Internal Control and Managent Practices in Non-Profit Organisations

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I. INTRODUCTION

Non-Profit Organisations sometimes try to run their operations without adequate controls, on the grounds that they would "cost too much", or that they "trust their staff". However, the cost of operating a new control should be compared with the possible amount of loss that may occur if the control were not in place. The operation of internal controls is not a guarantee that fraud or mistakes will not occur. Controls minimise the risk to acceptable levels, and should enable management to be aware of problems at an early stage.

II. INTERNAL CONTROL DEFINITION

Internal control is a process continually operating at all levels within the entity to achieve:

- efficiency and effectivenes,
- reliability, completeness and timeliness of financial and management information, and
- compliance with applicable laws and regulations.

III. OBJECTIVES OF INTERNAL CONTROL

- To assist management in orderly and efficient conduct of its operations,
- Adherence to management policies and procedures
- Safeguarding of assets
- Prevention and Detection of Fraud and Error
- Accuracy and completeness of accounting records
- Timely preparation of reliable financial information
- Inspire confidence in the organisation by its funding partners and beneficiaries.

IV. SOME EXAMPLES OF DEFICIENCIES IN INTERNAL CONTROLS

- Absence of appropriate segregation of duties consistent with appropriate control objective,
- Absence of appropriate reviews and approvals of transactions, accounting entries, or systems outputs
- Inadequate provisions for the safeguarding of assets
- Evidence of failure to safeguard assets from loss, damage, or misappropriation
- Evidence that a system fails to provide complete and accurate output consistent with the auditee's control objectives because of the misapplication of control procedures
- Evidence of intentional override of internal controls by those in authority to the detriment of the overall objectives of the system
- Evidence of failure to perform tasks that are part of the internal controls, such as

reconciliations not prepared or not timely prepared
- Absence of a sufficient level of control consciousness within the organisation
- Significant deficiencies in the design or operation of internal controls that could result in violations of laws and regulations having a direct and material effect on the financial statements; and
- Failure to follow up and correct previously identified deficiencies in internal controls.

V. **DIFFERENT TYPES OF INTERNAL CONTROLS**

Budgetary Control

All transactions carried out in an organisation should, be in accordance with the activities that are stated in the annual budget.

It is therefore essential to evolve the budget control mechanism, which involves:

Planning, executing the plan, monitoring and evaluating the performance and financially managing the activities of the organisation.
The system will determine the objective to be achieved over the budgeted period and the policy to be adopted to achieve objectives and determines the activities to be undertaken to achieve the objectives.
The system will also help to interpret the vision by preparing a detailed plan of activity in physical and financial terms and provides a yard stick for measuring the performance by comparing the plan with the actual performance activity-wise both in physical and monetary terms.

Organisation Control

It is important to have an effective organisation structure which provides for:

Division of the organisation's operations into appropriate departments, and the appointment of persons to assume responsibility for different activities.
Communication of delegation of authority and scope of responsibilities at various levels.
Design, so far as practicable, to preclude individual from over-riding control system.
Segregation of incompatible functions

Division of Duties

Duties should be separated so that no one person is in a position to record and process a complete transaction. Segregation of duties reduces the risk of fraud and error. This control demonstrates that each staff member is part of an inter-reliant team that has to work well together if the organisation is to achieve its mission.

Authorisation and approval controls

All transactions will require approval and authorisation by a responsible official. The limits of authority should be clearly defined by means of delegation of powers.

Accounting Controls

These controls include checking the arithmetical accuracy of records; also the preparation of reconciliation, for example, reconciling cash in hand with the cash book balance, and amounts due to a project, per head office statements, with amounts due per project records.

A computerised system may include a number of in-built mathematical calculations, but we should be careful to ensure that when designing “spreadsheets”, visual checks should be incorporated within these; for example, the total adds and total crossadds of several columns of figures should be displayed in separate cells on the worksheet, so that they can be visually checked and agreed with each other.

The printouts made of the respective statements should be duly signed by the competent authority.

Personnel Controls

Proper functioning of any system depend on:

Competence and integrity of those operating it.
Qualifications, selection and training as well as personal characteristics of personnel involved.
These include proper procedures over selection and training of staff, to ensure that their abilities and experience match up to their responsibilities.

Non-government organisations know from experience that it is tempting to take on staff who appear to be committed to the objectives of the organisation, or who are known personally to existing members of staff. If normal procedures are not followed, the organisation may find that the new staff member is not really capable of carrying out the job. Dismissing staff is unpleasant; sometimes it proves extremely difficult; in this situation the reputation and work of organisation may be damaged.

Supervision Controls

The job description and detailed work programmes of senior staff should include the routine daily supervision of junior staff. This has to be done in a sensitive but programmed way; in most cases the staff whose work is being supervised should be aware that this supervision is taking place; they will be encouraged to share difficulties, and to make suggestions as to how their job might be carried out more effectively. In carrying out supervisory responsibility, management should: Review adequacy of internal control on a regular basis to ensure that all significant controls are operating effectively. Where the organisation has an internal audit system, entrust to it some of its supervisory functions, especially with respect to review of internal control. The internal audit, in addition to other control functions, may carry out surprise cash counts, physical inventories of stores, and checking vehicle log books.

Preventive & Detective Control

Preventive

Require two cheque-signatures on all large disbursements.
Require the use of an Authorised Vendors list.
Reconcile invoice to receiving reports before authorising payment.
Check mathematical accuracy of invoice before payment.

Detective

Prepare Bank reconciliations
Reconcile vendors statements to recorded payables
Count physical inventory Observe payroll distribution on a test basis. Trace detail.

Control Activities

Reporting and reviewing reconciliations.
Checking the arithmetical accuracy of the records.
Controlling applications and environment of computer information environment systems. For example, by establishing controls over changes to computer programmes access to data files.
Maintaining and reviewing control over accounts and related subsidiary ledgers.
Approving and controlling of documents.
Comparing internal data with external sources of information.
Comparing the results of physical verification of cash, fixed assets, investments and inventory with corresponding accounting records.
Restricting direct access to assets records and information.
Comparing and analyzing the financial results with corresponding budgeted figures.

Safeguarding Controls

Internal controls over safeguarding of assets constitute a process, effected by an entity's Governing Body to provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Safeguarding controls relate to the prevention or timely detection of unauthorised transactions and unauthorised access to assets that could result in losses that are material to the financial statements, for example, when unauthorised expenditure or investments are made, unauthorised liabilities are incurred, inventory is stolen or assets are converted to personal use.
Such controls are designed to help ensure that use of and access to assets are in accordance with management's authorisation.
Authorisation includes approval of transactions in accordance with policies and procedures established by management to safeguard assets.
These include restricting physical access to cash, stocks and other assets.
They would also include comparing existing assets with the related records at reasonable intervals and taking appropriate action with respect to any differences.

Understanding these safeguarding controls can help auditors assess the risk that financial statements could be materially mis-stated. For example, an understanding of an organisation’s safeguarding controls can help auditors recognise risk factors such as:

failure to adequately monitor decentralised operations;
lack of controls over activities, such as lack of documentation for major transactions;
lack of controls over computer processing, such as a lack of controls over access to applications that initiate or control the movement of assets;
failure to develop or communicate adequate policies and procedures for security of data or assets, such as allowing unauthorised personnel to have ready access to data or assets; and
failure to investigate significant unreconciled differences between reconciliations of a control account and subsidiary records.

Controls over Compliance with Laws and Regulations

Auditors should design the audit to provide reasonable assurance that the financial statements are free of material mis-statements resulting from violations of laws and regulations that have a direct and material effect on the determination of financial statement amounts. To meet that requirement, auditors should have an understanding of internal controls relevant to financial statement assertions affected by those laws and regulations. Auditors should use that understanding to identify types of potential mis-statements, consider factors that affect the risk of material mis-statement, and design substantive tests. For example, the following control environment factors may influence the auditors' assessment of control risk:

a) management’s awareness or lack of awareness of applicable laws and regulations. b) Organisation’s policy regarding such matters as acceptable operating practices and codes of conduct, and c) assignment of responsibility and delegation of authority to deal with such matters as organisational goals and objectives, operating functions, and regulatory requirements.

Control Risk Assessments

When auditors assess control risk below the maximum for a given financial statement assertion, they reduce their need for evidence from substantive tests of that assertion. Auditors are not required to asses control risk below the maximum, but the likelihood that they will find it efficient and effective to do so increases with the size of the entities they audit and the complexity of their operations. Auditors should do the following when assessing control below the maximum:

a) identify internal controls that are relevant to a specific financial statement assertion;
b) perform tests that provide sufficient evidence that those controls are effective; and
c) document the tests of controls.

Auditors should remember the following when planning and performing tests of controls:

The lower the auditors' assessment of control risk, the more evidence they need to support that assessment.

Auditors may have to use a combination of different kinds of tests of controls to get sufficient evidence of a control's effectiveness.

Inquiries alone generally will not support an assessment that control risk is below the maximum.

Observations provide evidence about a control's effectiveness only at the time observed; they do not provide evidence about its effectiveness during the rest of the period under audit.

Auditors can use evidence from tests of controls done in prior audits (or at an interim date), but they have to obtain evidence about the nature and extent of significant changes in policies, procedures and personnel since they last performed those tests.

Auditors may find it necessary to reconsider their assessments of control risk when their substantive tests detect mis-statements, especially those that appear to be irregularities or due to illegal acts. As a result, they may find it necessary to modify their planned substantive tests for some or all financial statement assertions. Deficiencies in internal controls that led to those mis-statements may be reportable conditions or material weaknesses, which auditors are required to report.

Governance

In addition to the day-to-day controls which are to be carried out by the Senior Staff, there will be other supervisory procedures which should take place at Board level.

The Board should not be monopolised by a single interest group (e.g. members of one family).

The Board should have identified experts drawn from various disciplines.

The statutes / bye-laws of the organisation should provide for transparent process of taking decisions, election of office bearers and members of the Board.

Transparency

The organisation should have transparency in purpose of work by:

making clear documentation as to who they are, what they do and how they do;

explicitly following and documenting financial norms, accounting policies, staff and management policy;

preparing and making available annual reports with a summary of major activities undertaken, achievements made, tasks to be undertaken and financial statements about their constituencies, affiliates etc.

Limitations of Internal Control

Internal Control cannot:

- change an inherently poor manager into a good one,
- ensure success, or even survival.

An internal control system, no matter how well conceived and operated, can provide reasonable, not absolute, assurance regarding achievement of an entity's objectives. Internal control is not a cure-all.

Inherent Limitations of Internal Controls

Inherent inability to achieve 100% control due to control risks, such as:

Judgement – individual judgement and decision making can be faulty.
Breakdowns – can occur because of human failures such as simple errors or mistakes.
Management Override – management can have the ability to override controls.
Collusion – some controls can be circumvented by the collusion of two or more