

# The Theoretical Framework of the Necessity of Conducting Operational Auditing in Iran

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**Abstract**—Nowadays, efficiency, effectiveness and economy are regarded as the main objectives of managers and the secret of the continuity of an organization in competing economy. In such competing settings, it is essential that the management of an organization has not been neglected and been obliged to identify quickly the opportunities for improving the operation of organization and remove the shortcomings of their managed system in order to use the opportunities for development. Operational auditing is a useful tool for system adjustment and leading an organization toward its objectives. Operational auditing is indeed a viewpoint which identifies the causes of insufficiencies, weaknesses and deficiencies of system and plans to eliminate them. Operational auditing is useful in the effectiveness and optimization of executive managers' decisions and increasing the efficiency and economy of their performance in the future and prevents the waste and incorrect use of resources. Evidence shows that operational auditing is used at a limited level in Iran. This matter raises some questions like the following ones in the minds.

- Why do a limited number of corporations use operational auditing?
- Which factors can guarantee its full implementation?
- What obstacles are there in its implementation?

The purpose of this article is to determine executive objectives, the operation domain of operational auditing, the components of operational auditing and the executive obstacles to operational auditing in Iran.

**Keywords**—Operational Auditing, Iran

## I. INTRODUCTION

**A**FTER the industrial revolution in nineteenth century and the development of organizations and large corporations and the separation of management from ownership, the range of accounting activities also expanded and the public gradually didn't believe in the sufficiency of only financial auditing reports for the evaluation of managers' performance and requested the evaluation of managers' performance from other viewpoints. For this purpose, the provision and presentation of the reports which could inform stockholders and investors about the conditions of managing their stocks, the evaluation of performance and the assessment of the efficiency of the managers and institution's operators and eventually the future of their investments was taken into consideration and in order to meet this crucial need, operational auditing was developed to improve management performance through the examination of three elements including efficiency, effectiveness and economy. The phrase operational auditing was first used by internal auditors to describe their work with the specific intention of the development of auditing operations. Subsequently in 1972 the United States General Accounting Office (GAO) brought up the conception of operational auditing in an applied way by publishing Governmental Auditing Standards. In the late 1970s, operational auditing was brought up as an activity on a large scale [7].

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In 1980s, the scope of operational auditing expanded rapidly due to the management of limited sources, ever-increasing demand for managers' accountability and the discharge of answering responsibility (Barzelay, 1997). Also in Iran operational auditing has officially started its activity by organizing the operational auditing committee of auditing organization in 1373.

In addition, according to the article 218 of the fifth program of country development act all governmental corporations and also approved corporations in stock exchange are bound to implement operational auditing from the second year of the program and at least once until the end of the program on an occurrence and for the purpose of increasing economy, efficiency and effectiveness of the activity of corporations and increasing the credibility of financial reports through auditing organization or auditing institutions which are members of Iranian Association of Certified Accountants (IACPA).

Nevertheless, the implementation of operational auditing in Iran hasn't been developed as expected and despite the professional publicity of some auditing institutions about the ability to offer services related to operational auditing, carrying out these professional services has been actually with obstacles and difficulties. In this article, it has been tried to explore the obstacles of operational auditing in Iran, together with determining the executive objectives, operation domain and components of operational auditing.

## II. THE DEFINITION OF OPERATIONAL AUDITING

In scientific literature auditing has been defined in different ways some of which are provided below. According to the United States General Accounting Office (GAO), operational auditing is defined as the regular scrutiny of the evidence and documents of a governmental organization, an activity or a duty for the purpose of the independent evaluation of its operation.

This kind of auditing provides information for raising governmental answering responsibility and facilitating decision making by units responsible for monitoring and taking corrective measures and consists of the auditing of efficiency, effectiveness and economy. According to Institute of Internal Auditors (IIA), operational auditing is a methodical and regular process which evaluates effectiveness, efficiency and economy of an organization within the framework of management controls and reports the final results of evaluation together with providing appropriate people with practical suggestions in order to improve operations.

American Institute of Certified Public Accountants (AICPA) has defined operational auditing as the systematic examination of an organization or a specific part of it with respect to access to definite goals such as the evaluation of performance, identifying the opportunities for the improvement of operations and also providing suggestions for the improvement of operations or the necessity of conducting further measures and measures. Also Australian National Audit Office (ANAO) has defined performance auditing as the independent and systematic operation of unit or units for the purpose of judging whether the management of present operations is economical, efficient and impressive

and the internal procedures are enough for improving and monitoring these features and also identifying the ways of improving management activities. According to the approval of operational auditing committee of Iran's auditing organization, operational auditing is the regular and methodical evaluation of effectiveness, efficiency, and economy of the operations of organization and the final report of results together with practical suggestions to appropriate people in order to improve operations.

### III. THE MAIN COMPONENTS OF OPERATIONAL AUDITING

Operational auditing consists of three elements of efficiency, effectiveness, and economy which are of great importance. Nowadays, the evaluation of efficiency, effectiveness and economy is considered as the common part of the management of every commercial unit and managers regard the survey of performances as one of their responsibilities to control activities and the evaluation of managers' performance is conducted by means of operational auditing [4].

*National Audit Office (NAO) has defined the three above mentioned elements as follows:*

*Economy:* minimizing the total cost of the required or consumption sources regarding definite quality.

*Efficiency:* the maximum return for the original amount with the minimum original amount that is possible.

*Effectiveness:* comparing the case results and the real results of projects, programs, and other activities (NokhbehFallah, 2006).

According to these definitions, efficient operation is an operation which provides maximum output (return) using minimum sources (original amount) by means of optimization methods. Economy is attempting to minimize the cost of acquisition and use resources with the preservation of proper quality. This definition emphasizes the cost of acquisition of incomes for achieving the goals of commercial unit (Pendlebury & Jones, 1992). The elements of operational auditing notes and emphasizes all dimensions of operations of economical units and improves accountability, increases profiting, makes adjustments to structures, increases financial and operational discipline, makes changes in information reporting systems, and reduces the cost of continuous improvement of the performance of economical units.

### IV. THE OBJECTIVES OF OPERATIONAL AUDITING

The three main objectives of operational auditing are as follows:

- The evaluation of performance by determining the operational goals of organization and distinguishing appropriate criterion for its testing. The evaluation of performance is the comparison of the manner of performing the organizations' activities with the compiled objectives by the management or contract party such as organizational policies, standards and quantitative objectives and other criteria of measurement.
- Identifying the opportunities for improving operations. By identifying improving operations it is meant increasing regard for economy, efficiency and

effectiveness or a combination of these factors. Operational auditing identifies the definite opportunities for improvement through the analysis, interview with individuals, the observation of operation, the survey of the current and previous reports and other appropriate instruments.

- Suggestion for improving the operation or the necessity of more surveys and measures.

The type, the nature and the range of the provided suggestions during operational auditing are very different. Most of the times, auditor can offer specific suggestions. In other cases, more surveys might be necessary. In such a case the auditor gives the reasons for the need for conducting more surveys and measures (AICPA, 1982).

### V. THE NECESSITY OF CONDUCTING OPERATIONAL AUDITING

Nowadays because of managers' need for finding a solution to survive in the competing markets, operational auditing is used as an instrument for conducting and leading institutions and corporations toward their goals; furthermore, operational auditing prevents the worsening of existing systems through surveying the state of the systems and paying close attention to them and will provide suggestions for improving and adjusting them when necessary; therefore, it can be said that one of the ways of improving effectiveness and efficiency is implementing operational auditing in organization (Drucker & Henke, 1975). Instead of emphasizing the analysis of financial deals, operational auditing lays stress on surveying the manner of designation and use of sources, in addition, operational auditing focuses on the evaluation of controls and the performance of management (Azad, 1994). On the basis of this, it can be said that the main feature of operational auditing is improving performance during the time [13].

### VI. THE ADVANTAGES OF IMPLEMENTING OPERATIONAL AUDITING

*Implementing operational auditing in an independent way would have advantages as follows:*

- The identification of indefinite objectives, policies and techniques of organization.
- The identification of the criteria for the evaluation of operations proportionate to the objectives of organization.
- The independent and impartial evaluation of operations.
- The evaluation of the degree of paying regard for objectives, policies, techniques of organization or related rules and regulations.
- The evaluation of the effectiveness of planning systems and management control (including information systems).
- The evaluation of the quality of management reports in terms of credibility and relevance.
- The identification of limitations, deficiencies, weaknesses and their causes.
- The identification of capabilities and potential opportunities for improving profitability, increasing incomes and reducing costs.
- The identification of the inadequacies of organizational structure.
- The identification of the alternative solutions.

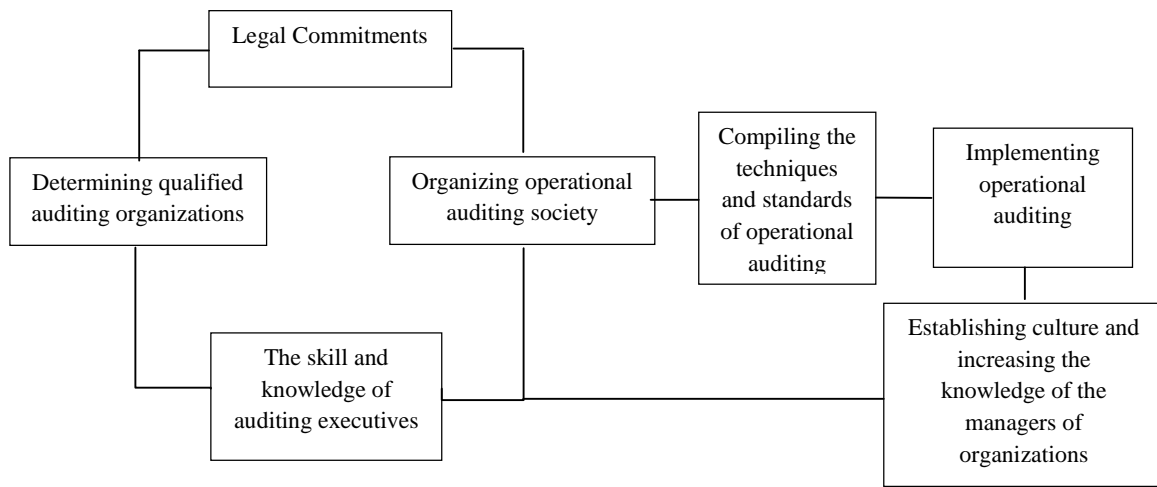


Fig. 1 the executive obstacles to operational auditing in Iran

VII. THE OPERATION DOMAIN OF OPERATIONAL AUDITING OF BENEFITS AND ADVANTAGES FOR ORGANIZATIONS AND CORPORATIONS. The existence of these profits and the related legal commitment (the article 218 of the fifth program of country development act) justifies conducting operational auditing in Iran, but surveys show that in comparison to the other developed countries, operational auditing in Iran has not actually been paid enough attention thanks to the absence of inspectors, inadequate experience and training.

Operational auditing is carried out by the people who are trained in different subjects such as management, management of production and operation, accounting, auditing, financial management, statistics and computer, so the operation domain of operational auditing is extensive but in general it might include the following:

- The evaluation of internal controls system and main and major systems.
- The survey of information management system and the procedure of decision making.
- Judging the management of human sources and profiting from personnel.
- The analysis of contracts and the techniques of preparing goods and services.
- Determining the matching degree of subjects with applied rules and principles.
- Surveying the rate of the desired use of sources especially financial sources with regard to the organizational goals and objectives and governmental policies.
- Surveying and determining the extent of the commercial unit's accomplishment of the compiled goals.
- Surveying the level of satisfaction of the customers of the focus group.
- Surveying and identifying any kind of major and basic extra costs in commercial unit and finding its sources.
- Identifying any major and basic waste of time in commercial unit and its sources.

VIII. THE EXECUTIVE OBSTACLES TO OPERATIONAL AUDITING IN IRAN

Surveys show that in comparison with leading countries on this ground, operational auditing in Iran has not grown and developed sufficiently. In spite of the professional publicity of some of the auditing institutions in Iran concerning the ability to provide services related to operational auditing, these kinds of professional services is faced with a series of executive obstacles in practice. Lack of the independent society of operational auditing, absence of the compilation of operational auditing standards, want of determining and defining the indices and criteria of evaluation, lack of professional institutes specialized in operational auditing, absence of managers' awareness about the importance and advantages of conducting auditing, and want of skill, proficiency and knowledge for conducting operational auditing in auditing institutions are among the obstacles to establish and implement operational auditing system in Iran (figure 1).

IX. CONCLUSION

Understanding the manner of performance of different parts of organization is one of the fundamental needs of an organization management in today's competing and developing settings. In such settings, organization has to enhance organizational operations continuously in order to continue its existence. Operational auditing is a useful instrument for improving the operations of organization and achieving its objectives. Feeling the need for operational auditing is a prerequisite to the establishment of operational auditing system. Regarding the above mentioned factors, it can be concluded that conducting operational auditing has a

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