

## **Internal Controls and Problems in Governmental Segment: Evidence from Iran**

**Saeid Abdi<sup>1</sup>, Mohsen Zareei<sup>2</sup>, Ali Bayat<sup>3</sup>**

<sup>1,2</sup>Department of Accounting, Fouman and Shaft branch, Islamic Azad University, Fouman, Iran.

<sup>3</sup>Department of Accounting, Zanjan branch, Islamic Azad University, Zanjan, Iran.

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### **ABSTRACT**

In order to gain assurance of achieving the anticipating aims, successful accomplishment of activities in all areas, preventing any embezzlement, fraud, or misuse of resources and assets, and also fulfill the responsibilities of accountability for activities carried out, managers of state and private sectors design and implement the internal control systems. Regarding to the high volume use of the public resources in state sectors and the government's responsibilities in utilizing and conservation of such resources and its accountability, designing and implementation of internal control systems in state sector proves significant. Current paper is one applied kind researches, and has been carried out as a case study in state organizations of Zanjan province. The purpose of the research is not to apply the limitation theory in state organizations, but to discuss topics related to that and get acquaintance with significance of identifying the limitation and barriers of a system, and implements the limitation theory though in the system as the following step. Methodology, from the point of nature and content, is of descriptive and conductive type. Findings suggest that effective practical training of the financial staff, internal control regularities, and expert labor force prove as the trial conditions to accomplish the internal control effectively.

**KEYWORDS:** internal financial controls, internal operational controls, financial supervision, operational monitoring, limitation theory.

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### **1. INTRODUCTION**

The most of organization face with different constraints in achieving to the objectives. Based on the constraints theory, each organization has at least one constraint in the operational processes which prevent it from operating. If the organization does not face any constraint, they could achieve whatever they want. Constraints theory considers the product and service system as a chain of continuous processes. This process is reinforced if each component of chain is reinforced. In other word, if the organization is considered as the general system, the different parts of organization are considered as the subset for this general system. Theory of constraints Introduced by Goldratt and Fox. The objective was application of the scientific methods in solving the management problem. Based on them, constraint refers to the every factor to avoid the organization achieving the objectives. Goldratt extended the 5-stage management process along with the management of constraints and continuous improvement. It is shown in the perspective1. this process has been applied in elevating the throughput and Decreasing the inventory and operation expense. The objective of this research is not application of theory of constraints in the government organization but it has familiarity with the importance of identifying the constraints and problems in the system and then application of constraint theory in this system. During the last 15 years, a movement to apply the constraint theory is raised in different organizations. The principle of constraint theory can be effective in change within the service organization. Mobin and Gliberon suggest that the constraint theory principles should be performed by the whole organization. Now, many studies are conducted in the application area of constraint theory in the service organization. In the most service units, Goldratt's 5-stage is applied and there are improvement in the time of service delivery, flow of information and reengineering of the administrative process. In Iran, there is not yet any study on the application of constraints theory within the government organization. Five stages in constraints theory

1. Identify the constraints of system
2. Decide how to maximize the benefits with respect to the current constraints
3. Apply the existing capacities to remove the constraints in the next stages
4. Upgrade the constraints of the system i.e. to decrease the effects of current constraints or demand level or increase the capacities and having knowledge about constraints and effects on the performance of other stages

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**\*Corresponding Author:** Saeid Abdi, Department of Accounting, Fouman and Shaft branch, Islamic Azad University, Fouman, Iran. +989123416851 Abdi\_Saeed2010@yahoo.com

5. If the constraints are removed in the previous stage, return to the first but don't allow stopping the solving problem process in the system. Well-defined planning help the management to achieve the goals identify the opportunities and minimize the negative effects of the inevitable events.

The success of an organization depends on the accurate planning and performance. In contrast, often failure in planning results in the financial problems and staying away from objectives. Instead, a good planning is one which has desired performance. Then design and performance of the internal controls are necessary to ascertain the optimal performance in planning by the workers. The importance of internal controls is clear as a significant tool in the accounting from the professionals' point of view and it is emphasized during the analysis of its performance in the executive agencies. Based on the legal obligations and audit standards, the auditors should have enough knowledge about the internal control structures for planning and to determine the desired time of test. In addition, the auditors should document the knowledge from the accounting system and internal controls in the audit worksheets. Finally after that, the auditor should inform at first the management about the weaknesses and strengths in design or performance of accounting systems and internal controls. One of the main responsibilities of the accountant and financial management within the executive agencies is financial supervision. It needs some mechanisms to insure the accurate performance of financial regulation in the executive agencies and to avoid the abuse, embezzlement and other corruption. Desired performance of internal controls could, in addition to above objectives, assure the top and middle management about the effective use of government financial resource. The internal controls have the key role in the financial system in terms of the wide credits and government resource and supervision on its application. With desired performance of the internal controls, we could assure the survival of expenses and capital affairs in the long term period and avoid the personal interests of executive managements. An internal control system should be organized based on the qualities principles as the organization, self-control, continuity, inclusiveness, independence, informative, coordination and quality of employees. Then, the internal control is a continuous process in which management and employees are involved in the whole levels and the objective is to achieve the predetermined goals. An effective control system should be able to prevent the problem before emerging its unfavorable effect or to decrease the loss from it. For this paper based on the interview with the experts, study of the regulation and directives of competent authorities, it seems that the performance of internal control in the executive agencies does not occur optimally. In this paper, we seek to identify the barriers and provide the required recommendations.

## 1. LITERATURE REVIEW

In the recent years, some researchers are conducted in this area as follows. Jafar Babakhani in a research (2001) as ((accountability and internal controls in the public sector)) mention that the non-commercial actions called non-profit activities considered as the main government affairs and the public organizations in addition to some general similarity have a significant difference in the content of the objectives and the components of internal control. He said that the objectives and internal control structures within the large public organization are influenced by the properties of non-profit activities and a concept called public accountability. the objective and internal control structure of large public organization, in particular government have some interactions with the accountability .with elevating the national and operational accountability level, the concepts and objectives and internal control components are balanced according with. some of the internal control component such as information and information and communication and control method have more significant difference in the non-profit activities and large public organization than commercial ones and in some cases, such as control and evaluation of risk and supervision, these difference are not meaningful. Now, despite of the prediction of accountability principles in the constitution of Islamic republic of Iran, the normal laws and regulation are not developed and there are not necessary conditions for real time accountability of selected authorities. For solving this problem, the following should be considered:

1. review the rules governing on the operational and financial supervision based on the comparative studies and using the experiences of developed countries and considering the special characteristics of Iran
2. enact the appropriate laws and require the executive authorities to financial and operational accountability and disseminate the reports related with the financial and operational accountability for availability to provide the citizen rights
3. design and performance of accounting system, financial reporting and methods of appropriate control and operational accountability
4. Design the innovative methods of control and supervision with emphasis on the system and control shifts from data to output, provide the results and remove the unnecessary controls.mr. Hassan Reghane (1386) refers to the necessity of review in control and internal audit of bank system which the recent change in

bank system with emphasis on the globalization, increase the need for cautious supervision to keep the confidence and stability.

Given to the impending privatization of government banks, it is required that the internal control system framework and the performance of internal audit is reviewed and the given requirements should be considered by the Basel committee in bank supervision. Paragraph 2 in the art 4 within the constitution as ((preparation of domestic firm before transfer for intelligent exposure to global trade rules in a gradual and targeted process)) emphasize the review within the internal controls framework and performance of government bank's internal audit. then, the bank's internal control system should be based on some necessary components such that they are necessary for ensuring the compliance with laws and regulations achieving to the long term profitability, providing the financial and management reports, reducing the risk of unforeseen loses or undermining the bank's reputation. Also to ensure the final work of internal auditors, it should be an effective cooperation and coordination between the supervisor, internal and independent auditor in the certain principle framework. Fadzilharon and Jantan consider the effects of internal audit on the reinforcement of internal controls. They stress that the management of internal audits, internal auditor's abilities and fairness have significant effects on the internal control system's ability in monitoring and influence some stages in auditing performed by evaluating the internal control system. This it lead to changes in risk from the auditing. finally, they note that the auditor's report is heavily affected by the variety of internal control action and also the internal audit .although the changes in the internal audit area is gradually occurs in the last century, development and application of internal audit and the effects of internal audit on the improving the internal control has increased.

## **2. Internal controls in Iranian public sectors**

Internal controls include the methods and policies to provide the relative reliability from achieving the organization objectives. Relative reliability means that there are not any ideal controls and expenses should not be beyond of the expected benefits. The definition in the government area is as follows. Internal controls are the rules and regulation, policy and method with components which have been provided with the supervision responsibility to ensure reasonable reliability with respect to achieving the predetermined objectives within the agencies. Operational objectives are for optimal use of organization's recourse and achieving the mid- and long-term objectives.

1. Encourage the employees to comply with the procedures, directives and to evaluate the compliance
2. Evaluate the performance

To perform optimally the internal control system in the public sector, we should motivate the employees and improve their capabilities. For this, it seems necessary to provide the inclusive directives and instructions by the relevant authorities and to hold the educational classes. On one hand, given to the importance of analyzing the employee's performance in promoting the financial and operational actions within the efficiency of internal control system. Some mechanisms should be designed and performed for evaluating their actions until their weaknesses are identified and theirs strengths are promoted which include: first, maintain the assets against the abuse, failure and fraud. Second, Increase the accuracy and reliability of accounting documents. Indeed, Given that the cash and non-cash assets have the key role in achieving the pre-determined goals, then they should be kept safely to prevent the abuse, embezzlement .the financial information related with the capital assets should be enclosed accurately. In other word, government should be accountable to the applied national recourse. They do this by the financial reports from the government accounting system. Based on the content of art95 and 103 of general public accounting law, ministry of economy and finance develop the statement of annual performance of country's budget as the important government financial reports. The information from the financial reports is reliable if it is provided based on the reliable monetary documents. The appropriate performance of internal controls may reinforce the reliability of the accounting documents and payable or receivable statements. In addition, internal control system may insert the information in the statements based on the accounting standards and the following qualities properties:

- Control accountability it is assumed that desired control system should allow analyzing the accuracy of information
- Inclusiveness sometimes the accuracy of information is not enough i.e. when the information is not complete .for this reason the internal control system should consider the whole component during the processing period.
- Relatedness the information should be always, related with the give objective.
- Profitability to provide the information is not only enough, sometimes the information is not given timely For this reason the internal control should avoid these situations and provide the information timely.

### **3.1. Kind of supervision and supervision:**

In the democratic countries, the government requires to provide the financial and operational accountability instead for protection of the public resources and its application along with the pre-determined objectives to perform the financial accountability involve applying a financial supervision system and operational accountability require applying an operational supervision system based on the accountability. In Iran, legislator assigns some legal duties along with the financial and operational supervision for the government which we should refer to art 90 and 91 of general public accounting law

### **3.2. Operational supervision:**

Government's operational supervision on performing the activities and plans which their expense credits in state budget is about evaluation and results with the objectives and policies provided in the state budget and a compare of activity progression with some schedules. Although the operational supervision is performed by the government, the operational supervision in Iran yet has not any success. Operational supervision is a prerequisite in achieving to accountability and performance and design of appropriate control method and procedures has a significant effect on achieving to the operational accountability. 53 year's operational supervision of government from 1327 up to now indicate that management and planning department has not enough success in achieving to this level and the authorities agencies avoid accepting this kind of supervision. As a result some design and projects which are more quantitatively and qualitatively super visible than other activities, the authorities may not be accountable for.

### **3.3. Financial supervision:**

Within the government audit, evaluation of internal control system and financial supervision is performed by the ministry of economy and finance, auditors of general public accounting department and general state inspector organization. Evaluation of internal controls and supervision on the expenses of departments, government organizations is performed by the ministry of economy and finance. The objective in this supervision is ensuring about not elevating the expenses beyond the given credits. Accountants also should perform the following:

1. To supervise on the financial and accounting affairs and account regulation according to the related instructions and their accuracy.
2. To supervise on keeping the financial documents.
3. To maintain and deliver or changes in funds, deposit and bonds.
4. To maintain the government asset franchise and to supervise on them.

Based on the law, the authorities of agencies and employees should coordinate with the accountants which are 105 refer to? In addition to financial supervision, judicial supervision, a kind of financial supervision, is performed by the public accounting organization. Based on the art 55 of constitution, auditors should audit the whole accounts for department, organizations, government firm or other institutions using the general budget. in achieving the art 50, general public accounting gather the necessary accounts and document based on the law and deliver the annual budget settlement report To the assembly this report should be available in public.

### **3.4. Internal controls in computer systems:**

Auditors duty in the computer systems is like the manual systems in which to convince the auditor that the statements indicate the information processing and interpretation is according to the wide accepted accounting principles .to deliver the unfavorable function to the computer does not result in weakness in the internal controls however, it seems necessary to provide the offset controls for preventing the humans intervention .computer systems somehow increase the reliability of financial reports but some computer processing errors by the employees may not be identified ,due to the few number of processing agents .then , hardware accuracy of a computer does not ensure the reliability of output .

## **4. RESEARCH METHOD**

The proficient and expert human resource is one of the most important resources in an organization. Nowadays, most of the developed and industrial countries, consider as the most important asset .these countries require the management to improve the efficiency of decision-making associated with human resource by using the management theory .with improving the empowerment and efficiency , the motivation to archive the organization objective is increased. Base on the studies conducted, it seems that there are not enough proficient and expert human resource in the agencies and it is necessary that the organization apply the proficient human resource for performance of Internal controls 5-lach of enough fundamentals. To perform optimally the internal Control we need

some basics such as employment of expert provision of necessary equipments, cooperation, and motivation in the employees to n achieving the object. To achieving these research procedures we sent some questionnaire to sample members that surmised at table 1.

Table1. distribute of the questionnaire		
Organizational position	distributed	returned
Accountant/assistant accountant	31	21
Auditor	38	24
Financial expert	42	33
Chief financial officer	14	8
total	125	86

Data gathering tool is questionnaire which includes 30 questions and for each question it is considered 5 items in terms of severity of impact i.e. based on the Distance scale or relative scale. In this research, it is used from Likert spectrum for measuring data. Given error is %5 and confidence level is %95 and the examiner measure in the research is statistic by using the t-test.

## 5. Research Findings and Test of hypothesis

### 5.1. Test of Hypothesis1

**H1= efficient and applied training of the financial employees hold to optimally perform internal controls.**

Table2. Result of hypothesis1 Analysis						
Number of question	Confidence interval 95 percent		average	Significance level	t	result
	maximum	minimum				
5	-3/302	-5/150	10/76	0.000	-9/206	Accepted H0

Given to the chart 2, it is recognized that average question sets in this hypothesis equals with 10/76 of 25 with indicate that there is a significant variation of desired level and to test confirm this with respect to the obtained statistics. In the hypothesis .Then it concludes that the efficient and applied optimally perform the internal controls. These findings summarized at Table2.

### 5.2. Test of Hypothesis2

**H2= the related regulation of internal controls within the executive agencies is not clear and transparent.**

Table3. Result of hypothesis2 Analysis						
Number of question	Confidence interval 95 percent		average	Significance level	t	result
	maximum	minimum				
5	-1/943	-3/515	12/27	0.000	-6/908	Accepted H0

Given to the chart 3, it is recognized that average question sets in this hypothesis equals with 12/27 of 25 and t-test confirm this with respect to the statistic from H. Then it concludes that the related regulation of internal controls within the executive agencies is not clear and transparent. These findings summarized at Table3.

### 5.3. Test of Hypothesis3

**H3= the efficient human recourse within the executive agencies exist to optimally perform the internal controls.**

Table4. Result of hypothesis3 Analysis						
Number of question	Confidence interval 95 percent		average	Significance level	t	result
	maximum	minimum				
5	-1/609	-3/049	12/67	0.000	-6/431	Accepted H0

It is clear that the average question sets of this hypothesis equal with 12/67 of 25 and t-test confirm this with respect to the statistics from the hypothesis. Then it concludes that there is an efficient human resource within the executive agencies does not exist to optimally perform the internal controls. These findings summarized at Table4.

#### 5.4. Test of Hypothesis4

**H4 = the executive agencies underlie to perform the internal controls.**

**Table5. Result of hypothesis4 Analysis**

Number of question	Confidence interval 95 percent		average	Significance level	t	result
	maximum	minimum				
5	-2/165	-3/646	12/09	0.000	-7/807	Accepted H0

It is recognized that average question of this hypothesis equals with 12/09 of 25 and t-test confirm this with respect to the statistics from the hypothesis. Then it conclude that the executive agencies dose not underlie to perform the internal controls. These findings summarized at Table5.

#### 5.5. Test of Hypothesis5

**H5=the existing internal control system is evaluated to improve the quality and to solve the problems by the respected authorities.**

**Table6. Result of hypothesis5 Analysis**

Number of question	Confidence interval 95 percent		average	Significance level	t	result
	maximum	minimum				
5	-2/695	-3/256	12/38	0.000	-6/908	Accepted H0

Given to the Table6 the average question of this hypothesis equals with 14/39 of 25 and t-test confirms this with respect to the statistics from the hypothesis. Then it concludes that the existing internal control system is not evaluated to improve the quality and to solve the problems by the respected authorities. These findings summarized at Table6.

#### 5.6. Test of Hypothesis6

**H6= executive agencies, employees enjoy the enough impetus to optimally perform the internal controls.**

**Table7. Result of hypothesis6 Analysis**

Number of question	Confidence interval 95 percent		average	Significance level	t	result
	maximum	minimum				
5	-2/465	-4/285	11/29	0.000	-6/908	Accepted H0

The average question of this hypothesis equals with 11/29 of 25 and t-test confirms this with respect to the statistics from the hypothesis. Then it concludes that the executive agencies, employees' dose not enjoy the enough impetus to optimally perform the internal controls.

#### 5.7. The result of Freedman ranking:

After gathering the questionnaire and completing the hypothesis test, another question arises, is there any significant difference between the examples within the research hypothesis in terms of ranking? Then, to answer the question, we conducted the Freedman ranking test for combined question of main hypothesis:

**H7= there is significant difference between the examples within the research hypothesis in terms of ranking.**

Result of Fridman Test summarized at Table8 in the below

h	
number	86
Critical point	5/356
Calculated statistics	22/17
Freedom degree	3
Significance level	000

Rank of Tested Hypothesis by Fridman Test summarized at Table9 in the below.

**Table9. Rank of Tested Hypothesis by Fridman Test**

hypothesis	Rank	average
Efficient and applied training	first	2/79
Clear regulation	second	2/66
Enough efficient human resource	third	2/56
Evaluation of existing internal control system	fourth	2/26
Employees impetus	fifth	2/16
Providing the underlying by the executive agencies	sixth	1/98

## 6. Conclusion:

We know that the Executive , cooperate with the Legislature to achieve the long and short term objectives including the budget law ,5-years economic and social development laws and 20- years perspective. The private and public managers attempt to design and perform the internal controls system , in addition to planning , to provide the relative confidence of achieving the predicted objectives , the well-defined performance of activities in the variety of fields , avoiding the embezzlement , Frond and abuse of resources and assets and accountability to the performed activities. Given that the consumed resources in the government sector is in the high volume , and the government is accountable to how to consume and maintain the resources ,then , design and performance of internal controls is significant in the government sector. Based on the constraint theory, each organization confront with the constraints and problems to achieve the objectives. The executive agencies also confront with constraint, along with achieving the economic, political social, science objectives and performing, the internal control system. In this research 6 factors are identified as constraint of internal control system within the executive agencies including lack of efficient and applied training of finical employees, within the integrated and transparent executive agencies, Not- standardized directives and instruction, related with the internal controls, lack of efficient human resources within the executive agencies, not providing the impetus with the employees. The executive agencies can find the active and efficient system by solving the above problems which it will lead to achieve the long and short terms plans with the better quality and less time.

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