

Internal Control System Practices and its Management's Responsibility in Nepalese NGO's

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Abstract: Internal Control Practices of NGOs has become a subject of discussion for Non-government organizations (NGO). This study examines the practice of internal control system and the management's responsibility for internal control in Nepalese NGOs. The methodology includes primary and secondary data collection and their interpretations. The researcher employs survey method to collect the view of respondents, which includes 116 finance officers/manager of NGOs and uses the descriptive tools of in data analysis. Secondary sources included the published journals and bulletins. The analysis of data reveals that there is optimal level of internal control system within Nepalese NGOs and the result indicates that management responsibility is recognized in internal control system of Nepalese NGOs

Key Words: Internal Control, Non-Government organization, Managerial responsibility, Financial Accountability.

Introduction:

Internal control system in the organization becoming more important for survival of organization from 1980s [8]. Internal controls are processes, policies and procedures, which NGOs can realized through by organizational management and human resources. It ensures organizational internal processes, design to minimize risk to achieve the organizational goals, it includes separation of duties, authority delegations, policies, procedure manuals, work practices, account reconciliations, arithmetical accuracy checks, restricted physical access, password, stock counts, asset counts, budgets, plans etc. When an organization (Non-Governmental Organization) faces issues, the main cause behind the issue could be breakdown in the internal control within the organization.

There is general understanding that most of NGOs in developing country think that external auditors are responsible for an organization's internal controls but which is not. It is obvious that external auditors evaluate internal controls as part of their audit planning process, but they are not responsible for the design and effectiveness of the organizational controls. The management including the governing board is responsible for making sure that the right controls are in place, and that they are performing as planned.

The purpose of the research article is to examine the internal controls practices of Nepalese NGOs and management responsibility for the effective internal control and accountability. The specific factors that are of interest to the study related evaluating whether a system of internal control meets the requirements for effective internal control of Nepalese NGOs or not.

Literature:

Internal control system is the key accountability and governance tool for an organization (Non-Governmental Organization), it is used to provide accountability to its stakeholders and safeguard organizational assets. The reliability of an organization's financial statements and the process of preparation of those statements highly depend on effective internal control system over the financial statements and its reasonable assurance [5].

The study shows that effective Internal Control System as the tools for Financial Accountability [6]. Nowadays, most of NGOs follow a self-assessment of internal controls by management of individual departments. NGOs are undertaking organizational self-assessments for self-reflection and learning [9]. In July 1997 SNV Nepal prepared the organizational assessment tools for NGOs and CBOs in Nepal. SNV and CARE Nepal used the tools to assess the institutional capacity of NGOs. Many other organizations are using their own tools to assess the institutional capacity of NGOs and CBOs. NGO assessment tool includes the four major components and their indicators on program planning, implementation, monitoring and evaluation, organizational structure and management, resource mobilization, coordination and networking.

Nowadays, the worldwide growth of the NGOs have particularly concerned with developing an understanding of under what conditions self-regulation initiatives to increase NGO's accountability to their beneficiaries. There is a self-regulatory initiative worldwide to support and improve the accountability of Development and Humanitarian NGOs. The self-regulatory initiatives which work in a variety of different ways to promote and support NGO accountability. These include Codes of Conduct, Certification Schemes, Awards, Working groups and Information Services.

The management of the organization is responsible to establish internal controls to keep their organization on course toward its financial goals, to help it achieve its mission, to minimize risks, and to allow the organization to successfully deal with change [8]. The governing board relies upon management, the chief executive officer (CEO), to formulate the policies needed for the NGOs to ensure that their activities and services are provided effectively and assets safeguarded. The CEO of the NGO relies upon managers and department heads to recommend and implement procedures that lower identified risks. It is operational managers and department heads who are the front line for implementing and monitoring internal controls.

According to Committee of Sponsoring Organizations of the Treadway Commission COSO [3] model of internal control, it defined as activities undertaken to increase the prospect of achieving management objectives in three primary areas:

- Efficiency and effectiveness of operations
- Reliability of financial reporting
- Compliance with laws and regulations

COSO identifies these three components is important to function an effective internal control system as: control environment, risk assessment, control activities to ensure that management objectives are achieved and risk mitigation strategies implemented, information and communication, and monitoring. Nepalese NGOs are also established at the organization level to implement practical and effective internal control system which is intended to address general aspects of internal controls and consistent with the five interrelated components of internal control defined by the COSO. According to COSO [3], which must be present in order to conclude that internal control is effective namely; control environment, risk assessment, information and communication, control activities and monitoring.

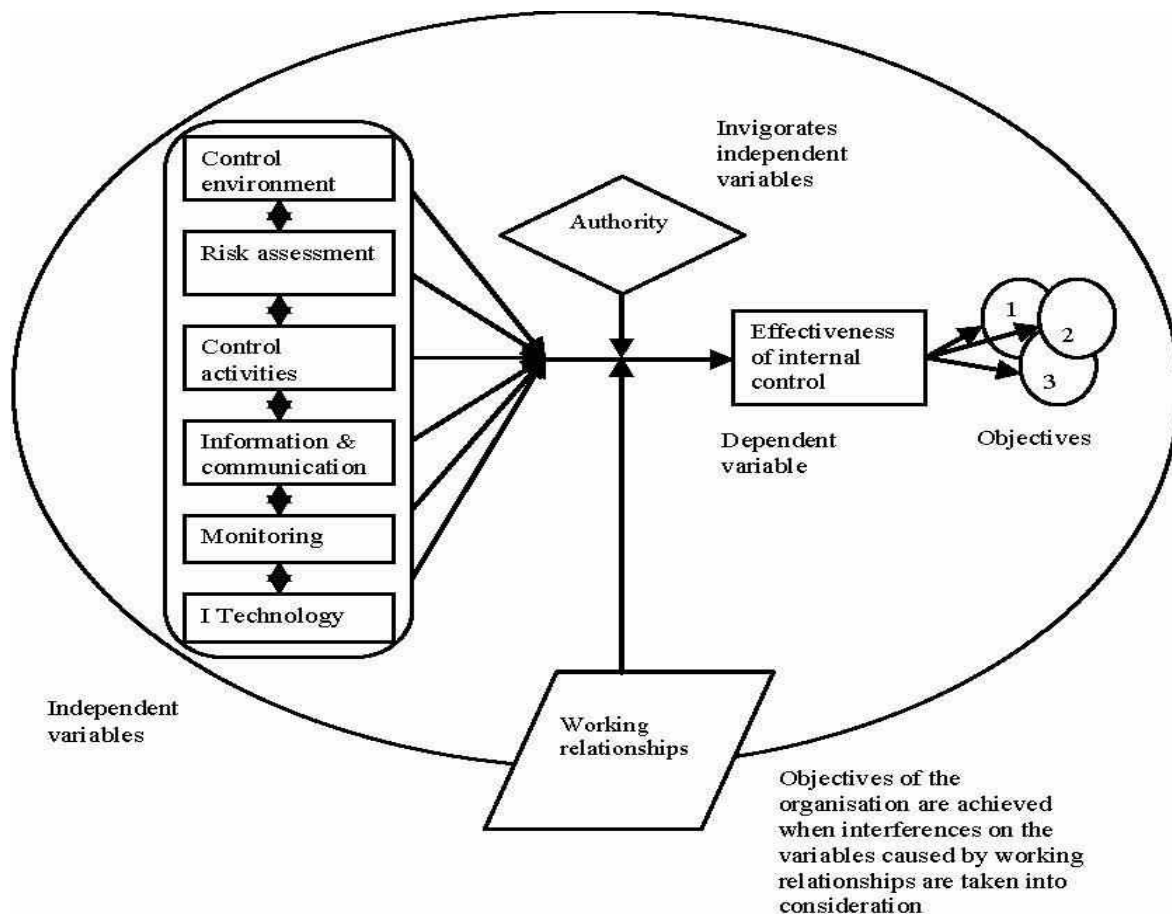


Figure 1. Internal Control Conceptual Framework Adopted from (Amudo & Eno, 2009)

The conceptual framework components of dependent and independent variables of internal control. The effectiveness of internal control is the dependent variable, right functioning of dependent variable provide provides reasonable assurance of efficient and effective operations of organization. It also support to produce accurate, reliable and informative financial reports that comply with applicable laws and regulations.

It is management’s responsibility for Internal Control and always good to use the self-assessment tool to evaluate internal controls in their areas of responsibility. The self-assessment tool is useful for Internal Audit support to improve organization internal controls system.

As such internal control plays a direct role in influencing management performance as they are charged to provide a reasonable assurance of the reliability of financial reporting, the compliance with laws and regulations and to uphold good corporate governance. Financial accountability has always been an important feature of organization. In fact, without accountability it is impossible to run any activities of any organization.

Methods:

The quantitative descriptive design method was used in this study. The method entailed a process of describing; analyzing and interpreting the data collected that measure assessment of application of internal controls by NGOs in their operations. A Questionnaire designed in the Likert scale (frequency) was used to collect the data from the 116 respondents from the 116 NGOs. The respondents were asked to fill in the questionnaire and allowed the researcher to collect once they had finished.

Result and Discussion:

The primary data have been collected from 116 respondents of NGOs financial officers responded, they were asked to rate their opinion for an organizational internal control as per their experience. Likert scale ranging from 1=not at all, 2=somewhat small, 3= neither small nor large 4=somewhat large, 5=very large for perceived system in the organization. The collected data have been entered into SPSS 22 and data analysis has been done. For preparing charts Microsoft Excel 2007 has also been used.

The data was analyzed using Statistical Packages for Social Sciences (SPSS) version 22 computer package analyzed the degree to which internal controls was applied by NGOs in Nepal. The NGOs finance Representative has done self-assessment of internal controls of the NGOs where they are currently working, their experience is key factors which they use while filling the questionnaire. The questionnaire were intended to address general aspects of internal controls.

Organization of the questionnaire also consistent with the five interrelated components of internal control defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The researcher has encouraged use their own experience and opinion during collection of quantitative data. The respondent are the finance representatives of same NGOs, most of them were heads of finance of the NGOs.

Table 1. NGOs integrated component of internal control framework (In Percentage)

Respondents opinion in range regarding their organization follow standard element of internal control	Control Environment	Information and Communications	Control Activities	Monitoring	Risk Assessment
not at all	2.4	1.8	2.4	1.7	5.2
somewhat small	10.4	3.5	6.1	2.6	17.4
neither small nor large	32.2	19.1	28.7	27.8	31.3
somewhat large	37.4	55.7	46.1	38.3	33.9
very large	16.5	20.0	16.5	29.6	12.2
Total	100.0	100.0	100.0	100.0	100.0

(Field Survey 2015)

According to table 1, the respondents agreed somewhat largely that their organization follow standard element of internal control, such as they agreed 37.4 % respondents believe they follow control environment during their organizational operation, as it is depend on management control level which determines control environment of NGOs. 55.7% respondents believe they follow Information and Communications, which seems good comprising other component of internal control. 46.4%

respondents believe they follow control activities, which means NGOs have optimal level control through policies and procedures and executed, it is identified by management, 38.3% respondents believe they follow monitoring, it means NGOs is still need focus on process of monitoring as necessary and 33.9% respondents agreed their organizational follow and aware on risk assessment, there is still more room for improvement on risk assessment for NGOs and can establish mechanisms to identify, analyze and manage the related risks.

Above analysis denotes Nepalese NGOs have concluded integrated component of internal control framework for their organizational effective internal control but still level of improvements are need in each components.

Table 2: The standard elements of internal control system followed by Nepalese NGOs

	Control Environment	Information and Communications	Control Activities	Monitoring	Risk Assessment
Mean	3.51	3.88	3.66	3.90	3.28
Std. Deviation	1.054	.860	.972	.977	1.128

(Field Survey 2015)

Internal control framework consists of five integrated component. Table 2 shows descriptive statistical of different variables/ indicate of internal control status considering internal control framework with five integrated components for the Nepalese NGOs. The mean values of each component have greater than 3.00 which indicate that Nepalese NGOs follows standard components of internal control system.

According to COSO, these five internal control components namely; control environment, risk assessment, information and communication, control activities and monitoring, should have within organization in order to conclude that internal control is effective. Nepalese NGOs are following internal control components which denotes NGOs has optimal level of effectiveness in their organizational internal control system [4].

Table 3: Organization implement an internal control system principle (In Percentage)

	Based on suitability of organization	Based on clearly defined responsibilities and Authority	As a tools of control	Based on practice & knowledge
not at all	8.7	5.2	1.7	3.5
somewhat small	10.4	7.8	9.6	2.6
neither small nor large	28.7	19.1	27.0	23.5
somewhat large	33.0	32.2	43.5	49.6
very large	19.1	35.7	18.3	20.9
Total	100.0	100.0	100.0	100.0

(Field Survey 2015)

Table 3 show that 35.7% Nepalese NGOs has internal control system implement on based on clearly defined responsibilities and authority. There are somewhat large respondents denoted that their organization implement an internal control system principles, 33% respondents stated that they implement the internal control system is based on suitability of organization, 43.5% respondents stated that they use implement the internal control as a tools of control and 49.6% respondent stated that they used internal control system based on practice & knowledge. The implementation of an internal control system must be based on over fundamental principles but although these principles apply to all NGOs but the way they are implemented vary depending on the size of NGOs.

Table 4: Nepalese NGO has formulated policy main focused

Organizational financial policy have focused on	Frequency in number	Percentage
Affordable.	21	18.1
Focused on internal control system	82	70.7
Meets legal requirements	81	69.8
Comprehensive (covers all likely situations)	37	31.9
Is realistic and can be implemented	38	32.8

(Field Survey 2015)

Table 4 data shows that 70.7 percentage NGOs believe that their policies have focused to maintain internal control system and 69.8 percentage believe in their policy is focused to meet legal requirement , 31.9 percentage of respondents have given their policy is also realistic and implemented in organization effectively. 31.9 percentage NGOs respondents have opinion that their organizational policy is comprehensive which covers all likely situations. 18.1 percentage respondent believe that their organization have also consider affordable of organization while formulating the policies.

According to Shapiro on Financial Control and Accountability Toolkit, the good financial policy should be focused on these above factors. The organization policy can be changed but no organization should change its policies too often. The policies are based on organizational key focus and they are intended to guide the work of the organization for a reasonable length of time. Once a policy becomes organizational practice, it helps everyone in the organization to bind on it and help to be consistent in the way it operates. The policy helps to keep an organization transparent and accountable. The above results how the finance polices of Nepalese NGOs focus to maintain internal control system [7].

In order to further verify the result an ANOVA test is carried out to know Nepalese NGO policy and practice formulation based and number of NGOs working in Nepal and the result of which is presented on table 4, explanation followed by thereafter.

Table 5. Nepalese NGO policy and practice formulation based and number of NGOs working in Nepal

		Sum of Squares	d f	Mean Square	F	Si g.
Focused on internal control system	Between Groups	3.093	4	.773	4.252	.003
	Within Groups	20.003	110	.182		
	Total	23.096	114			
Meets legal requirements	Between Groups	.734	4	.184	.874	.482
	Within Groups	23.300	111	.210		
	Total	24.034	115			
Comprehensive	Between Groups	1.093	4	.273	1.240	.298
	Within Groups	24.459	111	.220		
	Total	25.552	115			
Is realistic and can be implemented	Between Groups	1.171	4	.293	1.314	.269
	Within Groups	24.717	111	.223		
	Total	25.888	115			
Affordable	Between Groups	.595	4	.149	.995	.413
	Within Groups	16.603	111	.150		
	Total	17.198	115			

(Field Survey 2015)

In the ANOVA test F value of NGOs 4.252 along with p = 0.003 level, as p <0.05 on NGO policy and practice formulation based focusing on internal control system which indicates that Nepalese NGO policy and practice formulation based to maintain effective internal control system.

Table 6: The responsible person/body for NGOs internal control system

Responsible person for internal control system	N	Frequency	Percent
The Board of Directors or the Supervisory Board	116	56	48.3
Executive Management / Senior Management Team	116	101	87.1
Internal Auditor	116	42	36.2
External Auditor	116	35	30.2
Organizational staff member	116	47	40.5
Finance Manager/ Officer	116	90	77.6

(Field Survey 2015)

The effective involvement of management plays important role in NGOs financial accountability Table consist the NGOs finance representative opinion about internal control system responsibility of NGOs. The highest number of respondents i.e. 87.1% stated that Senior Management Team NGOs has responsibility to internal control management responsibility within organization. After that the respondents also believe they themselves as finance manager/officer have responsibility to maintain internal control system within organization.

There are no significant number of the respondents 48.3%, 36.2%, 30.2% and 40.5% who have opinion that the board of director, internal auditor, external auditor and organizational staff member are responsible of internal control respectively. Majority of the responded of NGOs stated that internal control is senior management team responsibility i.e. Overall management responsibility.

The management of the organization is responsible to establish internal controls to keep their organization toward its financial goals, to help allow the organization to successfully deal with change. Hence, to execute internal controls responsibilities effectively, management needs to understand how an integrated internal control framework works [6].

The Commission's suggestion that top management responsible to disclose accurate and complete financial information by managing the overall control environment within organization. In other hand, the audit committee of the board of directors is high to maximize the effectiveness of financial reporting, the accounting function, and the internal audit function [10].

Everyone in an organization has some responsibility for organization risk management and internal control system. The chief executive officer is ultimately responsible and have to take ownership. Other managers like risk officer, financial officer, internal auditor, and others usually have key support responsibilities. The board of directors provides important oversight to organization in internal control and risk management process. Other external parties, such as external auditors, regulators, and financial analysts often provide information useful in effective in organizational internal control and risk management, but they are not responsible for the effectiveness of, nor are they a part of, the organization's process [8].

Conclusion:

The research article is based on quantitative method. The researcher has adopted survey method to collect primary data from grass root level and secondary sources of information from related books, articles, publications and research papers. The research respondents were NGOs Finance Representative who were working for same organizations.

Nepalese NGOs are following five internal control components namely; control environment, risk assessment, information and communication, control activities and monitoring. The NGOs has optimal level of effectiveness in their organizational internal control system. They have concluded integrated components of internal control framework but still level of improvements are need in each components. The study shows that Nepalese NGOs implement an internal control system principle mostly as a tools of control and based on practice & knowledge. Although the principles apply to all NGOs but the way NGOs are implemented vary depending on the size of NGOs.

The study also ascertains that Nepalese NGOs policy and practice formulation based focusing on to maintain effective internal control system and follow internal control system to ensure accountability. The significant number of Nepalese NGOs are also aware that stated that internal control is senior management team responsibility which means every levels the management are working together to

create an integrated framework that lowers risk to an acceptable level and assists the NGOs in meeting its goals and objectives.

Commonly, governing boards do not design internal controls in Nepalese NGOs. The study on internal control system shows that governing boards responsible for internal controls primarily involve oversight, authorization and leadership.

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