Report On

Internal Control Practices: A Study Conducted on Small and Medium Enterprises (SMEs)

By
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An internship report submitted to the BRAC Business School in partial fulfillment of the requirement for the degree of Bachelor of Business Administration

BRAC Business School
BRAC University
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Declaration

It's hereby declared that

1. The internship report submitted is my original work while completing my degree at BRAC University.
2. The report does not contain material previously published or written by a third party, except where this is appropriately cited through full and accurate reference.
3. The report does not contain material that has been accepted or submitted for any other degree or diploma at a university or other institution.
4. I have acknowledged all main sources of help.

Student's Name & Signature:

Kafshat Azad Toshin
ID: 21204042

Supervisor's & Co-Supervisor's Full Name & Signature:

H. M. ARIF, PhD
Assistant Professor
BRAC Business School

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Associate Professor
BRAC Business School

Letter of Transmittal

H. M. ARIF
Associate Professor,
BRAC Business School
BRAC University
Kha 224, Bir Uttam Rafiqul Islam Ave, Dhaka, 1212

Subject: Submission of Internship Report titled "A Study Conducted on Small and Medium Enterprises (SMEs)."

Dear Sir,
It's my honor to present my internship report as a partial fulfillment of the degree requirement of the Bachelor of Business Administration program in BRAC Business School, BRAC University.

The report is titled "Internal Control Practices: A Study Conducted on Small and Medium Enterprises (SMEs)". This study examines the presence and implementation of internal control policies in SMEs, based on practical observations made during audit engagements. The report focuses on identifying common internal control weaknesses, evaluating the gap between policy existence and actual practice, and analyzing how these weaknesses affect audit risk and organizational governance.

I sincerely hope that this report reflects the knowledge and practical experience I have gained during my internship period. I would be grateful for your kind evaluation and any feedback you may provide.

Sincerely yours,

Kafshat Azad Toshin
ID: 21204042
BRAC Business School
Brac University

Non-Disclosure Agreement

I, Kafshat Azad Toshin, hereby solemnly declare that the internship report entitled "Internal Control Practices: A Study Conducted on Small and Medium Enterprises (SMEs)" has been prepared by me based on the practical experience and observations gained during my internship period. The internship was completed as part of the requirements of the Bachelor of Business Administration (BBA) program at BRAC Business School, BRAC University.

I certify that this report is an original work carried out solely by me and has not been submitted, either in whole or in part, for any other degree, diploma, or academic purpose at this or any other institution. All information collected from primary and secondary sources has been properly acknowledged, and the report has been prepared exclusively to fulfill the academic requirements of the BBA program at BRAC University.

Acknowledgement

I am deeply appreciative of Allah (SWT), who has provided me with the strength and wisdom to finish this internship role, as well as the research project. I believe that this opportunity is a major step in my academic and career path.

I would like to express my utmost appreciation to my supervisor, H. M. Arif sir, who is an assistant lecturer at BRAC Business School, for his guidance throughout my preparation of this report. He has been encouraging and giving constructive feedback, and his perseverance and inspiration.

I would like to extend my utmost gratitude to my organization supervisor, Shiekh Imtiaz Mahmud, Deputy Manager at Hasan Mohin, Chartered Accountants, who was consistently guiding and supporting me throughout my internship on many things that are included in the organization, and I got to know new terms that are being used in this organization.

I would also like to thank all my seniors at Hasan Mohin, Chartered Accountants. Their support and the desire to help me during the internship were critical and assisted me in gaining an in-depth knowledge of assurance and audit practices.

Executive Summary

This internship report, titled ‘Internal Control Practices: A Study Conducted on Small and Medium Enterprises (SMEs)’, has been prepared as a partial fulfillment of the requirements for the Bachelor of Business Administration (BBA) degree at the BRAC Business School of BRAC University. The research has been based on the practical experiences of auditing during my internship tenure as an Audit Associate at Hasan Mohin Chartered Accountants.

The main purpose of this report is to identify and evaluate the internal control processes of SMEs and the common lapses identified during the audit procedures. Even though internal control processes are critical for financial reporting, asset protection, and regulatory issues, SMEs commonly experience difficulties in their control processes because of a multitude of factors.

The research takes a descriptive research methodology since the primary data can be gathered from direct observations of audit assignments, analysis of working papers, current and previous, and professional discussions with audit team members. Out of all available client audit reports or audit assignments, five client organizations belonging to SMEs have been selected as a prerequisite was established where the chosen organization must have written SOPs and therefore could be scrutinized for their control lapse in said policy. All identities will be anonymized to promote confidentiality as internal reports by nature are for management only or very select users and not general users and stakeholders. Secondary information is only used to validate the analysis done using literature from academic and professional circles.

The results highlight the poor and anarchic state of internal control procedures of SMEs in Bangladesh. Lapses identified include the lack of written policies or continuous updates, ineffective or nonexistent authorizations, poor documentation, lack of segregation of duties, little to no reconciliation procedures, and inconsistent management reviews. A presence matrix was created to highlight the results and the extent to which control policies exist and are followed.

The report finds that weaknesses in internal controls in SMEs mainly arise because of weak enforcement, supervision, and resource constraints, but not due to a lack of awareness. The report proposes simple, inexpensive ways of dealing with such weaknesses, which include written procedures, enhanced controls over authorization, reconciliation, and management review. The proposed measures will enable SMEs to strengthen their internal controls.

Table of Contents

Chapter 1: Overview of Internship

1.1 Student Information

Name: Kafshat Azad Toshin
Student ID: 21204042
Program: Bachelor of Business Administration (BBA)
Major: Accounting

This internship project was a mandatory requirement of our BBA course with an aim to gain practical exposure to professional accounting and auditing practices and thus bridge the gap existing between our theoretical learning and practical application.

1.2 Internship Information

1.2.1 Organization Information

Organization Name: Hasan Mohin, Chartered Accountants
Internship Period: 26 June 2025 to 31 December 2025
Department/Division: Audit
Organization Address: 12th Floor, 115, Sheltech Rubynur, Dhaka 1216

Hasan Mohin, Chartered Accountants, is an accounting firm specializing in audit, assurance, and other forms of consulting in a wide array of industries in which their clients in Bangladesh operate. They render assistance in statutory audits, internal audits, process audits, and other kinds of advisory work.

The organization is important in supporting clients in assessing financial report accuracy, understanding control systems, and ensuring they conform to all relevant legislation. The organization functioned as an ideal learning platform for an accounting major since it offered experience with auditing engagements and practices.

1.2.2 Internship Company Supervisor’s Information

Name: Sheikh Imtiaz Mahmud
Designation: Deputy Manager

The internship project was run under the guidance of the Deputy Manager, who oversaw managing audit projects and delegating tasks for audit work. The direct or indirect guidance offered by the deputy manager covered aspects of conducting audits, preparing their supporting working papers, and seniors in an audit by auditing smaller or simpler matters like Cash at Bank, Petty Cash, Share capital, inventory counting, etc. Engaging in this manner offered a practical understanding of how such a firm coordinates decision and how every articled student learns to conduct audits in the future by themselves.

1.2.3 Job Scope (Job Description, Duties, and Responsibilities)

During the internship, my official designation was “provisional audit associate”, where my main responsibility was to work with different audit teams in their audits and assurance functions. My duties were both at the office and field level, that involves, but were not limited to, the following:

- Aiding in the compilation and organization of working papers in an audit
- Verifying and examining supporting documents such as invoices, vouchers, receipts, and ledgers
- Engaging in Internal Audit and Process Audit activities, with emphasis on Internal Policies/Procedures Compliance
- Providing support to audit teams during fieldwork in observing clients' processes and identifying any discrepancies in documentation
- Providing support to senior auditors in understanding and documenting clients' internal control systems
- Engaging in simple audit procedures under supervision, including authorization, documentation, and reconciliation procedures

They offered hands-on experience with audit work and gave me an insight into how audit theories are put into practice in an organization.

1.3 Internship Outcomes

1.3.1 Student’s Contribution to the Company

During the internship, I participated in and contributed to 3 separate audits. The outcome from these audits includes:

- The completion of three audit assignments
- Active participation in the audit work
- Aiding in the review and verification of documentation
- Providing support to audit teams in organizing working papers and ensuring the completeness of audit evidence
- Assisting in identifying deficiencies in documentation and control methods during field work

These efforts benefited my seniors by completing their audit work in an efficient manner and ensuring good standards of audit documentation.

1.3.2 Benefits to the Student

The internship offered a wide array of learning and networking opportunities. Some of these benefits include:

- Knowledge of auditing procedures, planning, and standards for documenting
- Being acquainted with the inner workings of different industries, achieved by taking up work with various kinds of clients
- Improving our understanding of internal control systems, process audits, and compliance obligations
- Enhancement of professional skills in communication, teamwork, responsibility, and time management
- Enhanced skill in using knowledge of academic accounting and auditing practices in practical situations

In conclusion, this internship experience greatly enhanced my professional capability and readiness for future work in accounting and auditing.

1.3.3 Problems and Difficulties Faced During the Internship

Although the internship at an audit firm was a great learning experience, some challenges were faced during the learning/internship period. These were:

- Unclear or vague guidance or instruction from supervisors in early project phases
- Minimal guidance regarding carrying out new or unfamiliar tasks
- Observational learning instead of formal learning, in some cases

While these sometimes raised a degree of uncertainty, they promoted self-directed learning, flexibility, and problem-solving abilities.

1.3.4 Recommendations to the Company on Future Internships

Based on this internship experience, I propose some recommendations that have been presented below for a better internship experience:

- Give the student clear task instructions and expectations before each assignment
- Supervise and observe interns and newly hired employees during employee training sessions.
- Implement a short orientation or training guidance for interns to acquaint them with audit work practices, documentation requirements, and professional standards.
- Assign a designated mentor or focal person where interns can get guidance.

Adaptation of such recommendations would increase internship productivity, alleviate confusion during the early stage of internship, and make the internship program more effective.

Chapter 2: Organization Part

2.1 Introduction

This chapter gives an overview and through analysis of **Hasan Mohin, Chartered Accountants**, the organization where the internship was completed. This chapter aims to provide a clearer insight into the company's background, management practices, services it offers, accounting methods and practices, competitive environment, and future prospects.

The analysis is based on direct observations made throughout the internship period, discussions with firm personnel, and the internal procedural understanding that was gained through audit engagements. Due to the confidential nature of audit firms, access to financial statements was restricted for interns or an articled student. As a result, this analysis mainly focuses on qualitative aspects rather than quantitative financial performance.

2.2 Overview of the Company

Hasan Mohin, Chartered Accountants, is a professional service firm operating in Bangladesh. The primary business activity of the firm includes the provision of audit, assurance, and advisory services. Additionally, the firm provides strategic insights and professional advice to businesses to ensure operational efficiency, compliance with regulations, minor/major control weaknesses, and sustainable growth.

The range of services offered by the company is aimed at enabling its customers to face regulatory problems while still upholding robust corporate governance. The services enabled by the company include audit services, assurance, secretarial services, and a range of other services aimed at enhancing corporate governance.

With a skilled team backed by managers and Senior partners, the company is quickly gaining a reputation for its service quality and professionalism. The firm is also seeing massive growth in its client base as SME's dominated the market and their audit is far less time and labor intensive. However, firms also have some large organizations to ensure year-round work opportunities.

Services Offered

The firm's main service offerings are:

- Audit and Assurance Services
- Tax and VAT Services
- Business Process Outsourcing (BPO)
- Advisory Services
- Secretarial Services

Human Resources and Organizational Size

Currently, the firm has around forty professionals, and the general hierarchy includes:

- Senior Partners
- Deputy Managers
- Articled Students
- Probationary Students
- Interns

This structured workforce allows the firm to handle multiple engagements while ensuring supervision and quality control.

2.3 Management Practices

Leadership Style

Hasan Mohin, Chartered Accountants, follows a collaborative management style with a weaker hierarchy, which encourages open communication and teamwork among employees. While hierarchy is maintained for senior partners to ensure accountability and respect towards decision-making authority, the overall work environment promotes participation and professional interaction, especially among audit teams.

Human Resource Planning

The firm focuses on structured human resource development through articled and probationary programs that meet ICAB requirements. Interns and students work with audit teams to gain practical experience.

Recruitment and Selection

The recruitment process typically involves:

- A letter of intention sent to well-known Public & Private Universities
- Interested candidates submit a CV in person or by mail
- The HR selects promising CVs and invites them for a written examination
- The call to the written exam is done on short notice by choice to see a candidate's basic accounting proficiency without preparation
- The exam is conducted by managers or senior students, and the scripts are also evaluated by them
- If candidates pass the exam, then they are called for an interview
- The interview is always taken by senior partners, and they evaluate communication skills, professionalism, and suitability

This process ensures that candidates possess both academic competence and professional aptitude.

Training and Development

The firm places strong emphasis on continuous professional development. Skill development courses are conducted monthly, ranging from key topics like Taxation, Assurance, ERP integration, and audit protocol. The firm also conducted general skill development classes like Canva & Excel. These classes are facilitated by senior partners or experienced professionals, or even ICAB officials. Training topics are not selected by Senior Partners, but rather are based on student feedback, ensuring relevance and effectiveness.

Performance Appraisal

Performance evaluation is conducted through regular work reviews by the deputy managers. In the office, all students are reviewed at the end of the day, every day. On-field students usually require less review due to experience and involvement of Senior Partners. But still, our deputy manager reviews their work at least once a week. This continuous review mechanism supports skill development and quality assurance and creates confidence amongst students.

Compensation System

The firm’s basic compensation structure follows ICAB-mandated allowances. But additional benefits are provided based on educational backgrounds, like accounting majors or graduates from reputed universities, and individual performance. This system ensures regulatory compliance while rewarding merit. All employees and students are also entitled to phone and transportation expenses incurred during audit engagements.

2.4 Marketing Practices

Hasan Mohin, Chartered Accountants, does not have a marketing department. Instead, client acquisition is primarily driven by word-of-mouth, networking events, and industry connections. Our audit report also attracts clients from various stakeholders. The firm’s reputation, professional conduct, ethics, integrity, and audit quality play a critical role in attracting new clients since audit services rely heavily on trust and credibility

- **Target Customers**: Small and Medium Enterprises (SMEs)
- **Promotion Strategy**: Reputation-based, client referrals
- **Distribution Channel**: Direct professional engagement

This conservative yet effective marketing strategy underscores the firm’s commitment to professional integrity over aggressive promotion.

2.5 Financial Performance and Accounting Practices

<u>Financial Performance</u>

As an audit firm, Hasan Mohin, Chartered Accountants, does not publicly disclose its financial statements. Due to confidentiality and professional restrictions, financial data was not accessible to students during the internship period. Therefore, traditional ratio analysis or financial performance evaluation is not applicable in this context.

However, operational sustainability can be inferred from:

- A year-round client base
- Monthly advisory services provided to larger companies without any end date

- Continuous intake of article students and interns
- By weekly development sessions
- Expansion of advisory and secretarial services
- Inclusion of a new senior partner and a 40% increase in articles during the internship period

Accounting Practices

The firm adopts an accrual basis of accounting; the practice is in line with professional requirements. The firm's accounting systems are handled within the firm. Therefore, they are not open to external sources.

2.6 Operations Management and Information System Practices

The main operational activities of the organization revolve around engagements based on audit work. Audit teams are constituted for each assignment involving managers, seniors, and technicians.

In view of confidentiality concerns, information about their internal information systems and software used is not disclosed. Nonetheless, their methodical documentation practices for working papers adhere to auditing standards.

2.7 Industry and Competitive Analysis

Competitive Environment

Since our firm's current mission is to become a key player in the Audit service sector, the firm operates in a highly competitive segment. Major competitors include well-established and reputed audit firms such as:

- Huda Vasi Chowdhury & Co.
- Qasem & Co. (Aknabin)
- Rahman Rahman Huq (KPMG)
- A.Qasem & Co

These firms compete primarily with reputation, experience, audit quality, and advisory capabilities.

Industry Trend

A notable industry trend is the expansion of advisory services following statutory audits. Since many businesses are starting to adopt the IFRS but don't have the expertise and or know-how on how to apply it, many audit firms, including Hasan Mohin Chartered Accountants, leverage their audit engagements to provide value-added advisory services and follow-up audit, BPO services to help clients improve internal controls, compliance, and governance.

SWOT Analysis

Strengths

- Strong professional expertise
- Collaborative work culture
- Focus on quality and compliance

Weaknesses

- Limited formal marketing activities
- Restricted digital visibility

Opportunities

- Growing SME sector
- Increasing demand for advisory and compliance services

Threats

- Competition from large, reputable audit firms
- Price sensitivity among SME clients

2.8 Recommendations

Hasan Mohin, Chartered Accountants, operates as a professional audit and advisory firm with a strong focus on service quality, compliance, and professional development. Its culture of collaboration, extensive training programs, and very clear focus on audit quality give the firm strong market credibility.

Based on organizational analysis, the following recommendations are proposed:

- Enhance digital presence to support reputation-based marketing
- Introducing basic client feedback mechanisms
- Expand structured documentation for internal knowledge sharing
- Gradually integrate affordable audit technology tools to improve efficiency

Although it is not formally marketing and providing financial transparency, the firm remains competitive based on reputation, client trust, and the extension of advisory services.

2.9 Summary and Conclusion

In conclusion, Hasan Mohin, Chartered Accountants, is a professional audit firm that focuses on quality while providing services, and makes sure to be compliant and puts heavy emphasis on staff development. It focuses on strong audit control and strong training programs, and its collaborative nature supports its credibility on market. The firm remains competitive through its strong reputation, client trust, and advisory services despite not providing full financial transparency.

Chapter 3: Internal Control Practices in SMEs

Internal Control Practices: A Study Conducted on Small and Medium Enterprises (SMEs)

3.1 Problem Statement

Internal control policies underpin accurate financial reporting, asset protection, and compliance with applicable laws and regulations, and help organizations achieve their objectives by providing reasonable assurance regarding operational effectiveness and reliability of reporting. To the auditors, the effectiveness and extent of the internal control system of the organization have a direct relationship with the determination of materiality, planning of the audit, risk assessment, and the nature, timing, and extent of the audit procedures.

Small and Medium Enterprises (SMEs) form a major segment of the business environment in Bangladesh. Based on available statistical estimates, SMEs contribute approximately 25 – 30 percent of the country's GDP and constitute a significant proportion of employment and industrial enterprises in the economy (The Business Standard, 2024; The Daily Star, 2023). Even though SMEs form a major segment of the business environment, they operate in a business environment where resources are scarce, the decision-making style is centralized, and the management style is also informal. Hence, the internal control systems of the SMEs are not as structured as those of the large organizations. Though the owners and beneficiaries of SMEs sometimes have a structured policy and a Standard Operating Procedure (SOP) in place, the extent of the internal control systems is not clear.

From the point of view of the audit, this type of inconsistency is considered a problem. Auditors are expected, in accordance with ISA 315, to "establish an understanding of the entity's internal control system in order to assess the risks of material misstatements in the financial report." When controls are present, as they are in this case, but are not well implemented, auditors are expected to "assess the control risk and place greater reliance on substantive procedures."

The study was conducted in the context of an audit and was based on actual observations made during the internship period at Hasan Mohin, Chartered Accountants. Through the auditing of several SMEs, the study aims to investigate actual control practices, as opposed to those that are documented.

3.2 Research Objectives

Despite the acknowledged significance of internal control systems and the availability of proven frameworks, such as the COSO Internal Control Framework, the implementation of internal control policies in SMEs is considered to be a challenge. The literature has identified that the major problem faced by SMEs is not the absence of internal control policies, but the lack of implementation, monitoring, and control.

Considering the context of Bangladeshi SMEs, the problem is considered to be of significant concern to the auditor, since the lack of implementation of internal control systems increases the inherent risks, control risks, and the auditor’s reliance on control testing. The previous literature has identified the absence of empirical evidence regarding the implementation of internal control from the perspective of the audit.

Consequently, the problem under investigation in this study is the discrepancy between the existence of internal control policies and the actual implementation of such policies in SMEs, as noted during audit engagements.

In view of the problem under investigation, the following specific objectives of the study have been formulated:

- To determine the degree of compliance with internal control policies and Standard Operating Procedures in SMEs.
- To identify the most frequently encountered internal control issues noted during audit engagements in SMEs.

3.3 Research Questions

The research questions of this study are directly linked to the previously mentioned research objectives:

1. To what extent do SMEs comply with their own documented internal control policies and SOPs?

2. What are the common internal control lapses observed during SME audit engagements?

3.4 Literature Review

Internal control has been recognized as a vital element in attaining organizational accountability and managing risks. According to the Committee of Sponsoring Organizations of the Treadway Commission, also referred to as COSO, internal control is “a process designed to provide reasonable assurance that the organization’s objectives and goals will be met” (COSO, 2013). The COSO definition of internal control stresses that ‘internal control is a process, not a condition.’ COSO Internal Control Framework suggests that an effective internal control system consists of five components: control environment, risk assessment, control activities, information and communication, and monitoring activities.

Research literature suggests that the effectiveness of internal control systems depends not only on their establishment but also on their implementation. Large organizations possess the potential for developing an effective and well-structured internal control system. On the contrary, Small and Medium Enterprises face numerous problems in developing internal control systems. According to empirical research, SMEs possess limited resources in terms of finance, human resources, centralized management, and high levels of ownership.

Research studies conducted in developing economies show that internal control procedures in SMEs are often ad hoc and discretionary (Setyawan et al., 2021). Although many SMEs have written policies or Standard Operating Procedures, their implementation is often constrained by cost considerations, a lack of qualified personnel, and an emphasis on results rather than effective governance (Pramana et al., 2025). As a result, internal control procedures in SMEs are often more of an administrative guideline than a controlled procedure.

In the context of auditing, the effectiveness of an entity’s internal control system is an important consideration in determining the risk of audit. The International Standard on Auditing (ISA) 315 states that auditors must obtain an understanding of the entity and its internal control system in order to assess risks of material misstatement at the financial statement level and the assertion level (IAASB, 2022). When internal controls are well-designed and well-operated, auditors can rely on control testing and reduce substantive procedures. When internal controls are weak or poorly operated, auditors must perform substantive testing and exercise greater professional skepticism.

Some research papers have highlighted the importance of the point that the lack of monitoring and authorization controls has been one of the most frequently identified issues in SMEs (Asmira & Sulkiah, 2025). Insufficient segregation of duties, lack of documentation, and improper reconciliation procedures have also been identified as control deficiencies. These control deficiencies not only lead to an increased risk of errors and fraud but also make it difficult for management to detect and correct misstatements in a timely manner.

Regarding the context of Bangladesh, it has been found from the literature that SMEs in Bangladesh use manual accounting and control systems (World Bank, 2023). Although various guidelines and regulations have emphasized the importance of internal control systems, there is a large gap between control policies and practices. The gap between control policies and practices has also been identified as an important issue, especially in audit engagements of owner-managed SMEs.

In spite of the significant amount of literature on internal control systems, audit-based research on internal control practices in SMEs from a practitioner's point of view is still relatively few, and most of them are from a Bangladeshi perspective. In most of the literature on internal control practices in SMEs, survey data and perception data have been used, which may not be as reliable as audit data.

This study aims to contribute to the literature on internal control practices in SMEs from an audit point of view and provide relevant implications for auditors and management of SMEs based on actual audit observations and working papers.

3.5 Research Methodology

3.5.1 Research Design

This study employs a descriptive qualitative research design to explore the practice of internal control in SMEs from an audit practitioner's point of view (Setyawan et al., 2021). A qualitative research design is deemed appropriate for this study as the aim is to explore and gain an understanding of the nature and practice of internal control systems as witnessed during audit engagements rather than seeking to measure and test hypotheses statistically.

The descriptive research design is appropriate as it provides an avenue for an in-depth analysis of control practices and deficiencies as witnessed in practice.

3.5.2 Sources of Data

Both primary and secondary data sources were utilized in conducting the study.

Primary Data: The primary data collection methods employed were direct participation in audit work during the internship period. The direct participation included observing clients' internal control procedures, reviewing audit working papers, studying the internal control policy manuals, walkthroughs, and direct interaction with audit seniors and managers during the course of the audit work. The above data collection methods provided firsthand knowledge of how internal control policies are implemented in the field, especially in the SME industry.

Secondary Data: The secondary data collection methods employed included various sources of data that were used to enrich and validate the primary data collection methods. The sources of data included auditing standards such as COSO's Internal Control Framework, various journal publications, auditing regulations, and clients' internal control policies and Standard Operating Procedures of the selected SME clients.

3.5.3 Sample Size and Scope

The study is based on audit observations from five different Small and Medium Enterprise (SME) client organizations that were audited during the internship. For conducting the study, a purposive sampling technique has been used, where the sampling of organizations has been done based on the availability of documented internal control policies in place.

The five SMEs chosen for the study belong to different business industries, such as trading, manufacturing, and service-oriented businesses. This has provided an opportunity to study different aspects of internal control systems in different operating environments, keeping in view the consistency of audit approach and regulatory requirements.

The study is based on the internal control practices of these organizations in terms of financial reporting and operational control, such as authorization, documentation, segregation of duties, reconciliation, and monitoring. Due to ethical requirements of maintaining confidentiality of client information, the names of the organizations have been kept secret, using reference codes instead.

SL No.	Sample Code	Business Sector	Nature of Business Operations	Type of Audit Engagement	Availability of Documented SOPs
1	SME–A	Service	Hospitality	Policy Compliance Audit	Fully Documented
2	SME–B	Trading/ Retail Sector	Supermarket	Statutory Audit	Fully Documented
3	SME–C	Construction	Construction	Statutory Audit	Partially Documented
4	SME–D	Manufacturing	Manufacturing	Monthly Advisory	Fully Documented
5	SME–E	Trading	Import & Distribution	Purchase Audit	Partially Documented

Table 3.1: Profile of Sampled SME Audit Clients

Source: Audit working papers, internal control documentation, and field observations during the internship period

The consideration of SMEs with different levels of internal control documentation enabled the research to not only determine the existence of control policies but also the level of implementation and enforcement. However, the results should not be generalized for all SMEs, as the research stresses the level of audit observation rather than statistical significance.

3.5.4 Data Analysis Technique

The analysis of the data was performed using qualitative content analysis of the observations and working papers (IAASB, 2022). The internal control practices and weaknesses identified were grouped according to major control areas such as authorization processes, documentation processes, segregation of duties, reconciliation processes, and monitoring processes. The trends and recurring weaknesses in the selected SMEs were then analyzed to determine the level of compliance and consistency of control implementation.

The analysis aimed at determining trends rather than organizational performance. This allowed the research to point out the systemic internal control problems that are commonly observed during SME audit engagements.

3.5.5 Ethical Considerations

The ethical issues have been accorded due significance in this study. The information gathered from the audit engagements has been used only for academic purposes and in strict compliance with the rules of confidentiality. No names of clients, financial information, or any other confidential data have been revealed in this study. The research has been carried out strictly in compliance with the ethical principles of academic research as well as audit practice.

3.6 Findings

3.6.1 Overview of Internal Control Practices in SMEs

Audit observations revealed that all the selected SMEs had existing internal control policies or Standard Operating Procedures in place. Although these documents provided basic details of authorization limits, documentation requirements, and financial procedures, the practical implementation of these documents was lacking in most of these organizations.

In most of these SMEs, internal controls were present in theory in the form of documentation, but the enforcement of these controls was lacking. Centralization of control responsibilities was also present in most of these organizations, i.e., owners or senior management were responsible for these controls. This is in line with existing literature that points out difficulties faced by SMEs in implementing control structures in practical operational environments.

3.6.2 Internal Control Policy Presence and Compliance Matrix

All five SMEs had written SOPs for the essential business processes. To evaluate their effectiveness, the presence/policy compliance matrix was created. This was done after the walkthrough audit.

Internal Control Area	**SME 1**	**SME2**	**SME 3**	**SME 4**	**SME 5**
Written SOP Compliance	1	1	3	1	4
Authorization Procedures	1	1	3	2	5
Documentation & Recordkeeping	4	2	2	2	5
Bank Reconciliation Practices	1	1	4	2	5
Cash Handling Controls	1	3	4	2	5
Segregation of Duties	4	2	4	4	1
Management Review & Supervision	1	2	3	3	2
Monitoring & Follow-up Controls	1	1	2	1	3

Score	**Interpretation**
1	Policy exists but is not implemented
2	Very weak compliance
3	Partial compliance
4	Mostly compliant with minor gaps

5	Fully compliant and consistently followed

3.6.3 Interpretation of Findings

The findings of the study revealed that, while all the chosen SMEs had internal control policies or Standard Operating Procedures (SOPs) in place, the effectiveness of the implementation of such controls was inconsistent in the chosen organizations. Internal controls in most of the organizations were more in form than in function.

Notably, there was a centralization trend in terms of control responsibilities, as seen in the management structures of many SMEs. Most owners and managers had central control over authorization, supervision, and review activities. Although central control structures guarantee effective control, in reality, control execution was entirely informal. According to the COSO Internal Control Framework, the effectiveness of internal controls in an enterprise is not just determined by good design but also by consistent operation and monitoring at all levels (COSO, 2013).

Additionally, the lack of any effective monitoring mechanisms within the organizations still diminishes the ability of management to check deviations from preset processes. Meanwhile, internal control weaknesses often went unadjusted until they were discovered during audit engagements. This is in line with the past studies on SMEs in developing countries, where internal control systems are often set up simply to please regulatory requirements, rather than as an active tool of governance.

3.6.4 Common Internal Control Weaknesses Identified

From the analysis of the audit observations carried out in the chosen SMEs, the following were some of the common internal control weaknesses that were identified:

1. **Authorization Controls-** Authorization controls were generally informal and highly dependent on the owner's discretion. Although authorization limits are documented in SOPs, the authorization itself is likely to have been granted verbally without much documentary evidence. This is a weakness in audit trails and increases the risk of unauthorized and/or improper transactions. ISA 315 also recognizes that poor authorization controls have a major impact on control risk and reduce reliance on internal controls by the auditor (IAASB, 2022).

2. **Segregation of Duties**- segregation of duty was identified as one of the significant weaknesses, primarily due to the small number of personnel involved, which led to incompatible responsibilities such as authorization, recording, and asset holding being handled by the same person. According to previous research, indeed, SMEs are characterized by inherent limitations that render the proper segregation of duties impossible, thereby increasing the chances for a material error (Pramana et al., 2025).
3. **Documentation and Record-** The documentation approaches of the SMEs were found to vary greatly. In some cases, documentation was incomplete, disorganized, or poorly maintained. Such an approach to documentation makes traceability difficult, which is important in auditing. As per COSO (2013), documentation is the fundamental element of strong internal controls as well as financial reporting.
4. **Reconciliation Procedures-** The practice of regular bank reconciliations and reviews was generally absent in SMEs. In some cases, reconciliations were merely done during audit periods, thus ignoring their main objective of being done on a regular basis. This creates opportunities for fraudulent activities, thus highlighting gaps in monitoring controls.

3.6.5 Implications for Audit Risk and Audit Planning

These identified internal control issues would cover the areas of direct identification about audit risk and planning. First, the issues in authorization, improper segregation of duties, and documentation all constitute high control risk. There would then be an emphasis on decreased reliance on internal controls and the extension of substantive tests.

In the case of ISA 315, where the controls are not effectively designed or operating, the changes made include an increase in sample sizes, further substantive tests, and increased skepticism. In that way, therefore, increased testing of transactions is what happens in the audited engagements, meaning there is an effect on the efficiency and cost of the audit.

This, in fact, creates a vicious circle where SMEs are forced to realize that if they do not make proper investment in internal controls, they are bound to suffer from increased audit risk, which may lead to an increase in audit costs and effort. This, once again, emphasizes the importance of investing properly in internal controls that are cost-efficient to support audits.

3.6.6 Cross-Comparative Analysis of SME Control Practices

A comparison of the internal control practices in the sampled SMEs reveals that generally, organizations where SOPs were fully documented complied with controls at a higher level compared to organizations where controls were partially documented. However, documentation was not solely enough for effective implementation.

Sectoral differences were also seen. Service-based SMEs showed relatively better documentation, while trading and construction-related SMEs were weaker in terms of authorization and reconciliation procedures. However, all SMEs still revealed that the most serious weakness lies in monitoring controls. Monitoring, therefore, is of primary importance in any internal control improvement. This also supports the COSO framework, wherein continuous monitoring is considered integral to internal control effectiveness.

3.6.7 Synthesis of findings with prior literature

The findings from this study support the literature that indicates that implementation failure, and not the absence of policies, presents the internal control challenge for SMEs. Past literature has indicated that SMEs, for the purpose of satisfying external regulations and audit demands, often develop and utilize internal control policies that they later fail to implement. (Setyawan et al., 2021).

The study can be considered a significant contribution to the existing literature, as this paper offers audit-based evidence regarding the monitoring component as the underlying cause of weaknesses in other control component parts. Furthermore, the paper offers implications indicating the positive impacts of improving underlying governance practices, such as documented approvals and management reviews, on the strength of internal controls without substantial financial costs to SMEs.

3.7 Discussion and Recommendations

3.7.1 Discussion

The findings of this study are a clear manifestation of what has been discussed in the literature regarding the application of internal control systems within SMEs, particularly within developing economies. Although there is an understanding of the concepts of internal control, there is a lack of effective application of the same. For instance, the study has demonstrated that weaknesses in monitoring have a direct impact on other aspects of internal control. Although there is an established authorization process, the lack of monitoring of the same has a negative impact on the overall effectiveness of the control environment. This is a clear manifestation of what has been discussed in the literature regarding the impact of monitoring on the effectiveness of the internal control environment.

3.7.2 Recommendations

Based on the results of the study, the following recommendations are made to improve the practices of internal control in SMEs:

Strengthen Monitoring Mechanisms- SMEs should adopt monitoring mechanisms on a regular basis, such as management reviews. The adoption of even simple monitoring mechanisms can improve the effectiveness of internal control.

Formalize Authorization Procedures- SMEs should adopt well-defined authorization limits and strictly adhere to them. The management should ensure that there are proper justifications for any exceptions to the authorization procedures.

Improve Documentation and Record-Keeping- SMEs should maintain proper documentation for all financial transactions. Documentation of financial transactions can improve transparency and verification of audit trails.

Implement Compensating Controls- In cases where segregation of duties is not possible due to a lack of staff, compensating controls should be implemented to reduce control risks.

Enhance Internal Control Awareness- SME management and accounting staff should be provided with a basic understanding of internal control concepts and their significance in financial reporting and management.

3.7.3 Limitations of the Study

The study has some limitations. Firstly, the results are derived from a small number of SME audit engagements and cannot be generalized for all SMEs. Secondly, the study is based on qualitative observations of the audit process and not on quantitative data regarding the effectiveness of controls. Moreover, the confidentiality requirement limited the presentation of specific information related to the clients.

3.7.4 Scope for Future Research

Future studies can be developed on the basis of the current study by considering a larger sample size or by using a mixed-methods approach that combines both qualitative and quantitative analysis. Future studies can also focus on industry-specific issues in internal controls or assess the effect of enhanced internal control procedures on financial performance and audit efficiency.

3.8 Conclusion

The aim of this research is to explore internal control systems in Small and Medium Enterprises (SMEs) from an audit practitioner's viewpoint using information collected from audit experiences carried out as part of an internship program. The overall aim of this research is to evaluate how far Small and Medium Enterprises are adhering to their internal control policies as documented, and identify areas where internal controls are frequently inadequate and impact audit risk assessment and audit planning.

The research findings showed that while most Small and Medium Enterprises have documented internal control policies or Standard Operating Procedures in place, their overall efficacy is hindered by inconsistent application and inadequate monitoring procedures. Out of the five components of internal control systems, monitoring was found to be the most significant challenge for selected Small and Medium Enterprises.

From the auditing point of view, these factors increase the control risk and reduce the extent of reliance on internal control systems. Hence, the auditing process becomes much more focused on substantive auditing. This research is in line with the requirements of the ISA 315 and the literature on the internal control problems faced by SMEs in the context of the developing economies of the world.

From the above discussion, it is evident that the main problem faced by SMEs in the context of internal control systems is not the lack of internal policies but the lack of proper enforcement and supervision of the internal control systems. This will not only improve the quality of the financial statements and the auditing process but also enhance the quality of governance practices in SMEs.

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