to how companies should structure their internal control when outsourcing, the study will also try to provide recommendations to the framework about how outsourcing arrangements should be handled in order to maintain an effective internal control.
1.4. Research questions

Based on the above aim the following research questions was developed:

- How is the internal control affected by outsourcing the transactional processes within Swedish SMEs?
- How do Swedish SMEs identify and mitigate risks within their internal control when outsourcing the transactional processes?
- How should the COSO-framework be modified and implemented in order for SMEs to avoid internal control risks found within transactional processes outsourcing?
2. Theoretical framework

In this chapter, the theoretical framework is presented which constitute the basis for the data collection and analysis process. The chapter contains definitions of key concepts such as outsourcing, internal control and risks and ends with a description of the COSO-model for evaluating companies internal control systems.

2.1. Outsourcing

The business strategy of outsourcing parts of a company’s operations has been highlighted by both scholars and companies alike as a promising and favorable choice of conducting business for several years (Christ et al. 2015; Sonnenberg 1992). Outsourcing, as defined in the literature, is when a company expands their organizational borders and delegate parts of their operations to a third-party actor, often through the use of a written contract (Arwinge 2014). This type of strategy has become such common business practice amongst companies today that researchers has come to question what the boundaries of an organization today actually is. The common business practice of outsourcing parts of the company’s operations is clearly evident where a large number of companies within EU chooses to outsource (Ernst & Young 2013) and is forecasted to increase even more in the future (Deloitte 2015). However, the increased pressure that characterizes many markets are affecting companies in such a way that in order to stay competitive they choose to more often than not focus on their core processes (Arwinge 2014). Thus, business operations that the company deem as non-core are often outsourced to a third-party.

Amongst the different operations within a company, one operation that more often than others are deemed as non-core is that of transactional processes. Transactional processes or business processes as it is defined within previous research consists of routinized work such as accounting, book-keeping and payroll (Christ et al. 2015). Why companies chooses to outsource these types of operations is mainly due to the access it provides to expertise of professionals in the area of accountancy and the possible lower costs it provides (Ernst & Young 2013; Höglund & Sundvik 2016). The choice of outsourcing the transactional processes has become rather popular in today’s market, especially amongst Swedish companies. A study conducted by the accountancy firm VISMA shows that around 30 % of 800 participating Swedish companies chooses to outsource some part of their transactional processes (Visma 2014).
Thus, outsourcing the transactional processes is argued to be a rather common type of business strategy amongst Swedish companies.

Although many companies chooses to outsource parts of their operations, for some companies the reality of outsourcing the transactional processes are not voluntarily decided but instead becomes a necessity. The characteristics of an SME is that compared to larger companies they lack the resources and skills necessary for conducting all operations in-house (Höglund & Sundvik 2016). Thus, the choice for SMEs to outsource their transactional processes are not based on possible benefits of cost reductions and access to expertise, instead it becomes a necessity due to their lack of knowledge and resources (Höglund & Sundvik 2016). Thus, outsourcing the transactional processes are often more prominent amongst SMEs compared to that of larger companies (Niemi et al. 2012).

2.2. Internal control

Traditionally, internal control got its first attention in the literature in the end of the 19th century when an English audit specialist Lawrence Dicksee argued that the audits should focus more on the internal processes within the organization to make the auditing more effective (Arwinge 2015). From that day the internal control has become more in focus for each year and numerous definitions of internal control has been developed (Wikland 2012). However, there is one definition of internal control that is widely accepted which is developed by COSO. Their definition of internal control is “internal control is a 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.” (COSO 2013, p.3).

This definition of internal control consists of some central concepts which according to COSO shows that that internal control is focusing on the achievement of the objectives in different parts of the organization. The definition also establishes that internal control is an ongoing processes and activity. Furthermore, it states that the internal control is affected by people and not primarily by manuals and process descriptions, in the end it is always a person that performs the tasks within the internal control. Lastly, this definition of internal control is flexible and can be applicable on all different structures within an organization (COSO 2013).
Furthermore, internal control is about creating a healthy risk culture by having a clear control environment, be able to manage threats and opportunities by performing risk assessments, be able to take actions to manage threats and opportunities by implementing control activities within the organization. Moreover, a healthy internal control involves the ability to coordinate these actions through information and communication and lastly to maintain the system for internal control by executing monitoring activities (Arwinge 2015).

If an organization manages to create an effective internal control it can be seen as one of the best ways to avoid business failure. An organization’s internal control functions as a way to protect the organization from risks that can occur and affect the organizations achievement of their objectives (Moeller 2014). A well-functioning internal control that provides valid information works as an assurance for managers when they make decisions and also ensures that the daily work are performed as planned (Arwinge 2014). A well-functioning internal control helps the organization to ensure that authorization of transactions is done properly and that the IT-systems are well-managed. Furthermore, an effective internal control ensures the organization that the information presented in the financial reports is reliable and in compliance with all laws and regulations (Moeller 2014).

2.3. Risks in outsourcing

Inherent amongst all companies and their operations is that of the phenomena of risk. All decisions that are made by management on how to act on resources and assets must be made with a certain amount of risk in order to become profitable (Arwinge 2014). However, the risk associated with all business operations and decisions does not always result in a positive outcome (Verbano & Venturini 2013). Instead, the risks found within businesses might also result in negative outcomes if they are not acknowledged and monitored. Thus, the definition of risk can be explained as possibilities of economic and financial gains or losses as a consequence of the uncertainty associated with pursuing a course of action (Chapman & Cooper 1983; Verbano & Venturini 2013).

These consequences of the uncertainty, or risks, associated with the decisions are important to consider and recognize in order to be able to mitigate and manage them. Risks to varying degrees influences everything companies do and might have greater or smaller consequences depending on the situation. However, the management of risks becomes more important dependently on the size of the company (Verbano & Venturini 2013). The lack of in-house
knowledge and resources that characterizes SMEs makes them in general more vulnerable towards internal and external threats. Moreover, the lack of resources makes SMEs ability to respond and adapt to both internal and external threats more difficult than larger companies. Thus, possible negative outcomes associated with risks might instead become a threat to their survival (Verbano & Venturini 2013).

In order to continue their operations but also evolve and prosper, it is essential that SMEs identifies and manage the different risks associated with different parts of their operations (Verbano & Venturini 2013). However, since risks can be found within all parts of a company and the type of risk associated with each operation can be different from the other it is important to clearly distinguish between different types of risks in different situations. The lack of attention given to outsourcing of transactional processes has resulted in a knowledge-gap regarding what specific internal control risks are associated with that type of outsourcing arrangement. Thus, little to no information is available regarding risks when transactional processes are outsourced. However, it is hypothesized that similarities can be drawn from that of general outsourcing arrangements (Christ et al. 2015). The different types of risks identified within general outsourcing are often related to that of alliance risks which was developed by Das and Teng (1999) and are often classified into two different categories: relational risk, and performance risk.

2.3.1. Relational risk

The risks that are classified within this category relates to the characteristics of outsourcing when there is an alliance between two companies. Relational risks cannot arise if there are only one single company or entity and thus, these types of risks are unique to alliances. The different types of relational risks often occur due to the lack of authority that the outsourcing company can impose on the service company combined with separate motives of profit (Christ et al. 2015). However, relational risks associated with outsourcing the transactional processes is mainly related to that of information. Since the service company provides the information which the outsourcing company uses as a basis for evaluation and decision-making, the outsourcing company can find it difficult to measure how well or poorly the outsourcing service has been provided. This intangibility that characterizes information can largely affect the relationship between each alliance and creates opportunities for the service provider to take advantage of the outsourcing company (Aron & Liu 2005). Since it can be
difficult to evaluate the performance of the service company, the performance of the provided service could not be up to the standards required by the outsourcing company while a higher cost is being extracted at the same time without the knowledge or compliance of the outsourcing company. This possibility of opportunistic behavior puts the outsourcing company in a situation where they might be penalized by regulatory agencies which can have significant negative implications for smaller companies such as SMEs (Christ et al. 2015).

### 2.3.2. Performance risk

Compared to that of relational risks, risks that are classified in this section are not solely unique to alliances. Instead, performance risks are related to the failure of not achieving the performance goals set by the company which all organizations face. However, the difference between companies that choose to outsource parts of their operations to those that perform the tasks solely in-house are the reasons why the goals are not achieved. When companies choose to outsource the transactional processes, they are especially subject to performance risks due to the difficulties of translating their goals, implicit knowledge and visions to the service company which is crucial in order to achieve company objectives (Christ et al. 2015; Leonardi & Bailey 2008).

Thus, when companies outsource their transactional processes they are facing new risks and threats that are not present within companies that perform all their tasks in-house. The first performance risk that outsourcing companies faces are called “quality performance risks” and relates to the service company’s lack of knowledge, experience or expertise in the outsourcing company’s business. Having less or no insight into who the individuals are and how the outsourcing company operates might result in failures of not including all the necessary transactions of wrongfully adding transactions that are not appropriate. Moreover, deadlines or time-sensitive objectives might further be affected or even missed due to the ambiguous knowledge of the outsourcing company (Christ et al. 2015).

The second performance risks that outsourcing companies are facing is that of “coordination risks”. These types of risks arise due to errors in communication and coordination. If the needs and goals of the outsourcing company are not clearly defined and communicated, the service organizations might perform their appointed tasks wrongfully by making inappropriate valuations and assumptions due to misunderstandings (Christ et al. 2015; Willcocks & Lacity
These types of risks are more prominent to arise if the outsourcing arrangements are with an alliance partner that is located overseas or in another country due to cultural differences (Bierstaker et al. 2013). However, the types of risks associated with poor coordination and cooperation are still present within outsourcing arrangements between alliance partners in the same country.

The last performance risks are called “verification risks”. It is argued that the main reasoning as to why many companies choose to outsource is due to the competitive nature that characterizes many markets today. This competition forces companies to focus on their core-processes and outsource processes that are deemed as non-core. However, the reality for SMEs is often very different from that of larger companies and often chooses to outsource due to their lack of resources and knowledge. This lack of knowledge from the outsourcing company and lack of resources within SMEs creates verification risks within non-core processes such as transactional processes due to the inability to verify or evaluate the performed work (Christ et al. 2015).

2.4. The COSO-framework

In 1985 The Committee of Sponsoring Organizations of the Treadway Commission (COSO) was founded in the United States. Because of the many scandals with fraudulent behavior from several companies five independent organizations found it important to investigate why and how this behavior occurs (Steinberg & Tanki 1992; Rezaee 1995). Thus, The Committee investigated the reasons for this fraudulent behavior from companies and published a report in 1987 with several recommendations to avoid such behavior in the future (Wikland 2012.). Continuing the work of providing companies with internal control recommendations, The Committee developed a standard later named Internal Control - Integrated Framework. The framework consisted of explanations and guidelines for creating and maintaining an effective internal control. The Internal Control - Integrated Framework was first released in 1992 and got a major breakthrough (Rae et al. 2017; Rezaee 1995) mainly within the United States but later also in other countries including Sweden (Wikland 2012).

Nowadays, the Integrated Framework is used all around the world and is widely accepted as the leading framework for designing, applying and maintaining a good internal control. The Integrated Framework presents three types of objectives which allows organizations to put the focus on different parts of the internal control. Operations objectives which relate to the organization's
operations and the efficiency and effectiveness of that part. Reporting objectives relates to the reporting of both financial and non-financial business. Compliance objectives relate to the compliance with regulations that the organization is subject to but also to laws that must be followed (COSO 2013).

Moreover, the Integrated Framework consists of different principles that are divided into five integrated components; control environment, risk assessment, control activities, information and communication and lastly monitoring activities (COSO 2013).

Figure 1. COSO – Framework, based on the model found in Sanusi et al. (2015).

2.4.1. Control environment

The control environment within internal control can be described as the basis of how the internal control is carried out within the organization. It consists of a different set of standards, processes, and structures that constructs the basis for the control environment. The importance of internal control and how the control environment is structured is established by the management and the Board of directors that sets the tone at the top which later is mediated throughout the whole organization. Furthermore, the management has to have clear expectations that are reinforced at every level of the organization for a successful control environment (COSO 2013). Thus, the key to an effective internal control depends more on the management and their actions than rules and control activities (D’Aquila 2013). Moreover, the control environment that
the organization manages to develop provides the basis for the other components within the internal control (COSO 2013).

2.4.2. Risk assessment

Organizations face different types of risks from both external and internal sources. The definition of risk that is used in the Integrated Framework is the possibility that something will occur and later on affect the achievement of the organization's objectives. Furthermore, it can be explained as the understanding of the combined effect between probability and the consequences (COSO 2013; D’Aquila 2013). The risk assessment component of internal control involves the processes for identifying and evaluating risks that can affect the achievement of different objectives. Thus, risk assessment constructs the basis for evaluating and determining how risks will be managed within the organization (COSO 2013). The starting point for the risk assessment is that the organization needs to evaluate every risk specifically with regards to the probability and the consequences if that risk occurs. Furthermore, when assessing risks for the organization it is important to have clear and specific objectives in order to be able to clearly evaluate the risks. However, for the risk assessment to be successful it is crucial to consider risks at lower levels within the organization and not only risk exposures for the organization as a whole (Wikland 2012).

2.4.3. Control activities

Control activities are those guidelines and processes that help the organization ensure that risks are mitigated and do not affect the organizations' achievement of their objectives. The control activities should be performed within all different areas and on all levels within the organization (COSO 2013). Moreover, control activities are used to ensure that the decisions made by the management are being realized. The organizations' control activities can be either automatized or manual and also function to prevent or detect risks. Effective control activities are created by matching the activities to the organization's objectives. Hence, as the objectives of the organization change the control activities performed has to change as well (D’Aquila 2013).

2.4.4. Information and communication

The communication of information throughout the organization is necessary to ensure that the responsibilities connected to the internal control are known within the whole organization. Information from both internal and external
sources are composed by the management which later is sorted by the management based on what information that is important for the maintaining of the internal control (COSO 2013).

2.4.5. Monitoring activities

When the organization has developed a well-functioning internal control, it has to be monitored otherwise it is easy for the internal control to deteriorate and have a problem to adapt to the changes within the organization and the surroundings (Wikland 2012). Hence, evaluations of different kinds are crucial for all components of the internal control to ensure that they are present and functioning. These evaluations can be ongoing which means that evaluations are performed at all levels of the organization which provides adequate information about the internal control. Furthermore, evaluations can be done more separated and conducted periodically and depend more on the risk assessment and what results from the ongoing evaluations (COSO 2013).
3. Methodology

In this chapter, the choice of method is presented and argued for. Moreover, the background for each case company is presented and choice of data collection process. The chapter ends with a description of how the data has been processed and how the study achieves trustworthiness.

3.1. Qualitative method

In order to investigate and answer the research questions and fulfill the aim, the study adopts the characteristics of a qualitative methodology. Prior research within the areas of internal control and outsourcing has adopted various methodological approaches where qualitative, quantitative and literature reviews are all different methods used within the field (Arwinge 2014; Christ et al. 2015, Gantman & Fedorowicz 2016; Höglund & Sundvik 2016). The limited attention given to what effects outsourcing transactional processes has on the internal control system provides the authors with multiple choices of methods. Moreover, after conducting the literature review, it is evident that the area of outsourcing and internal control could be investigated using both qualitative and quantitative methods (Christ et al. 2015). However, the authors argue that adopting the characteristics of a qualitative method will provide the most insightful data in order to answer the study’s aim and research questions due to the ambiguous information that characterizes internal control.

A qualitative method is often described as a flexible method due to the possibility it offers the authors to adopt different theories and data collection methods such as surveys, interviews, and observations (Gray 2017). The main characteristics of a qualitative study are the researchers’ close relation to the studied object, the real-life setting the study is conducted within and the possibility it offers to understand how people act in different settings (Gray 2017). Since the aim of this study is partly to identify and analyze the risks found within the outsourcing arrangements of transactional processes and partly offer recommendations to SMEs and the COSO-framework as to how the internal control should be constructed in order to mitigate the identified risks. The authors argue that the possibility to understand why managers act as they do and to understand how they construct and maintain the internal control system when these outsourcing arrangements are in place is making the qualitative method the most suitable. Moreover, the internal control system within companies is not universally similar, meaning, there is no one correct way of
constructing the internal control. This context-specific system is further argued to most efficiently be studied using a qualitative method.

However, it is important to highlight the negative aspects of the qualitative methodology. Due to the close relationship between the researchers’ and the object of study, the qualitative method is argued to become more subjective than its counterpart, the quantitative method (Gray 2017). The subjectivity and narrowed scope make generalizations within the qualitative method difficult, if not impossible. Moreover, the data that is being gathered could be subject to several interpretations depending on what paradigms and perspectives the researcher are influenced by (Gray 2017). While many quantitative researchers argue that the qualitative method is not feasible, this type of method offers more than rigorous data due to the contextual setting the method is used within.

### 3.2. Multiple cases study

Closely related to that of a qualitative method and sometimes used synonymously is that of case studies (Gray 2017). A case study is an inquiry strategy that like the qualitative method is characterized by using multiple data collection methods (Yin 2014). The use of several different sources of information provides the researchers with a rich and descriptive understanding of the studied context while also providing a basis for triangulation (Gray 2017). However, within the case study design it is essential to clearly define what the actual case is since a case can be almost anything. A case can consist of a role, organization, individual, group or a country (Yin 2014). To successfully conduct a case study, the unit of analysis or the cases must be related to that of the research questions posed in the study (Yin 2014). How the internal control is structured within companies are all different from one another COSO 2013. Thus, the cases or units of analysis within the present study is of three Swedish SMEs internal control systems. Once the cases or unit of analysis had been defined it was important to bind the case, this was done in order to limit the study and establish the scope of what the data collection would contain (Yin 2014). The binding of this study is that of the effects of transactional processes being outsourced and the possible risks the internal control faces. The three cases within this study consists of Swedish SMEs which comes from different industries. However, this is not something that affects the study since outsourcing transactional processes and the risks the internal control faces when management chooses to outsource do not diverge between different industries.
Apart from using multiple data collection methods, the case study is further characterized by how or why research questions. The research questions within the present study are all formulated as a how question, making the case study approach the most suitable inquiry strategy (Yin 2014). Moreover, a case study offers the possibility to explore issues that are uncertain or not clearly evident (Gray 2017). The anecdotal evidence and consultancy’s marketing strategies given to the risks of the internal control when outsourcing transactional processes make this area of study rather ambiguous (Christ et al. 2015). Thus, the authors argue that adopting a multiple cases study approach will provide the most feasible and descriptive data to explain and highlight any causal relationship between the risks and the internal control when transactional processes are outsourced. Moreover, the currently large amount of outsourcing arrangements in Sweden (around 30 % of companies in 2014) and because the trajectory of outsourcing transactional processes is forecasted to increase even more in the future makes this topic of research rather contemporary. Thus, the authors further argue that the use of a multiple cases study approach is the most suitable research methodology.

However, some factors might negatively influence the results of a case study. One of these factors is time consumption. The authors recognize the limited time and resources available for conducting a master thesis. A case study is often seen as rather time-consuming and resource dependent, however, Yin (2014) argues that this is not always the truth. Several different strategies can be implemented in order to reduce the time spent conducting a multiple cases study (Yin 2014). One of these alternatives that the present study has adopted is to base the study on a predetermined set of research questions. This allows the researchers to narrow the research and thus reduce the time necessary for completing the study (Gray 2017). The second criticism aimed towards case studies is similar to that of the qualitative methodology, the result of a case study cannot be generalized to a larger population. However, providing contextual evidence and a detailed description of how the data was gathered will provide future researchers with the tools necessary to further explore this rather ambiguous topic of research and contribute to the strength and rigor of the result present in this study (Yin 2014).

3.3. Case A

Company A is a small assembly company within a corporate group with around 15 employees and was founded in 1996 in Sweden. For over 20 years, Company
A has specialized in creating and assembling machines that can be found in all different sectors and industries around the world. With a mission to provide their industry with safe and innovative production machines of high quality and a vision to become the customers first choice, Company A today conducts business on several different markets around the world. Up until 2016 Company A had all work, including transactional processes in-house. However, due to changes within the organization in 2016, they decided to move their transactional processes to a third party actor. Ever since then, the outsourcing company has been taken care of all transactional processes including bookkeeping and payroll and Company A has slowly increased their profit each year.

3.4. Case B

Company B is a staffing agency located in Sweden that was established in 2003. For more than 15 years have Company B provided businesses around Sweden with talented staff in all different areas of business. They are a smaller company consisting of three part-owners and one more individual that is working at the main office. Apart from this, there are around 25 employees who are appointed different tasks within several businesses of varying sizes. The goals of Company B apart from having good values and a well-functioning company is to be a competitor in their local market while at the same time strive to gather new market shares. Up until 1.5 years ago all transactional processes and economical work was conducted in-house. However, after a reorganization, the company decided to outsource all economic work, including bookkeeping and payroll.

3.5. Case C

Company C is a tinplate company working mainly towards construction companies, that was first established in Sweden in 2015. The rapid growth that Company C has experienced from establishment to today has resulted in a large increase in employees which today consists of around 15 full-time employees and five extra staff currently hired. The goals of Company C is to be the customers obvious choice in all matters of tinplate and roof construction while at the same time perform quality work and achieve customer satisfaction. Ever since its foundation has Company C chosen to outsource all aspects of their economic work to a third-party actor including routinized work such as bookkeeping and payroll.
3.6. Primary data

The primary data used in the present study was that of semi-structured interviews. Interviews are a verbal exchange between the interviewer (the authors) and the interviewee (the participant) where the goal is to gain a better understanding of the latter party. There are mainly three different types of interviews; non-directive, semi-structured or structured (Gray 2017). The main difference between the interview approaches is to what extent prior questions has been constructed. Non-directive interviews do not use any pre-constructed questions and are thus more of a discussion between the two parties surrounding the studied phenomena. Structured interviews are the opposite where all questions a pre-planned and standardized and no other questions are asked (Gray 2017). However, semi-structured interviews, on the other hand, is a mixture of the two previous approaches where some questions are pre-planned while others might be follow-up questions on areas of interest to the study (Gray 2017). The well-established framework of internal control offered by COSO provided the authors with the tools and principles necessary for achieving an effective internal control system. Thus, the pre-constructed questions were all influenced by the COSO-framework and related to the internal control structure within each case company. However, since there is no one best way for structuring the internal control, companies are all structured differently (COSO 2013). The ability to ask follow-up questions provided the authors with the possibility of accessing data that might have been overlooked if the other approaches to interviewing were used. Thus, the authors argue that the use of semi-structured interviews was the best approach to accessing data for the study.

Once the predetermined questions were constructed the authors conducted a total of four interviews in Swedish between all three case companies where every participant had some managerial position representing each company. The choice of interviewing only managers or individuals with a managerial position was based on the crucial role, and impact managers have on the internal control (COSO 2013). Moreover, the choice of conducting the interviews in Swedish was so the participants could more easily understand and better answer the questions. Since managers are seen as the foundation for achieving an effective internal control and are the position most affected by the control system (Christ et al. 2015; COSO 2013) they were the obvious choice as participants within the study. Furthermore, all participants were offered the possibility to decline the interview, thus, only volunteers with interest in the research subject partook.
Moreover, most interviews lasted around one hour and were also recorded using a tape-recorder found on the iPhone 7 after consent from the participant. After the participants were informed of their right to refuse to participate and their right to confidentiality where everything, including the company name, was anonymous, the interview was conducted. This was done to retrieve the most truthful answers from the participants without putting them in a situation that might be harmful to them (Gray 2017). Once the interviews were conducted, all interviews were transcribed and later sent to the participant to verify that the information provided by them was accurately portrayed. Once the information was confirmed by the participants, the information was translated to English. Table 1 summarizes the length of all interviews for each participant and their respective role within each case company.

<table>
<thead>
<tr>
<th>Company</th>
<th>Participant code</th>
<th>Role</th>
<th>Interview length</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case A</td>
<td>1</td>
<td>Site Manager</td>
<td>70 minutes</td>
</tr>
<tr>
<td>Case A</td>
<td>2</td>
<td>Production Manager</td>
<td>65 minutes</td>
</tr>
<tr>
<td>Case B</td>
<td>1</td>
<td>Sales &amp; Market Manager/Part owner</td>
<td>30 minutes</td>
</tr>
<tr>
<td>Case C</td>
<td>1</td>
<td>Owner/CEO</td>
<td>53 minutes</td>
</tr>
</tbody>
</table>

### 3.7. Secondary data

Apart from using semi-structured interviews within the data gathering process the authors also used some secondary data. Secondary data are documents such as company reports, business plans, and contracts (Gray 2017). Moreover, information found at company websites are also classified as secondary data. The present study mainly used information found at the case companies’ websites and company reports of authentication procedures and monitoring activities.

The use of secondary data has mainly been to triangulate and verify the information provided by the interviews. Company documents and information found on companies’ websites can easily be falsified to provide an image of the company that does not reflect reality. Thus, this type of data should not be viewed as providing the actual truth (Gray 2017). However, the secondary data should not be restricted to merely function as a tool of triangulation either.
Thus, the company documents and information found at the case companies’ websites further provided information for the detailed write-up of each company’s contextual setting and internal control.

3.8. Data analysis

3.8.1. Within-case analysis

Once the data had been gathered and transcribed, the authors completed a detailed write-up on each case company’s internal control structure and relationship with the outsourcing company. This was done since within a multiple cases study; each case is a study on its own (Gray 2017). Providing a detailed description of each case was necessary in order to conduct a within-case analysis (Gray 2017). A within-case analysis is when the researcher looks at the data for each of the specific cases and identifies detailed patterns within each case (Gray 2017). Thus, the authors conducted a separate analysis for each case, outlining the internal control, identifying the risks associated with each SMEs outsourcing arrangement and possible solutions within the internal control. Once the risks and solutions were identified, they were summarized in a table for each case company.

3.8.2. Software program

In order to more efficiently conduct the within-case and later also cross-cases analysis, the authors used the program of NVivo 11 Pro to code the information provided by the data gathering process. NVivo 11 Pro is a program created for structuring what many times is an immense amount of data from the data collection process to more easily identify patterns and connections between different types of sources (QSR International 2018). Various documents such as word and pdf’s but also video and audio files can all be gathered within NVivo 11 Pro to more efficiently analyze the qualitative data.

Through the use of the theoretical chapter, the authors then created different parent codes and sub-codes related to the different risks and internal control structures. The parent codes consisted of five different areas: COSO, History of the Company, Internal Control, Outsourcing and Risks in Outsourcing. Related to the parent codes were the different sub-codes which were all based on the theoretical chapter for each parent code. Once the codes had been created, different segments of the case-companies’ information were then put under the related code. After all the data had been reviewed and coded the data
could more easily be analyzed to find the unique risks that the internal control faces when outsourcing the transactional processes and possible recommendations to the COSO-framework.

3.8.3. Cross-cases analysis

After the write-up of each case and the within-case analysis and coding had been conducted the authors moved on to the second step in the data analysis process which was the cross-cases analysis. Conducting a cross-cases analysis means that the researcher looks at the patterns across the different cases in order to identify what similarities and differences there are between the cases (Gray 2017). Using NVivo 11 Pro, the identified risks associated with outsourcing the transactional processes within each case was compared to the risks found in the other cases. These were then compared and related to the risks identified within previous research and the theoretical framework.

3.9. Trustworthiness

As previously illustrated, one of the more highlighted aspects with regards to the qualitative methodology and case studies is their ability to not generalize to a larger population. This narrowed approach and arguably subjective interpretation of data is affecting the qualitative method and case study negatively and portrays it as less rigor than its quantitative counterpart (Gray 2017). However, there are some strategies which the researcher could use to strengthen the legitimacy and rigor of the study. One of the strategies that more often than not is implemented within quantitative studies that can also be applied to qualitative studies is that of validity and reliability. Although some researchers, especially those from the naturalistic paradigm, argues that validity and reliability are not as important for qualitative studies. Instead, qualitative studies should focus their efforts on presenting the level of trustworthiness within the study (Gray 2017). In order to achieve trustworthiness, the researcher must reflect upon and incorporate four different criteria; Credibility, Transferability, Dependability, and Confirmability (Gray 2017; Shenton 2004).

3.9.1. Credibility

The first criteria, namely that of credibility, is one of the key criteria in order to achieve trustworthiness and is argued to be the most important amongst the four criteria (Shenton 2004). Much like the internal validity of quantitative studies, credibility ensures that what the study claim to test or measure is actually
being measured. In order to achieve this criterion, the study has chosen to adopt the strategies of triangulation, honesty insurance, frequent debriefing sessions and member checks.

Triangulation is a strategy for comparing data from different sources to determine the legitimacy of the gathered data (Gray 2017; Shenton 2004). Within the present study, the primary data collection method was that of semi-structured interviews with one or two participants at each case company. The other source of data within the study is that of secondary data where mainly the companies’ website, documents, and contracts were used. These multiple sources of information supported the authors in their work of verify the gathered data and to determine if the participants provided a falsified image of the studied phenomena.

The second strategy used to achieve credibility was that of honesty insurance. All of the participating companies and the individuals within the study were given the opportunity to not partake in the study. Thus, only volunteers that took a genuine interest in the studied phenomena participated which increased the credibility of the gathered data (Shenton 2004).

Moreover, the third strategy the study adopted was that of frequent debriefing sessions with the authors’ supervisor and seminar group. By providing feedback on a continuous basis, the study gathered alternative views and ideas from other sources but themselves. These factors supported the authors’ in their choice of methodological approach, literature review and other areas of importance to complete the study.

Lastly, the study adopted the credibility strategy of member checks. This strategy is often argued to be the most important within the criteria of credibility (Shenton 2004). After the interviews were conducted and transcribed the authors’ provided the participants with each of their transcribed conversations. This was done to ‘check’ whether the information provided by the participants were correctly formulated and the meaning of the data was as intended (Shenton 2004). Thus, the authors argue that the implementation of these strategies supported the study in becoming a credible study.

3.9.2. Transferability

The second criteria that must be fulfilled in order to achieve trustworthiness in a qualitative study is that of transferability. Much like its quantitative counterpart, external validity, transferability refers to the extent the findings of
the study can be applied or generalized to a larger population (Shenton 2004). Even though qualitative data are narrower and much smaller in size which results in no possibility of generalizations, some strategies could be applied to make the results and data transferable to other situations. This means that the researchers conducting the study cannot themselves generalize to other situations. However, by providing a detailed description of the context, participants and restrictions of the data gathering process it is possible for readers to transfer the results found in this study if the above information applies to their situation (Shenton 2004).

In the present study, a detailed description of the case companies’, their internal control system and outsourcing arrangements is provided. Moreover, details regarding how the data has been gathered, the duration of each interview, number of participants and time period for the data gathering process is presented within the methodological chapter of this study. Thus, the detailed description of how the data was gathered and ability to compare contextual settings in the case companies with that of reality which the study provides, the authors argue that the criteria of transferability are fulfilled.

3.9.3. Dependability

The third criteria is that of dependability which is similar to the reliability criteria within quantitative studies (Shenton 2004). Within qualitative studies, the dependability criteria are fulfilled if the work was to be replicated with the same case companies, participants, context and methods, the results and findings would be the same. However, the flexibility and changing nature that characterizes qualitative studies might prove an exact replica to be difficult to achieve (Shenton 2004).

Thus, in order to fulfill the criteria of dependability, Shenton (2004) provides three possible strategies that should be implemented within qualitative studies. They are a detailed description of how the research was planned and conducted on a strategic level, what was done in the field and to evaluate the effectiveness of the data gathering process. The authors argue that all three strategies are fulfilled due to the detailed description outlined in the study’s methodological chapter. The information contained in this chapter offers a rich description of how the study was conducted, and at the end of the paper, limitations concerning the method and other parts of the study are reflected upon. Moreover, Shenton (2004) argues that if the credibility criteria are fulfilled, one can argue that dependability is to some extent also fulfilled. Thus, the authors
argue that dependability is achieved due to the detailed credibility criteria and a descriptive methodological chapter which future researchers can use in order to conduct the same study.

3.9.4. Confirmability

The last criteria that must be fulfilled is that of confirmability which relates to the study’s objectivity. Shenton (2004) highlights that it is almost impossible to achieve complete objectivity due to the role of the researchers and their creation of measuring instruments. The study’s use of semi-structured interviews required a set of pre-constructed questions that the authors’ created before conducting the interviews. Thus, complete objectivity was difficult to achieve. However, in order to mitigate the subjective influence of the researcher, one must present a detailed description of how the study has been conducted and triangulate the data with different sources (Shenton 2004). The authors’ argue that the use of secondary data for triangulation and the detailed information in the methodological chapter within this study is enough basis for an outside party to verify to what extent the study achieves the confirmability criterion.
4. Findings

In this section the study’s findings will be presented based on the semi-structured interviews. The chapter contains a detailed write-up of the case companies internal control systems based on the integrated components in the COSO-framework together with their outsourcing relationships.

4.1. Effects of outsourcing

4.1.1. The importance of internal control

Throughout all the interviews one factor was described as one of the most important amongst all companies and participants, the importance of control. All the case study companies share some similarities in their goals and objectives. They all strive towards profitability and to be competitive in their respective market. However, in order to achieve these objectives, all participants highlighted the importance of being aware of what is happening inside and outside their companies’.

“[…] out of a corporate point of view, in order to reach a goal so to speak, the leader that sits in the company must have control over everything, both the market, the company, the purchases, the finances and the personnel” – Respondent 1, Company A

“You cannot lose the control. It is important to somewhere in all the chaos and stress have a goal and an idea about what you want and some guidelines to make that work. […]” – Respondent 1, Company C

All companies’ have chosen to outsource both their bookkeeping and their payroll. Commonly between all participants was their positive description of each of their respective outsourcing arrangement. According to the participants, several positive aspects with regards to control had evolved from their relationship with their respective outsourcing company. One aspect that all companies experienced was the sense of increased control over the company as a whole. The choice of outsourcing the transactional processes between Company A and Company B was that of changes in the organization while Company C already from the beginning in 2015 decided to outsource. The positive aspect of increased control was that all participants could focus much more on other aspects of their company that was in need of maintenance. Company A has experienced better control over the production process due to the outsourcing company’s knowledge about the business system and demand on Company A to faster conduct arrival checks and create purchasing orders
for each order. Company B on the other hand has experienced increased control over their finances due to the access of expertise within the field of financial work where a phone-call or e-mail is an easy solution to any questions they have regarding their company. Lastly, Company C have experienced support from the outsourcing company to achieve an effective control in the whole company. Since the CEO of Company C is also the foreman, calculator, project manager and financial manager, the support of the outsourcing company have provided them with the possibility to more easily focus on maintaining a profitable and healthy work-environment.

“All of us has gotten more meticulous since we started to outsource. [...] But, when the invoice arrives and it does not exist any purchase order it causes problems for the outsourcing company. Then we have to go back and look at what we bought and this both take time and cost money for us. In this way the outsourcing company has created more accuracy within our company” - Respondent 2, Company A

“We think it is a good relationship, it is good. We have a close relationship where we communicate through e-mail, telephone and meetings” – Respondent 1, Company B

4.1.2. The outsourcing companies impact

Although the transactional processes are conducted in another city. The knowledge and control regarding each case companies’ finances have increased since the choice was made to outsource. In the case of Company A, the knowledge provided by the outsourcing company helped them minimize their costs and increase their profit. When scrutinizing the financial work of Company A and identifying areas of interest, it was later up to Company A to decide how to lower the costs. In the end, the contribution margin was raised with 20% on some machines and the freight costs each month were significantly lowered. Further knowledge was acquired regarding pricing of different varieties. Moreover, the expertise of the outsourcing company and the resources that they possess further supported the integrity of the internal control in Company A. Thus, the outsourcing relationship has further minimized the errors within the finances that was previously a part of Company A.

Furthermore, Company A is not the only case company that have experienced better control and acquired more knowledge regarding its finances. Company B and Company C have further experienced similar attributes through their use of continuous communication between them and the outsourcing company. Regular meetings once every week or every two weeks has provided each
company with more up-to-date information about each company’s financial status while also providing the outsourcing company an opportunity to get an insight into how the case company operates which respondent 1 in Company C highlights as a key factor for having a successful outsourcing relationship.

“Yes, even better. It has taught me so much, the financial manager that previously conducted this work, I can do that today. On a scale of 1 to 10, I give the outsourcing company the grade 10.” – Respondent 1, Company A

“ [...] it is very important that we deliver what we should deliver to each other. Because I cannot do my job, and they cannot pay the employees’ salaries if they do not get the necessary salary details from me. If they do not pay the salaries then my employees will not stay here. Thus, we are dependent on each other.” – Respondent 1, Company C

4.1.3. Problems when outsourcing

Even if all companies mainly have experienced positive aspects of their relationships with their outsourcing companies, some areas are highlighted as a possible downsides to outsourcing. Company A for instance reflected upon the knowledge the outsourcing company have about their company and industry. One example was given where a purchase was theoretically made with screw packages. Since the outsourcing company is located in another city without specifically targeting the manufacturing industry, it could become a problem if they do not know what is reasonable for Company A to purchase or not. This lack of knowledge could result in losses or negative implications for Company A which was one negative aspect presented about outsourcing the transactional processes. Company B on the other hand reflected upon the difficulty to fully get what they wanted. Even though the outsourcing company is very attentive and open for suggestions made by Company B, some areas are more difficult to change than others. Since it is a cooperation between the two parties, they often meet half-way where both parties feel pleased with the decision.

“I think we have a good dialogue where we try to find what is most convenient for all, and they are listening and trying. Then of course, some things can be difficult to change. However, I think that almost everything have been positive.” – Respondent 1, Company B

“For example, if there is an inaccurate invoice of 23.000 screw packages, is it reasonable that the company purchases 23.000 screw packages or should it instead be 2.300 screw packages? That is a small risk, that the outsourcing company does not have enough knowledge about the company to know what is reasonable or not” – Respondent 2, Company A
4.2. Mitigating potential risks

4.2.1. Control Mechanisms

A common theme amongst all participating case companies was that everybody had control mechanisms installed in order to control and follow-up that every aspect of their operation functioned properly. One of these mechanics that was installed in Company A and B was that of budgets. The current budget for Company A stretches over three years and is presenting reasonable goals that the company in reality can reach. The budget is where they gather information and plan ahead regarding what costs there are within different sectors of the company. By gathering proper information about what material today should cost, what volume the inventory can handle, what suppliers there are in the surrounding environment and comparing this with the pre-planned budget has provided Company A with the possibility to minimize their costs and increase their profit. The budget within Company B is also one of the main tools they use to achieve their objectives. Company B currently set budgets semi-annually and annually. However, all four employees currently in the main-office of Company B have previous entrepreneurial experiences. Thus, respondent 1 in Company B highlighted the importance of knowing where to look within their financial records in order to compare with the projected result within their budget.

“[…] of course we have goals that we want to achieve and when we create the semi-annual and annual we always base it on some type of budget or something similar. We are a smaller company so we have really good insight and can see each month where we currently stand if you compare with the projections and budget. […]” – Respondent 1, Company B

“The reasoning as to why we have managed this, especially the high turnover, is because we have not incurred costs. That is because we have been watching what things cost today, what we can buy, what we can put in our inventory. Today we buy an annual volume for all our products because we know that they will sell […]” – Respondent 1, Company A

Although budget was not highlighted as a main control mechanism within Company C, the company had installed other forms of control, primarily that of their business system. The use of project accounting within Company C made it possible for the CEO to be up-to-date with what currently happens within their different projects. The project accounting supports Company C in such a way that they can keep track of all the expenses and incomes for each project.
and further supports the CEO to control that everything about a specific project is booked correctly. However, Company C was not the only company that used their business system in order to mitigate potential threats. The business system was further a key component within Company A. The business system compares arrival goods with that of the purchasing order through the use of a tool called reception control. Thus, by comparing what was ordered with what has arrived has resulted in better control over the flow of the organization. Since deficiencies within the production can heavily affect the overall company in ways such as higher costs for repairs, slower production times and reputational costs if the machine were to be defective.

“I work with projects and use project accounting. For example, if I change the roof at your house I want to know that it is profitable for the company and make sure everything is booked correct. Then I see in the system all the time the expenses and incomes for that project and can easily see if something does not match my calculation” – Respondent 1, Company C

“[…] we do a short test run but also a longer test run to ensure that the machine is capable of the pressures it has to handle. The test run is based on a protocol that has to be followed where everything is documented.” – Respondent 2, Company A

Even though many similar risk mitigations were present within the case companies, some practices were unique to the respective company. Company A not only used the business system and budget to identify and mitigate potential threats, they further conducted sporadic follow-ups of their finances, final attestation of each invoice and payment created by the outsourcing company, SWOT-analysis and PDCA-meetings (plan, do, check, act) for their machines. By having the final say in each of the booked invoices, planned payments and conducting regular follow-ups on different areas of their finances made it so Company A could identify possible outcomes in the future while also securing their current standings. Moreover, the SWOT-analysis of each machine and PDCA-meetings further provided the company with the necessary information to assess potential threats and mitigate any deficiencies within their operations.

Company B on the other hand mainly used that of weekly meetings at the main-office where they discuss everything about the company such as current financial standings, upcoming projects and delegation of responsibilities. Thus, providing information to all necessary parties so that they know what to do and when to do it.
Lastly, Company C mainly used that of information gathering and choosing not to outsource parts of their operations that they saw as a risk. The information gathering was explained by the CEO as related to the economy and industry overall. The construction industry on its own is a rather volatile market. However, the economy overall is not always that stable either. Thus, much effort is given to analyzing the market to predict what changes that can occur in the future. Company C highlighted the importance of being prepared for a recession in the market and this is done by keeping the fixed costs low and to have a clear view over the expenses. Moreover, Company C further mitigated potential threats by keeping some aspects of their financial work in-house. Although the outsourcing company is responsible for a majority of all the financial work, the respondent takes care of the invoicing process to the customers. This is mainly because of potential errors that easily can occur if one does not have all the information and knowledge about the different projects company C have.

“[...] everybody shall report what is happening from arrival to delivery. When it comes to quality overall and deficiencies, if there is something wrong and a customer calls and says that something has gone wrong and that is not okay, then we have a room that I call PDCA. There the construction manager, production manager, planning manager, a service engineer and I meet up. We then sit down and I tell everybody about the problem, this and that has happened, what do we do? [...]” – Respondent 1, Company A

“[...] I do the invoices to the customers on my own. This is something the outsourcing company absolutely could do. However, if they would do the invoices I still have to write data for the invoice, it sounds simple but it is easy that you miss something which is very important. This is something that the customer will receive. Thus, it is important that the invoice looks good when it arrives to the customer [...]” – Respondent 1, Company C
5. Discussion

This chapter contains the analysis of the empirical findings based on the study’s theoretical chapter. An analysis is presented for the case companies’ internal control which is followed by the potential risks and how the case companies mitigates them. The chapter ends with an analysis of the COSO-framework where areas of improvements are identified.

5.1. The effect on the internal control when outsourcing transactional processes

The choice of outsourcing the transactional processes is many times due to cost benefits and access to expertise within the area of finance (Christ et al. 2015; Höglund & Sundvik, 2016). However, this is not the case amongst the participating companies. All companies fulfill the criterion of an SME where all participating companies currently staff around 20 employees. With lesser resources at their disposal compared to larger companies’, the choice of outsourcing the transactional processes instead becomes a necessity. All participating companies’ chose to outsource due to either lack of knowledge or lack of resources. Thus, the study’s findings are similar to the findings presented by Höglund and Sundvik (2016) and Niemi et al. (2012) that SMEs often outsource out of necessity instead of voluntarily choosing to do so.

Even though the case companies have lesser resources and lesser knowledge about transactional processes, the access to expertise within the area of finances have had a positive effect on the internal control within all case companies. The COSO-framework presents five integrated components that the company must take into consideration in order to create and maintain an effective internal control (COSO 2013). However, after conducting the interviews and presenting the data, one might assume that all case companies fulfill the criteria of an effective internal control. Within the control environment, COSO (2013), Moeller (2014) and Arwinge (2014) highlight the importance of delegating responsibilities, incorporating all actors within the organization and have clear expectations on different levels of the company in order to achieve company objectives. Not only does the case companies’ apply these aspects in-house, they have further managed to influence the outsourcing company to varying degrees. Through their use of daily and weekly meetings with their in-house personnel and continuous debriefing sessions with the outsourcing companies, all case companies have established areas of responsibility and expectations on their in-house staff and the outsourcing company. Thus, one can assume that the component control environment is fulfilled in all case companies, by
establishing a tone at the top and inform all the necessary parties of their respective responsibilities (COSO 2013).

The second integrated component within the COSO-framework is that of risk assessment. This is where most of the effects of outsourcing the transactional processes can be found within the case companies. COSO (2013) argues that to achieve an effective internal control, the company must first establish clear goals and from there evaluate their operations in order to identify and mitigate internal and external risks. The addition of the outsourcing company have developed the risk assessment component within all case companies. The outsourcing companies’ knowledge about the case companies’ business system, suggestions to improve efficiency in areas that often attract higher costs such as freight costs, expertise within finances, and demands, all positively influence the internal control of the case companies. This could be seen as positive attributes since it supports the case companies in their risk assessment by providing an alternative point-of-view. Thus, it might be suggested that outsourcing the transactional processes could improve a company’s internal control with regards to risk management.

The third integrated component is that of control activities. Control activities should be implemented at all the different levels of the company in order to ensure that the objectives and decisions made by management is realized (COSO 2013). This is one area that could be difficult to develop when choosing to outsource the transactional processes. Although many control activities are installed within the case companies’ such as final attestation of payments and invoices, project accounting, budgeting and projections, it is still difficult to fully control the outsourcing company’s actions due to the lack of knowledge. Amongst the respondents, Company B were the only participants to confidently say that they could fully evaluate the performance of the outsourcing company due to previous entrepreneurial experiences. Although company A have gained much knowledge from cooperating with the outsourcing company they are still not experts within the area of finance. Similar findings can be found in Company C where project accounting supports the CEO. However, the lesser knowledge about accountancy as a whole makes it difficult to control and evaluate the outsourcing company. Thus, similarities can be found that aligns with the arguments presented by Christ et al. (2015) that it can be difficult to evaluate the work of the outsourcing company which becomes a verification risk.

The fourth component within the COSO-framework is that of information and communication. In order to have an effective internal control, the company
must establish a well-functioning communication process throughout the organization (COSO 2013). This becomes significantly more important when outsourcing the transactional processes. The rapid changes of the economy and some of the industries that the case companies’ operate in makes control over the finances vital to not experience major losses. However, when outsourcing the transactional processes you no longer have the financial work in-house. Thus, continuous communication between the company and outsourcing company could become a necessity. However, all case companies’ recognized the importance of communication between themselves and the outsourcing company and further also highlighted the simplicity of communication due to today’s technology. Although the work of the outsourcing company is performed somewhere else, the internet, telephone and e-mail makes it so that outsourcing the transactional processes is still almost performed in-house since the case companies’ can easily connect with the outsourcing company. Thus, the findings in the study may differ from what Christ et al. (2015) presented as a coordination risk when choosing to outsource the transactional processes.

The last component within the COSO-framework is that of monitoring activities. Once a well-functioning internal control is established it needs to be maintained which is done through different monitoring activities. Evaluations are a crucial tool within the monitoring component (COSO 2013). However, these tools can be seen as well-established within the case companies’. Apart from the daily and weekly meetings, budgets, and projections the case companies further monitor their internal control through follow-ups and communication between themselves and the outsourcing company. Moreover, the demands put forth by the outsourcing company on the case companies’ further promotes functioning monitoring activities. If there are deficiencies in the purchases or any other area of the company where cooperation is required between the outsourcing company and the case company, they must quickly be communicated to the responsible party to not restrain the work progress.

With the above information at disposal, the overall impression given by the participating Swedish SMEs is that the choice to outsource the transactional processes has had a positive effect on their internal control. All case companies experience more control over the organization as a whole while some participants further have gained more knowledge regarding their financial work.
5.2. Identifying and mitigating risks within the internal control

Characterizing for all three participating companies was their focus on having well-functioning control activities installed in the company. According to COSO (2013) control activities are processes that help the company ensure that risks are mitigated and that risks that occur do not affect the achievement of the company’s objectives. When using different control activities the case companies are ensured that potential risks are mitigated. Moreover, by having a well-functioning IT-structure and budgeting process, the companies’ can compare what is projected with reality. Even though the case companies do not have that much knowledge about finances they can still detect numbers that they find strange or unrealistic. In some cases the outsourcing company even contributes with knowledge about different IT-solutions that the case company did not have earlier which has resulted in a more effective way to identify and mitigate risks for the case companies. The findings can be seen as aligned with the control activities presented within the COSO-framework (COSO 2013).

All case companies highlights the importance of mutual trust between them and the outsourcing company. Christ et al. (2015) argues that one risk that can occur when outsourcing is relational risks. These risks can occur due to the possibility that the outsourcing company takes advantage of the lack of knowledge that may exist within the company that chooses to outsource. The lack of knowledge can make it difficult for the companies to evaluate how well or poorly the service has been performed by the outsourcing company (Aron & Liu 2005). The relational risks is difficult for the case companies to avoid since they do not have that much knowledge about the financial work that the outsourcing company performs. However, all three case companies seems very satisfied with their respective outsourcing company and they highly trust them. One could possibly assume that the relational risk is somehow difficult to mitigate since the case companies are dependent on the outsourcing company and needs to trust that they performs the service as good as they can. Thus, the findings are similar with what Christ et al. (2015) highlights as relational risks. Moreover, these relational risks is similar with one performance risk, also known as, “verification risk” which Christ et al. (2015) argues is a risk that involves the inability to verify the performed work done by the outsourcing company due to lack of knowledge. However, despite this lack of knowledge about the finances one of the case companies uses project accounting as a way to verify that the outsourcing company is doing their work properly. By using project accounting the manager
can follow up on everything within each specific project and thereby also identify if something is booked incorrectly by the outsourcing company.

Moreover, another risk associated with relational risks is that of information provided by the outsourcing company. Since the outsourcing company provides all the financial information that the case company uses when making decisions and evaluations it can be hard to know if the information provided is necessary information (Christ et al. 2015). However, all case companies highlights the importance of trust for one another. One of the case companies are participating in the process of deciding what information they need from the outsourcing company and also has an impact on how that information is presented. This could be seen as one way to mitigate the relational risks that can occur. By being active and participating in the process of developing information the case companies are controlling the process and ensures that they get what they want.

Furthermore, Christ et al. (2015) mentions one specific performance risk known as “quality performance risk” which relates to the lack of knowledge that might exist within the outsourcing company about how the case company operates and about their business. The findings implies that the “quality performance risk” can be mitigated by having the most crucial parts left in the company itself. One of the case companies takes care of the invoicing process themselves to avoid errors that can occur due to lack of knowledge about their projects and the industry. Moreover, it can be hard for the outsourcing company to know what is reasonable or not for the case company to purchase. This can create a problem if an inaccurate invoice arrives and the outsourcing company does not recognize the incorrectness on the invoice. Thus, by having the final attestation for invoices the companies might mitigate the “quality performance risk” in such a way that they get the final inspection for all invoices and can detect these inaccuracies before the invoice is paid. This insight shows that the case companies are aware of and have identified this as a risk when outsourcing their transactional processes.

Commonly for all case companies is their understanding of how important it is with communication between them and the outsourcing company. Christ et al. (2015) presents the coordination risks which Leonardi and Bailey (2008) means are risks that can occur if the goals and visions of the company is not communicated and understood by the outsourcing company. All case companies’ works with continuous meetings and contact with their respective outsourcing company to ensure that the outsourcing company is updated about what the case company strive to achieve and what currently happens in the
company. Hence, by having these meetings and contacts with the outsourcing company the case company mitigate risks that Christ et al. (2015) and Willcocks and Lacity (1999) argue can occur due to misunderstandings and poor coordination.

The authors suggest that one new risk might be identified when outsourcing the transactional processes. Since the outsourcing company often have much knowledge about the business systems and the financial work overall they could provide key insights into making the work of the case companies more efficient. By demanding the case companies to work in a certain way the outsourcing company may perform their work faster and more efficient. Thus, it is important that the companies’ communicates with the outsourcing company to evaluate their current operations in order to find improvements. One of the case companies transformed their whole business system when they chose to outsource since the outsourcing company identified areas of improvement. However, this is not always reality. As Christ et al. (2015) argues, the company that chooses to outsource and the outsourcing company have different motives and objectives since both companies want to be profitable. Hence, by providing the case company information and help in order to make both parties work more efficient the outsourcing company may lose hours to invoice the case company. Thus, the authors suggest that not only performance risks and relational risks are present when outsourcing transactional processes, “development risks” could also be present.

5.3. Modified COSO-framework for Swedish SMEs

COSO (2013) argues that their framework can be applied to all companies, no matter the size, industry or choices management makes. This statement presented by COSO (2013) further includes the choice of outsourcing. Thus, the COSO-organization argues that the framework does not need any changes regarding its principles and structure when choosing to outsource the transactional processes. After conducting the interviews with the participating companies, the authors agree with the statement by COSO that their framework is applicable on all companies. However, the authors have recognized similarities regarding the impact the outsourcing company have on the case companies. These similarities could possibly lead to a change in the COSO-framework in order to better support Swedish SMEs that outsource the transactional processes. The primary change that the authors would suggest is to add another actor within the decision making process in the control
environment. The main objective of the control environment is to establish a tone at the top and expectations that are later mediated and reinforced at all levels of the company (COSO 2013). This process mainly involves the board of directors and management which are the individuals that decide what happens within the companies (D’Aquila 2013). However, SMEs in general and the case companies are mainly characterized by lesser knowledge and lesser resources compared to larger companies. The authors suggest that excluding actors, such as the outsourcing company, out of the decision making process could negatively influence the company and their internal control. The knowledge and expertise that the outsourcing company possess may provide the case companies with crucial insights into what objectives and expectations can reasonably be achieved. Thus, the control environment might not only include the board of directors and management but instead further include parties of interest such as the outsourcing company when establishing the tone at the top and expectations.

Otherwise, the authors does not identify or provide any other suggestions to the COSO-framework. The other integrated components of risk assessment, control activities, information and communication, and monitoring are still crucial components when outsourcing the transactional processes. The current principles and information is still applicable and could even become more important due to separate motives of profit in combination with the amount of authority that can be bestowed upon the outsourcing company. These reflections aligns with the ideas of relational risks presented by Christ et al. (2015). However, the authors suggest that no other improvements are needed within the COSO-framework, only more meticulous implementation and monitoring.
6. Conclusions

In this chapter the findings of the study and answers to the study’s posted research questions is presented. Moreover, limitations within the study is further reflected upon while also presenting future research avenues within internal control research and outsourcing.

6.1. Findings of the study

The aim of the study was to identify and analyze internal control risks within Swedish SMEs when outsourcing transactional processes. Moreover, the study wanted to try to provide recommendations to the COSO-framework about how outsourcing arrangements should be handled in order to maintain an effective internal control. The authors argue that the aim is fulfilled through this study and the research questions is answered below.

How is the internal control affected by outsourcing the transactional processes within Swedish SMEs?

The access to expertise from the outsourcing company has improved the case companies’ internal control. The internal control within the case companies have become more effective due to the knowledge about different business systems and the knowledge about finances overall that the outsourcing companies possess. The outsourcing companies are also helpful with suggestions of improvement in order to make the internal control and the processes within the companies more efficient.

How does Swedish SMEs identify and mitigate risks within their internal control when outsourcing transactional processes?

By focusing on having well-functioning control activities installed, all case companies actively works with identifying and mitigating possible risks that can occur when outsourcing the transactional processes. The companies are aware of what risks that can arise and by having continuous meetings and contact with their respective outsourcing company they mitigate these risks. However, it is shown that the performance risks that can occur due to outsourcing the transactional processes are easier for the case companies to identify and mitigate by having the most crucial parts left in the company itself. The relational risks that are associated with outsourcing is harder for the case companies to identify and mitigate. Thus, the previously suggested performance and relational risks within the internal control when outsourcing the transactional processes is proposed to exists within the context of this study.
The authors suggest that one new risk may be found when outsourcing the transactional processes, which the authors calls “development risks”. Due to the fact that the outsourcing company has much knowledge about different business systems, they may also have knowledge about how the case companies can make their internal processes more efficient. However, by sharing this knowledge with the case company they can lose hours on invoices since it may result in their work becoming more efficient. Hence, there is a possible risk that the outsourcing company does not share all their knowledge with the case companies in order to develop the internal control system.

**How should the COSO-framework be modified and implemented in order for SMEs to avoid internal control risks within transactional processes outsourcing?**

Since there is a lack of guidance within the COSO-framework as to how companies should structure their internal control when outsourcing the authors suggest a change to the control environment. The authors suggest that the outsourcing company should be a part of the development of setting the tone at the top since they have much more knowledge about the financial aspects and the finances overall. Hence, the authors believe that it can be beneficial for the company to involve the outsourcing company as well as the management and board of directors when developing and maintaining the internal control system.

**6.2. Contributions with the study**

The main practical contribution with this study is that SMEs that outsource their transactional processes get an insight in how it can affect their internal control. The findings might give guidance to managers in becoming more aware of what possible risks that can occur and how to mitigate them when outsourcing the transactional processes. Furthermore, the study can possibly provide a theoretical contribution with regards to the COSO-framework for an effective internal control when outsourcing transactional processes. The findings suggests that the COSO-framework should not only include managers and board of directors when developing the control environment but also include the outsourcing company.

**6.3. Limitations and future research**

The primary limitation that this study experiences is the possibility to generalize to a larger population. The characteristics of qualitative studies is their close connection to the studied phenomena and narrower scope. This makes it difficult, if not impossible, to generalize to other situations (Gray 2017). Thus,
the findings within the present study could be context specific and not applicable to other companies and other situations. Hence, the authors could only suggest and highlight similarities found in the case companies with that of the theoretical chapter. In order to strengthen the results found in this study and possibly generalize future research should further investigate risks the internal control faces when outsourcing transactional processes on a larger sample.

Another limitation that the authors highlights is the interview with Company B. The interview was short compared to the other interviews which could negatively affect the information. However, despite the lesser interview time with Company B, the participant provided useful information for the study. Furthermore, the authors recognize the limitation concerning the secondary data. The data was mainly used to triangulate and did not provide that much information regarding other areas of the study. However, this could be context specific to the participating companies.

Moreover, the authors recognizes the limitation of only looking at Swedish SMEs. The risks and the modification of the COSO-framework presented in this study might only be the result of how Swedish SMEs operate. Thus, the authors would suggest that future research investigate whether similarities can be found in other countries in order to further improve the COSO-model and identify other risks.
References


Appendix – Interview guide

Background information

- Is it okay if record the interview?
- Who are you and what is your role in this company?
- What is your background relating to studies and previous working experiences?

Internal control system

- What are the goals and achievements you as a company strive to fulfill?
- How do you control/steer your organization in order to achieve this?
- When are you steering your organization forward?
- How is the company communicating responsibilities and tasks within the internal control?
- On a scale from 1 to 10 (one less important and 10 more important), how important are risks for your company?

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- What were the latest risks you have faced?
- Within what areas are you evaluating and judging risks? Internally and externally?
- Do you look at risks within your internal control? If yes, how do you handle them?
- What control activities are present within the company?
- How do you discover mistakes or wrongful actions on different levels within the company?
- How do you work with maintaining you internal control?
- On a scale of 1 to 10 (one less important and 10 more important), how important are evaluations of different kinds for your company?

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- What aspects of you organization do you evaluate?
- If you find any deficiencies within your operation, how do you handle them?

### Outsourcing transactional processes

- How long have you chosen to outsource your part of the administration?
- What company have you chosen and why?
- How would you describe your relationship with the service company?
- What knowledge is there within the company regarding the part of the administration you have chosen to outsource?
- During the time you have outsourced your administration, what impact do you have on the working process in the service company?
- What advantages does the service company have?
- On a scale of 1 to 10 (one is less and 10 more), how much knowledge would you say the service company have about your organizations and how you operate?

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- How is the communication between you and the service company? How often would you say that you are in contact with the service company?
- What do you communicate to the service company?
- Are there any special demands you have on the service company?
- Do they any special demands on you?