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Internal Control and Accounting Policies and Procedures Practices: An Institutional Perspective

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The present studies demonstrate the importance of organizational routines and institutions in shaping the internal control and accounting policies and procedures practices in two Saudi firms operate in the real estate sector. An attempt has been made to distinguish the control environment, which represents management’s overall attitude, awareness and actions, from control policies and procedures, which are the detailed set of guidelines and procedures that management stabilities over information and transactions processing.

Key words: Internal Control, Accounting Policies and Procedures, Accounting Practices, the Institutional Economic Perspectives, Organizational routines and Institutions.

INTRODUCTION

Accounting links decision makers with economic activities and with the results of their decisions. The more important the decision is the greater the need for accurate information. Accounting information is simply the means of measuring and communicating economic events to decision makers. Organizations are expected to have certain systems, policies and procedures in place for managing and controlling business operations to reduce exposures and any negative occurrence of potential financial effect.

Exposures are inherent in the operation of any organization and may result from a variety of causes such as excessive costs, deficient revenues, and loss of assets, inaccurate accounting, business interruption, statutory sanctions, competitive disadvantage, fraud and embezzlement. Internal controls are methods and procedures used to authorize transactions and safeguard assets, encourage adherence to company policies, promote operational efficiency and ensure accurate and reliable accounting record. At a minimum, certain financial controls should be in place as part of the financial management system.

Although a large body of empirical research has been undertaken during the last five decades in the area of existing accounting policies and procedures practices of the internal control accounting system, more efforts are needed to uncover the economic, organizational and political aspects of these policies and procedures practices of the internal control. In particular, more research is needed in developing countries as the bulk of research existed to date relate to the practices in developed economies.

The Internal Control Structure and Accounting Policies and Procedures

There was a considerable agreement in the literature that the scope of internal control structure includes: (1) control environment (2) accounting information system; and (3) control policies and procedures (Felix and Niles, 1988; lea et al., 1992; Gadh et al., 1993; Felix, 1998; Kinney, 2000; O’Leary et al., 2006). The current USA auditing standards and Committee of Sponsoring Organisations (COSO) model include general statements, which suggest that the internal control structure comprises these three elements. O’Leary et al. (2006) compare these three elements of the internal control structure to the national auditing standards in USA, Australia and UK.
and conclude that they are comparatively consistent.

The scope of the internal control structure can therefore, be summarized into three main elements: the control environment, the accounting information system and control policies and procedures. The control environment covers management’s philosophy and operating style, organizational structure, assignment of authority and responsibility, internal audit, use of the information technology, human resources and audit committee. The accounting information system component includes database contents, data input-processing-output and inclusion in the financial report. The accounting control policies and procedures component includes segregation of duties, authorization procedures, adequate documentation, independent checks, physical controls and records (O’Leary et al., 2006).

Leary et al. (2006) found out that prior research has not studied the relative importance of the component elements of internal control structures or the consequential effects of one element on the other. They concluded that the control environment forms a critical component of the internal control structure and is considered to be the most important element mitigating the effect of other elements. Felix (1998) suggests that most of the research into the internal control evaluation has not assisted internal control evaluation. Rather, it appears to have assessed auditors and their behavior. Research that contributes to our understanding of the role of internal controls in either the management of the enterprise or external auditing has been sparse. Most research that has appeared in the last ten years with internal control content has been focused on auditor judgments rather than use of enterprise internal controls in management or auditing” (Felix, 1998: 8).

The audit profession views the internal control structure of an organization as ‘management’s philosophy and operating style, and all the policies and procedures adopted by management to assist in achieving the entity’s objectives’ (AUS 402.10). This view further suggests the internal control structure comprises various elements, as management’s philosophy and operating style is quite distinct from specific control policies and procedures. However, management’s philosophy and operating style is likely to influence the design and implementation of specific control policies and procedures (Felo, 2001).

This research contributes to this on-going empirical research by investigating and evaluating the existing accounting policies and procedures practices of the internal control accounting system and the way data and accounting information flow in two Saudi firms operate in the real estate sector. Specifically, the research stemmed from the fact that, firstly, the maintenance of accounting records in reasonable detail and accuracy, and the adequacy of the internal control structure, which includes the assessment of control environment, accounting system, and control procedures over revenue and expenditure cycles, is a management priority and responsibility. Secondly, the management choices of policies and procedures practices of the internal control is delineated in each organization to a system of clear roles and responsibilities and subjected to economic, organizational and political aspects of these policies. This study distinguishes the control environment, which represents management’s overall attitude, awareness and actions, from control policies and procedures, which are the detailed set of guidelines and procedures that management establishes over information and transaction processing.

The Conceptual Framework

The theoretical framework of this paper builds on the institutional perspective. The institutional perspective literature outlined three areas of institutional economic namely: old institutional economic, new institutional economic and the socialist institutional economic.

Ahmed and Scapens (2000) distinguish three broad forms of institutionalism which have impacted, to different degrees, on accounting research: new institutional economic (NIE), new institutional sociology (NIS), and old institutional economics (OIE).

OIE approach provides a useful basis for understanding the institutionalized character of organizational routines and ruled-based behavior (Hodgson, 1988; Scapens, 1994). The OIE framework emphasizes the interplay between institutions and actions in economy and society and brings into focus both the enabling and constraining qualities of institutional (Nelson and Winter, 1982; Hodgson, 1988). In this case, whilst, existing routines and institutions may constrain individual action, by establishing more or less fixed patterns of human actions. They provide information, which enables actors in a highly complex world (Scapens, 1994).

Burns and Scapens (2000) differentiate between rules and routine. The rules are formalized statement of procedures and normally changed only at discrete intervals, where as routines are the procedures actually in use and have the potential to be a cumulative process of change as they continue to be reproduced.

Internal control policies and procedures constitute organizational rules and routines, which represent the structuring properties of institutions and the day to day actions and thoughts of organizational members. In order to understand the practices of accounting control policies and procedures, the institutional character is used to explain these practices. Although such an approach may be able to explain certain practices, it may not assist our understanding of how these practices come to be used in organizations, or the nature of resistance to their use. However, the extent to which specific routines are modified may depend on other rules and routines, including control procedures.
In this study, the rules are defined as the formal accounting control policies and procedures, as they are set out in the manual procedures. While routines are the management practices actually in use. It is assumed that management practices in use may not actually replicate the system set out in the policies and procedures manual as demonstrated by Roberts and Scapens (1985).

The new institutional sociology (NIS) approach explores the process through which organizations and social agencies initiate and design structures, political and procedures in order to demonstrate conformity with institutionalized rules, value and expectations (DiMaggio, 1988; Scott, 1995; Ahmed and Scapens, 2000). NIS approach has been used to explain: (1) The role of these broader institutions in shaping organizational accounting practices (Mezias, 1990; Covaleski et al. (1993), (2) the success and survival of the firms (Ahmed and Scapens, 2000). While NIS approach explains how the institutionalized rules and values and expectations influence the firm and the design of its accounting system, it does not explore how the latter shape the institutionalized rules and values and expectations (Ahmed and Scapens, 2000).

The new institutional economics (NIE) approach focus on the analysis of market and individual rationality, and based on Williamson transaction cost approach and the two core assumptions of neoclassical economics: the rational maximizing economic agent and the general equilibrium of market forces (Scapens, 1994). While the NIE approach seeks to broaden the domain of economic analysis by examining the transactions and governance structures internal to the firm, it is used to explain the choice and use of management accounting control systems (Scapens and Arnold, 1986; Scapens, 1994; Spicer and Ballow, 1993; Colbert and Spicer, 1995).

However, NIE approach is criticized by not recognizing the impact of the broader economic, political, and social institutions, which can be important in understanding the development of accounting practices. The complex set of relationships between economic, political and social institutions is grounded in the specific context and history of the company, and this lead to limit the use of NIE model to focus on the study of accounting history and management choices within the framework of neoclassical economics approach (Ahmed and Scapens, 2000). Thus the NIS approach demonstrates the impact of external forces on the organizational norms and practices, and control and structure.

Due to the complex set of the relationship between accounting, routines and institutions, the focal point of this study is limited to OIE and NIS approaches. The NIS approach considers the external macro-focus while the OIE focus on intra-organizational behaviors. This study focuses on both approaches in order to understand: (1) the conformity with institutionalized rules and values and expectations (NIS); and the institutionalized character of organizational routines and ruled-based behavior (OIE). Subsequently, the study presents (1) the research method and data collection, (2) a description of the control environment, the accounting information system, and the control policies and procedures operating of both revenue and expenditure cycles, and (3) findings, limitations and conclusions.

**RESEARCH METHOD AND DATA COLLECTION**

Given the wide view in a very complex area, we were limited to exploring the internal control structure and practices and their relationship. Specifically, we describe the internal control structure and practices and how they have arisen and used over the previous years in both companies. Because of the complex set of the relationship between the variety of accounting and behavioral issues that relate to internal control structure, it is intended to use a case study method. One advantage of using this research method is that it provides the possibility of an in-depth investigation and analysis of the subject matter of research under consideration. In addition, to the rich description, the major strength is that it allows researchers to deal with a variety of evidence and internal checks including observation, interviews and documentation on its validity (Ryan et al., 2002).

The reasons for limiting the study to two cases are, firstly, It allows replication of comparative logic among individual cases. Secondly, it permits the development of rich description of budgeting practices in a wide range of circumstances, which takes into account the differences that exist between the two cases. Thirdly, it ensures that research topic itself is of a manageable size. Finally, it improves the chances of being accepted to the organization that we will be dealing with.

In this section, we provide an overview of the case study method and outline how the fieldwork was conducted. This is followed by a description of the two cases under consideration.

**The Case Study Method**

Its proponents see case-based research as the salvation of accounting research from an overly normative approach to accounting theory formulation (Yin, 1984; Snow and Thomas, 1994). Many accounting researchers have shown that a case-based research strategy is particularly useful when "what, how and why" questions are being asked and when the researcher's wish is to explore new ideas (Ansari and Euske, 1987; Simons, 1990; Bakar, 1991; Berry et al., 1991; Archer and Otley, 1991). One of the major strengths of the case study is that it allows rich description of issues under considerations.

Case study research appears to have a number of potential roles to play (Scapens, 1990), but the central role seems to be that of exploration (Otley and Berry, 1994). It has been argued that the case study is more correctly a method of data collection, a point made by Scapens (1990), Llewellyn (1992) and Otley and Berry (1994). Each method of data collection has its own strengths and weaknesses. The case study allows researchers to deal with a variety of evidence and internal checks on its validity; for example, interviews, observations and documentation (Campbell and Fiske, 1959; Webb et al., 1966; Gross et al., 1971; Denzin, 1978; Yin, 1981, 1984; Hoque and Hopper, 1994; Snow and Thomas, 1994). However, the integration of such differently derived data might be confusing because of the danger of using, by accident, different epistemologies and ontological assumptions, which could lead to theoretical opportunism and incoherence (Berry et al., 1991; Hoque and Hopper, 1994). In addition, as the context of each case is particular, the findings lack generalisability (Halfpenny, 1979; Huberman and Miles, 1983, Yin, 1984; Patton, 1987; Scapens, 1990; Spicers, 1992; Otley and Berry, 1994; Snow and Thomas, 1994). Despite these criticisms, there is a prima facie case for the use of a case-based research method in a wide variety of contexts with the caveat that greater clarity
concerning the initial theoretical position is needed (Scapens, 1990; Spicers, 1992; Otley and Berry, 1994). The literature on case-based research has been centered on the debate about the theoretical presuppositions of researchers. Sometimes, it was not clear whether the written case studies reflect the initial theoretical position of researchers or new positions taken up in the light of the empirical evidence available (Otley and Berry, 1994).

Some researchers (Gersick, 1989; Bettenhausen and Murnigham, 1986, Eisenhardt, 1989, 1991) switched their research focus pursuant to issues emerging during data collection. There is thus an argument that a review of theory or assumptions is an essential precursor for the case study method. "It argued that, it is incumbent upon researchers using case-based methods to be clear about their initial theoretical positions, and to interpret their results in a way, which indicates the theoretical modification the empirical observations have triggered" (Otley and Berry, 1994).

Access for Data

The data for the two case studies were collected over three-month periods. The researcher had an access to two Saudi companies operate in the real estate industry through consultation projects. Data were collected from the two companies using semi-structured questionnaires, personal interviews, written narrative, secondary data, and direct observation of group discussion and a study of archival and documentary materials.

The findings were communicated to the consulting group and participants for feedback. Personal interviews were conducted during on-site visits with the discussion group and managers at various levels of management. The time to complete an interview varied in length between ½ - 3½ h. Key personal interviews were conducted with the following key administrators and management teams in the two companies, including the managing director (CEO), the internal auditor, the chief accountant, the financial controller and accounting staff. Seven meetings were conducted during the project time. A discussion group was formed and attended by all higher management team and the consulting group. The interview techniques involved the following:

1. A semi-structured questionnaire was developed and used as a guideline during the interview to make sure that all relevant topics were covered and to help the researchers conduct the interviews in a systematic and comprehensive fashion (Berry, 1976; Otley, 1976; Patton, 1987; Murshed, 1989; Hoque, 1993).

A copy of the interview guideline was sent in advance for each company. The guideline to interview meetings served several purposes: to introduce the subject, we are interested in and the proposed method of data collection, and to stress the confidentiality of information provided the possible involvement of employees. It also emphasized the importance placed on the view of the respondents regarding their perception and attitudes towards the internal control structure and accounting policies and procedures practices, market conditions and the strategic responses of their organization.

2. Note-taking: The members of the consultant team take notes in each interview. It was found useful to take notes of selected key issues to help formulate new questions if a subject showed especial interest, to help to review the discussion when written up the manuscript text, and it makes the researcher aware of the documentary evidence deemed relevant during the interview and serve as a reminder for him to collect it.

A manuscript text was written up for each interview usually within two weeks of the day of the interview. Each manuscript text was dated, with a note where the interview took place and who was present. The texts were used together with the study of relevant documents and direct observation to formulate the empirical evidence and database for each case. In addition to the personal interview, a study of documentary materials and direct observation of the group discussion were conducted. Documents and operating statements were collected during on-site visits, including corporate plans, financial plans and budgets, progress reports, production plans and reports, internal memos, instruction for and description of internal control structure and accounting systems. There was extensive data collection of procedures manual and reports for each company.

Secondary data was collected through the consulting group and includes but not limited to organization chart, job description for key positions, user manual and accounting system documentation, which included the chart of accounts, operating and maintenance manual, forms used with the system, accounting procedures flowcharts including the Revenue and Expenditure Cycles, and the audited annual reports.

In addition, a range of documentary materials and literature relating to the real estate sector was collected. Government rules and regulations documents on the historical development and changes in the economy and international market were collected from relevant sources.

Direct observation of the group discussion during interview meeting was carried out. These firsthand observations allowed the researchers to get a close view and personal knowledge of what is happening in the company. The management at the two companies provided full support and fruitful discussion in the area under consideration. We spent a total of 9½ h of group discussion in both companies. On these meetings we were accompanied by the managing directors, divisions' coordinators and administrative areas coordinators, controllers, financial directors/managers and senior and staff accountants. Table 1 presents a summary of interviewee and interview duration. It became clear that the market pressure in both companies were similar. Tours were given at both companies to accounting divisions and departments guided by the coordinators and directors who were senior employees in the company.

A database was created for each company and was kept in separate manual files, including the manuscript text of personal interviews and the archival documentation. While the handwritten notes were kept in a separate notebook for reference purposes.

At the initial stage, a report for each company was produced and continuous discussions with each company were maintained throughout this study. Such close discussion has ensured that the focus was maintained within the framework agreed at the outset. Then a first draft for each case was submitted and discussed with the relevant managers. This was used as a confirmation process to ensure that our description regarding internal control structure and control policies and procedures practices of each company were correct. No contradictory comments were made.

To further the process of confirmation, some techniques were used to validate field data. By using several sources of data including semi-structured questionnaire, personal interview, observation and documentary analysis, data from one type of source can be checked against data from another. In some cases, cross checking of the same point was carried out with different interviewees.

THE DESCRIPTION OF THE TWO CASES

This section is devoted to describe the internal control structure, which includes the study of the existing control environment, accounting information system, and control policies and procedures over revenue and expenditure cycles within the two local companies under consideration. Firstly, a brief historical background of both the company and the business sector, followed by a detailed description of the internal control structure (control environment, the accounting information system, and the control policies and procedures).
Company History and the Business Activities

The two cases under consideration are regional family business organizations operating in the real estate industry and located in the gulf region. The two companies have been established for long time of periods as a proprietorship and then became family partnership companies owned by family members. Both companies represent a good name in the real estate industry. Recently, each company is conducting a project that aims to reorganize and restructure their business activities and the way they deliver their services in order to meet future challenges and customer expectations. In addition, they entered into franchise brokerage agreement with the international organization to support their services and develop their own portfolios and electronic platform network over the last ten years. Both companies engage in providing commercial and residential local and international real estate services, including buying, selling, leasing, marketing, management and development of real estate. Each company defines their own market segments and business lines operating in a highly competitive and innovative marketplace. They introduced various business initiatives to coop with available market opportunities. They generate their revenues from their major business lines, including the sources from Portfolio Investment, Installment Sales, Placement, and Brokerage.

A portfolio investment activity is an administrative unit responsible for the purchase and sale of raw land. Land and real estate activities include purchasing, selling, marketing and valuation of raw land and other real estate. Each company developed their own programs with owners and investors to manage financing buy and sell raw land.

The real estate placement is one of the developed programs, where the company engages in planning and development of raw land and then resells at auction to investors at higher prices. Under placement, the company is a partner in investment of at least 20 to 25% of the project and generates additional auction brokerage fees plus any additional profit and loss from sales. The company recalls unsold shares at auction and resells at installments. Another program is the real estate portfolio where the company offers its services to potential investors for predetermined fees. In addition, both companies continue their conventional business to manage real state of other owners and as a brokerage. As their main business’s activities expand in terms of products, services and geographical areas, their operations become more complex, which needs to be matched with their internal control structure in order to meet competition and market changes.

The internal control structure

In this section, the three elements of the internal control structure will be described for both companies, with a view to determining strengths and weaknesses of the revenue and expenditure cycles.

The Control Environment and the Accounting Information System

Control environment is the overall attitude of management and employees about the importance of control. The control environment covers (1) management’s philosophy and operating style, (2) the integrity, ethical values, and competence of an organization’s employees; (3) the way the management assigns authority and responsibility (organization structure), as well as organizes and develops its business; (4) the attention and direction provided by the board of directors and audit committee. Management’s philosophy about the role of internal audit, use of information technology and personnel policies and procedures of hiring, training, evaluating, compensating

Table 1. Data Collection (Interviewee and Interview Duration).

<table>
<thead>
<tr>
<th>Company name</th>
<th>No. of Meeting</th>
<th>Interviewee</th>
<th>Interview duration (hours)</th>
<th>Observation of group discussion (hours)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case studies in real estate sector</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>X</td>
<td>2 meetings and 1 group discussion</td>
<td>Managing director, chief accountant, accounting staff, Consulting group.</td>
<td>4</td>
<td>3½</td>
</tr>
<tr>
<td>Y</td>
<td>5 meetings and 2 group discussions</td>
<td>Managing director, operation coordinator, financial controller, corporate planning director, consulting group, chief accountants Accounting staff.</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Total</td>
<td>7 meetings and 3 group discussions</td>
<td></td>
<td>11</td>
<td>9½</td>
</tr>
</tbody>
</table>
and promoting of employees have great effect on the control environment. The descriptions of the control environment and the accounting information system for the two companies are as follows:

**The First Company:** The existing organization structure of this company is relatively very simple administrative functional units and central accounting services. The family members chaired the company’s main business lines, and top management emphasizes maintaining close supervision over their business activities. The company has an internal audit, which reports directly to the chief accountant in a periodic and ad-hoc basis. The company builds excellent banking relationship and network, and the company develops good knowledge of computer applications with unified and homogenous manual accounting system and reliable source of information. However, the use of computer accounting packages is limited.

It seems that the way they develop their structure is based on the existing practices rather than on the best practices available and this leads to a position where the organization structure is not well defined and updated. In addition, the description of job responsibilities for each position in the organization is not clear due to lack of formal description, especially in the accounting department where the treasurer and the controller functions combined. This of course would sometimes result into confusion in terms of assignments and duplication of efforts.

As a matter of the control environment that relates to human resources, it seems that the company hires professional employees with good background, experience planning ability and clear analysis. However, the manpower is inadequate, and the personnel policies and procedures regarding hiring process, training programs, career path, and compensation and motivation packages are not clear.

**The Second Company:** Over the past decade, the organization structure of this company grew in an organic manner, and followed a relatively very simple horizontal structure with minimum communication between the different administrative units and central accounting services. The recent growth and shift in the market have led the company to add more management layers, and put pressure on the company where senior executives strive to maintain its unique culture.

Currently, the organization is structured around three segments and four core business line activities. A member of the family chair the company’s main business lines and top management emphasize maintaining a close relationship with investors. The company has an internal auditor who is a trusted person report directly to the group general manager in a periodic and ad-hoc basis. Under the existing organization structure, the financial controller is carrying out the dual responsibly of treasurer and controllership. This may be contributed to the lack of formal description of job responsibilities for each position in the organization which led to assignments and duplication of efforts. This of course also indicates sometimes the nature of the way family business is structured.

Due to the recent engagement with the international organization and the creation of new segments and business lines, the company is restructuring the way they conduct their business activities with emphasis on maintaining the close relationships between management and inventors.

The company has an organization structure that is currently under revision. The proposed restructuring initiatives depict the administrative arrangement within the company where organization structure gives greater power to work directly with customers and suppliers with simple reporting communication network between all levels of the organization.

The company builds excellent banking relationship and network, and develops good knowledge of computer applications and environment with a unified and homogenous manual accounting system. The computer accounting packages used by the group’s entities are separate, non-integrated and not unified, and do not contain all necessary application systems with some subsidiaries and business segments using only the manual system.

It seems that the organization structure is not well defined and updated where the revisions in practice have apparently not been documented formally and reflected in the existing organization structure. This might be explained by the fact that the increasing complexity of business activities and the new restructuring will influence the internal control structure, reporting requirements and the accounting system in general and will be reflected later in their future constructs on both their business activities and the types of information needed by the management team.

The company gives a considerable attention to human resources of their organization by hiring professional well-paid employees and reasonable employment positions. However, the manpower is inadequate due to rapid market growth and shortage of qualified manpower supply. In addition, the personnel policies and procedures regarding hiring process, training programs, career path, and compensation and motivation packages are not clear.

**The Revenue and Expenditure Cycles and Accounting Policies and Procedures Practices**

In this section, the revenue and expenditure cycles will be described for both companies, with a view to determining strengths and weaknesses of the existing accounting policies and procedures practices. Two processing steps
are considered in the revenue cycle: the sales processing system and cash receipts processing system. In addition, two processing steps are considered in the expenditure cycle: the purchase processing system and cash disbursement processing system.

The Existing Sale and Collection Model

The essential purpose of the revenue cycle is to facilitate the exchange of products and services with customers for cash. The revenue cycle composes of the sales processing system and cash receipts processing system. Sales involve cash and credit sales. The control points over sales processing include receiving the sales order, checking the customer's credit, order processing and delivering, and billing the customers. The control points over cash receipts processing include the receipt of cash, the processing of the cash deposit, and the posting of cash amounts to the ledgers. This section describes the exiting accounting policies and procedures practices related to the sales processing system and cash receipts processing system for both companies.

The First Company

Company differentiates between sales of land and real estate of the company and other owners, and the services provided by the company to them. Based on the accounting manuals of the company, the sales processing system for land and real estate as a source of revenue is described as follows: the sales process (or rent) begins in sales department with a receipt of customer to the company place or through telephone call.

The company salesperson welcomes the customer and tries to define and comply with customer's specifications and record his order in a requisite lists for future follow up. Upon meeting the customer's specification, the salespersons negotiate the sale price and brokerage fees, then prepare sales order authorized by sales manager, and then send the order to ownership department. Upon receiving the sales order, the ownership department prepares the sales contract and release and sends the release document to surveying department for approving compliance with specification. Upon approval by the surveying department, the ownership department sends the three documents including sales order, sales contract and release document to the accounting department to sign the contract and release document and to make sure that the sale amount will be paid in full. Then the ownership department follows up the change of ownership legal procedures and updates its inventory accounts for records and future follow up, and then sends copies of sales contract, release documents and the check to the accounting department for record purposes.

The accounting department receives the checks and prepares check receipt voucher with two copies. One copy is kept in the department. The original and the other copy with checks are sent to the cashier. The cashier receives and signs the check receipt voucher; give the original to the payee, then prepares an original and a copy of the daily cash lists. The cashier sends the copy of the check receipt voucher and the daily cash lists to the auditing unit for verification and then send them to the accounting department for GL posting and record. In the payment day, the accountants prepare a deposit slip and a deposit lists and sends them to the cashier for deposit in the bank.

The Existing Purchasing and Payment Model

The essential purpose of the expenditure cycle is to facilitate the exchange of products and services with suppliers for cash. The expenditure cycle composes of the purchasing processing system and cash disbursements processing system. The control points over purchase processing include receiving the purchase requisition, preparing the purchase order, receiving goods/services, checking invoices. The control points over cash disbursement processing include the ascertaining the validity of the payment obligation, preparing the cash disbursement, the processing of the cash disbursement, and the posting to the ledgers. This section describes the exiting accounting policies and procedures practices related to the purchase processing system and cash disbursement processing system for both companies.

The First Company

The company differentiates between land and real estate purchasing and other inventory purchasing. Based on the manual, the inventory purchasing processing system starts with filling a purchase requisition approved and authorized by the requesting department including ware-
house manager. The requisition is sent to a costing department for balance verification and then to the purchasing department. The purchasing department asks for bidding, and tenders and prepares a purchase order for the winning supplier. The purchase order is then authorized, and copies (six copies) are sent to supplier, warehouse, receiving, requesting and accounting department.

Upon receiving goods, a committee of technical and financial persons headed by the warehouse manager and the presence of the custodian of the inventory prepares an inspection memorandum. The custodian of inventory including warehouse department prepares receiving reports with three copies. A copy of the receiving report is sent to the accounting department. The invoice is sent to warehouse, purchasing and trading managers for verification and comparison with the purchase order and then to the auditing unit for revision. The accounting department receives the invoice from the auditing unit, compares the invoice with the purchase order, inspection memorandum and the receiving reports, and prepares check (or cash) payment slip.

The land and real estate purchasing is similar to the sales procedures except it is requested that the general manager (MD) appoints a person from the sales department to evaluate and follow up. Sales, surveying, and ownership departments perform similar procedures to sales processing, prepare purchasing contract and the accounting department reviews the documents, and issues the check.

The Second Company

The company differentiates between purchasing national purchasing and international purchasing. Based on the manual, the national purchasing processing system starts with filling a purchase requisition approved and authorized. The requisition is sent to the purchasing department. The purchasing department asks for bidding, and tenders sand prepares a purchase order for winning supplier. The purchase order is then authorized and copies are sent to supplier, receiving, and accounting department.

Upon receiving goods, a committee of requesting department and purchasing department prepares receiving and inspection memorandum. The receiving department prepares receiving reports. A copy of the receiving report is sent to accounting department. The accounting department receives the invoice from the supplier, compares the invoice with purchase order, inspection memorandum and the receiving reports, and prepares check payment slip.

The foreign and international purchasing is similar to the local and national purchasing except it is requested that the purchasing department prepare a line credit and overdraft order, and the accounting department authorizes it.

Observations from the Two Cases

The control environment and the Accounting Information System

This section accentuates observations related to control environment and accounting information system for both cases. These observations take into account the overall attitude of management and employees’ philosophy and operating style. Factors included within the control environment and accounting information system are: internal audit, assignment of authority and responsibility (organizational structure), human resources, use of information technology, database contents, data input-processing-output and inclusion in the financial report.

In both cases, the management at all levels lacked awareness of the overall policies and procedures used to direct operations toward desired goals, ensure accurate financial reports, and ensure compliance with applicable laws and regulations with minimum attention and direction provided by the board of directors or group general manager. This partly may be contributed by the lack of compliance to policies and procedures due to the inadequacy in the internal audit function and inadequate manpower or because organizational support attention may be directed to only some of the problem areas.

The management’s philosophy emphasizes maintaining close supervision over their business activities and close relationship between management, suppliers and customers. This led family members to chair the company’s main business lines. The first company has a small board of directors consist of 2 to 3 family members while the second company has 5 to 6 members who consider being a moderate size.

All members of the board are heavily involved in running their businesses and their background is varied. Nevertheless, the recent engagement with a total quality philosophy put pressures on both companies to think about how they conduct their business and restructure the way they do their business activities. However, less effort was devoted to the question of where they want to be in the future and how they cope with the recent changes in a real estate market. Under the new initiatives, both companies involve in a strategic planning project through which they determine their visions, missions, objectives and goals, and then they construct their organization structure on this basis to meet competition and market changes. Of course, the new restructuring will influence the internal control structure, reporting requirements and the accounting system in general.

The two companies have an audit function unit where internal auditor reports directly to either the chief accountant or to the general manager of the company.
However, there is a lack of proper internal auditing practices were the internal auditor possibly substitutes the functions of other that may not even be appropriate for the position. This seems a bit too ambitious when considering the existing practices of the auditing unit. Even so, the private companies are not required by the law to have an internal audit unit, both companies try to establish an internal audit unit devoted to internal auditing activities including financial and operational compliance. This might be explained by the fact that they may want to meet the expectation of external institutional pressures of financial and investor sectors.

Both companies give considerable attention to the human resources factor by hiring professional well-paid employees with good background, experience planning ability and clear analysis. However, the manpower is inadequate, and the personnel policies and procedures regarding hiring process, training programs, career path, and compensation and motivation packages are not clear. This may be contributed to both the rapid market growth and the shortage of qualified manpower supply. The overwhelming volume of work, the severe shortage in the number of qualification of employees, and lack of proper training programs put pressures on the shoulders’ of their employees to meet the management expectations and carry out their functional responsibilities.

The two companies implement a manual accounting system and separate non-integrated accounting packages in certain subsidiaries. The accounting packages currently used by the group’s entities are not unified and limited to a general ledger, do not contain all necessary financial and accounting application systems and some subsidiaries are still using manual accounting systems. This, therefore, creates a need to use other time consuming tools to prepare the required reports including excel sheets.

Using the manual accounting systems is a time consuming process and increases the demand on human resources. Moreover, implementing manual accounting systems in certain subsidiaries and separate non-integrated accounting packages in other subsidiaries restrict the management ability to prepare accurate and timely consolidated financial statements at the group level. The generated financial reports by the existing accounting system are not adequate, for example, financial reports are currently limited to two financial statements (balance sheet and income statement) and do not include the cash flow statement. It seems that when they report they do not comply with presentation and disclosure requirements. This may be explained by the fact that it is quite understandable that the private company is not required by law to comply with GAAP presentation and disclosure requirements.

Nevertheless, clearly the company pursued good accounting practices to enhance their financial position, but the current accounting system focuses on the book keeping activities and generating financial statement.

Limited attention is paid for other internal financial reports, including accounting receivable and collection, payroll and compensation, assets utilization. Managerial reports are completely ignored where there is no evidence of preparation of any formal financial budgets at both subsidiaries and group levels.

Given the current situation of the market opportunities, considerable attention has been paid by the management at both companies to incorporate additional financial reports emerged due to business expansion (for example, placement) including customer and product profitability, and divisional and business unit performance evaluation.

**Accounting Policies and Procedures Practices**

This section highlights the observations related to the accounting policies and procedure, including segregation of duties, authorization procedures, adequate documentation, independent checks, physical controls and records for both companies. Segregation of duties is overlapping functions; confusion to whom they should report to. Lack of clear duties, proper training, and function overloading creates a problem of confusion.

Clearly, at both companies, there are inadequate policies and control procedures in certain areas of operations related to cash processing and order processing system. For example, it is possible that account receivable is increasing with expansion of business, while there are no clear credit policies and procedures or the billing procedures are not clear, which may hinder financial control. Billing procedures are subjected to wide variations depending on the type of sales and industry (cash, credit or installments).

Based on the manual and leaf lets, it is clearly written that (1) in the case of delay of payments by customers, follow up may be conducted by sales, accounting department or management, (2) accounting department issues and record checks while Purchases handles LCs and decides on payment terms. Obviously, formal description of job responsibilities for each position in the organization is not clear, especially in the accounting department where the treasurer and the controller functions combined. This of course would sometimes result into confusion in terms of assignments and duplication of efforts.

The existing accounting system does not have a clear written chart of accounts and coding in the accounting policies and procedures. Furthermore, it is not clear whether the existing manual match with the existing end user manual of existing computer packages. It seems that the accounting system is a bookkeeping driven system with weaknesses and inadequate policies and control procedures in certain areas of operation. Certain subsidiaries have drafted some policies and procedures but these are not yet complete and have not been formally approved to date. The absence of formally approved financial policies and procedures covering all aspects of the business creates uncertainty and in-
consistency with regards to processes, standards, responsibilities, controls and chart of accounts.

The internal control policies and procedures (the rules) of order processing for both sales and purchasing is generally reasonable. However, compliance to these procedures (the routine) is questionable. Management attention has been paid to revise the existing control policies and procedures related to sales processing in order to expand their credit sales market. Currently, sales processing starts in the sales department without any consideration to obtain verification of credit authorization from the credit department for credit sales. It could be the case that the credit sales are at a minimum. Therefore, the second company introduces a billing department because there is a limited number of internal control procedures impeded in the company practices related to sales order processing system due to the missing of a credit and billing department. This department plays an essential role in follow up and preparing the sales journal vouchers to the accounting department for GL posting.

Based in the provided accounting manuals, the purchasing processing system starts with filling a purchase requisition approved and authorized. The requisition is sent to the purchasing department. The purchasing department asks for bidding, and tenders and prepares a purchase order for winning supplier. The purchase order will be authorized, and copies will be sent to the supplier, receiving, and accounting department. Upon receiving goods, a committee of requesting department and purchasing department prepares the receiving and inspection memorandum. The receiving department prepares receiving reports. A copy of the receiving report will be sent to the accounting department for payment arrangements.

In general, the cash processing of collecting and disbursement procedures sound good in both companies. In case of collections, accounting department received checks and then sends them to cashier. The cashier prepares deposit slip and sends a copy for GL posting. The Mailroom prepares a remittance list and sends copies to cashier and accounting department. Accounting department receives remittance advice and cashier receives checks. The cashier prepares deposit slip and cash receipts listing (journal voucher), and deposits the fund in the bank and sends the listing to the accounting department. Controller reconciles receipts and verifies all documents of remittance list, journal vouchers and deposit tickets. In case of payment, the accounting department authorizes checks and then sends them to cashier. Treasurer verifies all documents before preparing check. Controller compares the amount and payee’s name on returned check with check authorization.

Conclusion and Direction for Future Research

NIS approach is used to explain how external institutions influence accounting system and their associated behavior (James, 2009; Abernethy and Chua, 1996; Bealing, 1994; Berry et al., 1985; Carpenter and Feroz, 1992; Covaleski et al., 1993; Hoque and Alam, 1999). Accounting information plays an extensive role throughout the entire organization as it searches to conform to and represents itself in some form of rationality in order to gain legitimacy to its external influences (Meyer and Rowan, 1977). NIS approach suggests that reforms would prompt organizations of an affected field to change, that is, defensive responses to changing notions of what constitutes a legitimate organizational practice (James, 2009; DiMaggio and Powell, 1991).

Recently, accounting researchers have used NIS to explain the success and survival of firms in terms of the extent to which they encapsulate social values and expectations in their organizational structures and behavior. Over the last decay, real estate sector operates in a highly competitive and innovative marketplace. The market pressure and external forces of other institutional players, including funders, professionals and investors have a dynamic impact on the adoptive nature of organizational behavior and companies within this sector find themselves immersed in a certain cultural and historical context.

As part of the management’s philosophy at both companies, it was found that management is proactive in the concerns of organizational competitiveness and endeavor to incorporate components into the design that enhance an organization’s ability to be rational, competitive, and consistent with the needs and objects of external institutions. It is clearly that the management tries to legitimize the organization and its management’s philosophy to cope with external forces.

Each company is conducting a project that aims to define their own market and to reorganize and restructure their business activities and the way they deliver their products and services in order to meet future challenges and customer expectations. The accounting information plays an extensive role throughout the entire organization as it searches for, conforms to, and presents itself in some form of rationality in order to gain legitimacy to its external influences. For example, the second company considers a strategic planning project through which they determine their visions, missions, objectives and goals, and then they construct their organization structure on these bases to meet competition and market changes. Of course, the new restructuring will influence the internal control structure, reporting requirements and the accounting system in general.

Management at both companies considers cash processing of collection and disbursement procedures critical to maintaining the excellent banking relationship. Even so, the chief accounting officer carries out the dual’s responsibilities of treasurer and controllership. Cash processing procedures and documentation flow is quite good and reasonable and both companies develop a
sound and reasonable control over cash inflows and outflows. It seems that because of the overwhelming volume of work under the severe shortage in number and qualification of employee, the accounting department is just performing the daily operations, and to some extent, the main financial operations. However, management responsible to make sure that the accounting system and control procedures over cash processing are functioning and consistent with banking requirements that play the essential part in their businesses.

The observations and evidence from the two cases show that: (1) the process of institutionalization involves the creation of new structures, processes and roles that later become routines, formalized and embedded in the organizational constitution; (2) the accounting information plays an extensive role throughout the entire organization as it searches for, conforms to, and presents itself in some form of rationality in order to gain legitimacy to its external influences, and (3) the NIS approach explains how external institutions influence accounting systems and their associated behavior (Norhayati and Siti-Nabila, 2009; James, 2009; Hoque and Alam, 1999; Abernethy and Chua, 1996; Bealing, 1994; Berry et al., 1985; Carpenter and Feroz, 1992; Covaleski et al., 1993; Zucker, 1987; Meyer and Rowan, 1977).

Clearly, the NIS explained the institutionalizing process at the macro level and suggests that the impact of the competitive and innovative market and reforms prompt organizations of an affected field to change and attempt to model structures to appear legitimate. The adaptive nature of organizational behavior is defensive responses to changing notions of what constitutes a legitimate organizational practice (James, 2009; DiMaggio and Powell, 1991; Norhayati and Siti-Nabila, 2009). It seems that the NIS fairly explained how the institutional pressures motivate management to cope with external forces but does not explain the institutionalizing process at the micro level which involved social actions and interactions in individual organizations. OIE, on the other hand, helps to explain the change in the habits and routines of organizational members. The OIE approach explores the complex and ongoing relationship between actions and institutions, and demonstrates the importance of organizational rules and routines and institutions in shaping exiting accounting practices (Norhayati and Siti-Nabila, 2009).

OIE approach is used to explore the existing accounting practices as institutionalized routines, which enable organizations to function, reproduce and legitimate behavior, and achieve organizational cohesion (Scapens, 1994; Burns and Scapens, 2000). It argued that accounting as institutionalized routines creates understanding of activities according to particular sets of accounting rules and procedures, which enable decisions to be made and activities to be undertaken in a complex and uncertain world.

The OIE provides a useful basis for understanding the institutional characteristics and implementation of accounting policies and procedures. According to Burns and Scapens (2000), the new rules and routines might be institutionalized if the new system challenges the prevailing institutions. However, organizational members who champion the new system may use power to enable the change. Although it could lead to the enactment of the new rules and routines, it stayed at the level of ceremonial implementation. It means the rules and routines could be implemented but not translated into the daily of the organization (Norhayati and Siti-Nabila, 2009).

Based on the observation from the first company, it seems that the way they develop their internal control structure is based on the existing practices rather than on the best practices available and this leads to a position where the organization structure is shaped within existing routines and institutions. It is clear that organizational member’s position recognizes that the formal rules and informal routines can be changed and if the change is consistent with the existing routines and institutions it is easier to be achieved than change, which challenges those rules and institutions. However, the recent growth and shift in the market have led the company to add more management layers, and put pressure on the company where senior executives strive to maintain its unique culture. Even so, both companies develop a sound and reasonable control over cash inflows and outflows. The existing reporting system does not generate cash flow statement. This may be explained by the fact that it is quite understandable that the private company is not required by law to comply with GAAP presentation and disclosure requirements.

The internal control policies and procedures (the rules) of order processing for both sales and purchasing is generally reasonable. However, compliance to these procedures (the routine) is questionable in both companies. For example, sales processing starts in the sales department without any consideration to obtain verification of credit authorization from the credit department for credit sales. It could be the case that the credit sales are at a minimum. Lately, management attention has been paid to revise the existing control policies and procedures related to sales processing in order to expand their credit sales market. The market pressure and external forces of the institutional players, including legal and regularity system seem to exert pressure on the management of both companies in multiple and complex ways resulting in a response aiming at legitimacy rather than efficiency.

As such, although the selection of the ‘new’ accounting system may be based on efficiency criteria, it may not necessarily be optimal in the neo-classical economic sense, but is likely to represent a ‘satisfactory’ solution in a rational sense. Neo-classical economic theory is more concerned with predicting the rational or ‘optimal’ outcomes, rather than explaining the unfolding processes.
in moving from one equilibrium state to another. However, it will be path-dependent, in that the existing routines and institutions will shape the selection and implementation process. If, over time, the emerging routines become widely accepted in the organization such that they become the unquestionable form of management control, then they can be said to be institutionalized. As such, they are more than a set of routine procedures required by senior management and implemented by accountants; they are an inherent feature of the management control process, and represent the expected form of behavior and define the relations between the various groups (Burns ad Scapens, 2000).

Accounting control policies and procedures at both companies seems to be mainly driven by external institutional pressures rather than technical pressures. The routines which emerge in the two companies may be difficult to predict. However, they are not arbitrary, they can be explained where the selection of the new accounting system may be quite intentional and rational, and in a business organization will probably reflect a concern for economic efficiency while they construct normative models of organizational legitimacy. As changes occur in the institutional rules that define legitimacy, organizations respond by voluntarily adopting recommended changes or by giving the appearance of having adopted changes in order to appear legitimate (DiMaggio and Powell, 1991; Meyer and Rowan, 1977).

In conclusion, firstly, it was found that the accounting control policies and procedures practices at the two companies are closely similar while the control environment and accounting information system differs. Secondly, this study demonstrates the importance of organizational routines and institutions in shaping the internal control and accounting policies and procedures practices. Thirdly, it was found that at the macro level the NIS approach explains how external institutions influence both the control environment and the accounting information system, while the OIE approach provides a useful basis for understanding the institutional characteristic of the existing accounting policies and procedures practices at the micro level.

An interpretation of the results is that the control environment forms a critical component of the internal control structure and is considered the most important element mitigating the effect of the accounting control policies and procedures practices. This is in conformance of auditing practices and the audit profession views, which suggests that the internal control structure comprises various elements and represents the management’s philosophy and operating style, which is distinct from the control policies and procedures adopted by management to assist in achieving the organization’s objectives. This study provides useful insights for understanding the rules of internal control policies and procedures and the routine of compliance to these procedures.

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