

FINANCIAL MANAGEMENT AND INTERNAL CONTROLS IN NGO'S PROMOTE BETTER HUMANITARIAN FUNDS MANAGEMENT

INTRODUCTION

Corruption is the root cause of all financial management malpractices, and organizations are constantly examining how to eliminate or rather reduce the cases of the same. Transparency International defines corruption as the abuse of entrusted power for private gain (6). Therefore, internal controls are set up in place to ensure that all the necessary steps are taken up to ensure that correct management practices on funds and process management are taken up and that the changes or improvements can be implemented as and how needed. Like any other legally-established organization, Non-Governmental Organizations (NGOs) face the risk of corruption and bribery; however, they encounter a huge reputational risk in addition to management, financial, and other forms of risk. They may be under a higher level of scrutiny due to their functioning and the way they receive funding for their work, and they must protect their reputation as public perception is built upon their organizational reputation, good work and financial transparency and efficiency in spending the resources entrusted to them by the public. This has led to establishing and enforcing strict rules and regulations, internal controls, and reporting.

Based on the evidence from working with over 90 international and national NGOs, internal controls are a critical mechanism that ensures accurate funds management, supports the quality, and promotes efficient service delivery. There is a significant relationship between internal controls and financial management that results in better humanitarian funds management and subsequently better organizational reputation, program spending, and ultimate impact on the communities that NGOs serve. This enhances the credibility and legitimacy of services offered by NGOs.

SUMMARY

NGOs receive funds from multiple sources, including government funding agencies, charitable trusts, associations, individuals, faith-based entities, and organizations. Even though international non-governmental organizations play a crucial role in positively affecting the lives of individuals, there are documented cases of theft, corruption, and fraud, which limit the effectiveness of these organizations. For this reason, it is important to come up with financial management practices that will ensure that the funds raised are directed to the set purposes they are intended for.

Keywords: fund raising, corruption, non-governmental organization.

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This also strengthens the fundraising efforts that management and working teams take up and acts as a motivation factor by ensuring that everything is set according to the inefficient allocation of funds that NGOs manage. Internal controls also help counter critics among key stakeholders. Internal controls allow spot errors, fraudulence, and illegitimate counter conduct in the humanitarian sector. In summary, internal controls and financial management create better assurance that humanitarian funds are used to meet the goals and objectives set in place for them.

FINANCIAL MANAGEMENT AND INTERNAL CONTROLS

Non-profit organizations are set up for the benefit of the public and not for the purpose of generating profits. In addition, non-profit organizations and non-governmental organizations (NGOs) are designed to be independent of the government. The main role of NGOs is to promote social interests by ensuring that the needs of individuals are understood, assessed, planning is done in coordination with the communities in question, and the needs are met to the extent possible. With this amount of responsibility, these organizations are expected to portray high levels of integrity and responsibility when handling the funds assigned to them. With the vastly unequal distribution of resources globally, NGOs come up as centers that refine and try to close the gaps experienced by marginalized individuals and safeguard their welfare. (4) states that The existence of poverty legitimizes NGOs.

The most significant disease is corruption. The vaccine is transparency. (2)

NGOs have drastically developed and grown over the past few decades. The first International NGO to be formed was the anti-slavery movement back in 1839 (7). William Wilberforce founded it, and just like the NGOs today, it aimed to ensure that the rights of all individuals are equalized by fighting for the equal rights of black members of society. In a nutshell, it fought to provide better standpoints of unity as people can fight for their rights with a united front. The Anti-slavery society created the rise of International NGOs.

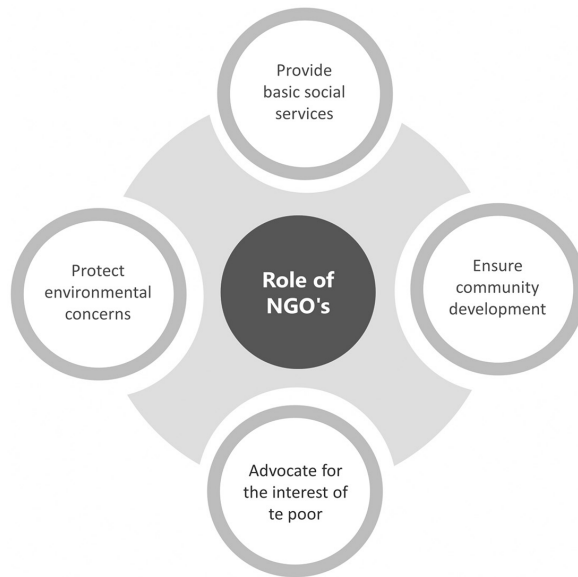


Figure 1: Roles of NGO's

Funding NGO's

All organizations require funding to carry out their operations smoothly. Since most NGOs do not engage in resource generating via self-fund generating activities (semi-commercial activities), most NGOs rely on funds from other sources. These organizations receive funds from multiple sources, including government funding agencies, charitable trusts, associations, individuals, faith-based entities, and organizations. In addition, although independent from the government, government funds contribute a substantial amount of funding to NGOs. While many of the funding sources are one-time funding opportunities, others are more cyclical. This way of financing has encouraged NGOs to diversify their funding sources.

Even though international non-governmental organizations play a crucial role in affecting the lives of individuals in a positive way, there are documented (and through professional experience, a large number of undocumented) cases of theft, corruption, and fraud, which limit the effectiveness of these organizations. Ethical accountability is required when handling resources in non-profit organizations. This includes coming up with other bodies to oversee the implementation of different factors to minimize fraud and corruption. In consideration of the humanitarian work that NGOs

Internal controls are incentives, policies, and procedures placed in an organization to ensure that activities are performed efficiently.

take up, corruption is considered to be low, and incentives to fight against it have thrived but have not been able to do away with the misappropriation of funds completely. There are numerous cases of misappropriation and dozens more that have not been discovered but are still taking place. At a UN summit in 2012, it was announced that more than 30% of funds raised for the purpose of humanitarian work do not reach their final destination to fulfill the role they were raised to perform. That percentage has only grown since 2012, considering the humanitarian crisis and funding that has supported Iraq, Afghanistan, Yemen, Libya, Syria, and similar large-scale documented humanitarian needs. With such a huge percentage of funds being used for corrupt and fraud dealings, international NGOs have taken responsibility to incorporate financial management and internal control practices to mitigate the misappropriation of funds. NGOs face the same corruption issues as any other form of business organization. For this reason, they must set up internal controls and strong financial management practices that will advocate for the appropriate use of funds to fulfill their overall purpose. Many organizations have also opted to partner with third-party monitoring organizations that provide independent, transparent, and ongoing/real-time program implementation monitoring. (10)

FINANCIAL MANAGEMENT AND INTERNAL CONTROLS IN THE HUMANITARIAN SECTOR

What is financial management? Financial management is a term used by all organization and is described as the process regarding how financing is managed in an organization.

What are internal controls? Internal controls are incentives, policies, and procedures placed in an organization to ensure that activities are performed efficiently. In addition, it allows for the efficient use of funds. Internal controls in NGOs have been developed mainly because of the general questions that donors ask regarding the course of action that the funds donated take.

Why improve financial management and internal controls in the humanitarian sector? The humanitarian sector is among the largest economies in the world. With billions of people ready to help, the financing and capital raised to alleviate the livelihood of the disadvantaged are massive. For this reason alone, it is important to develop financial management practices that will ensure that the funds raised are directed to the set purposes they are intended for. This is through the use

of control practices by overseeing the activities being carried out and measuring the impact and community perceptions of aid given to them. This is, however, not enough, as misappropriation of funds is not taken up without a “background story.” Some of the ways used to embezzle funds include hiring ghost employees and internal expenses.

Case 1:

American Red Cross Fraud scandal after the earthquake in Haiti, 2010

Fraud cases in the humanitarian sector have sparked many debates on the nature of control systems and financial management policies that are set in place to ensure that funds are used for their intended purposes. There have been many cases in international NGOs where fraud cases have led to skepticism about the nature of humanitarian organizations. After the earthquake in Haiti in 2010, which claimed over 250,000 lives and caused significant damage, many were left homeless. The American Red Cross raised funds which mainly were through donations from well-wishers. The overall amount of money raised was about half a billion dollars.

The American Red Cross promised to build homes for over 130,000 people who had been displaced after losing their homes to the earthquake. Even after raising a considerable amount of money that could help rebuild people's homes, the Red Cross ultimately built only six homes. This brought forth several controversies about how the money was used. After auditing, it was reported that over 25% of the amount raised was used for the internal expenses of the organization. Although running an organization takes up considerable resources in terms of operations and personnel, the percentage taken up for internal expenses was too high and questionable. In research regarding the issue, it was found that the organization could not provide all the required resources it was requested.

For example, some of the proof required on how the money was spent could not be found. In most organizations, the Ethics and Internal Investigations units are responsible for investigating any forms of discrepancies in an organization. This enables any wrongdoing or embezzlement to be detected at an early stage. However, the unit was not well funded by the organization, which raised a lot of questions regarding the transparency and principles of the American Red Cross.

Even though the organization took a great part in the disaster response program in Haiti after the earthquake, the main concern is that the impact the organization left behind does not match the amount of money that the organization received. This was a clear indication that there was a problem with the organization's internal controls. Since internal controls are essential in ensuring that financial management is handled in an organization, the reliability of the Red Cross financial statements was compromised altogether.

CHALLENGES FACED IN FINANCIAL MANAGEMENT AND INTERNAL CONTROLS

Following the multiple events that have occurred in the recent past regarding the misappropriation of funds, donor communities feel the need to get consolidated outlines of how funds are allocated to and within non-profit organizations. This ensures that all the funds are set to good use as they are intended to, including how many layers of sub-granting and sub-contracting happen within NGO as a main recipient of funding. For this to happen, internal controls must be allocated to non-profits. They set up a clear guide-

line of what should be included in the financial management practices to ensure that funds are not misappropriated, misused, and embezzled. With the increase in technology, many technologies help speed up the financial management, control, and reporting processes. For example, audit trails can be set in accounting and procurement software to ensure that all payments and orders are recorded and can be traced back in real-time, linking it to the point at the community delivery, not only at the warehouse or an NGO facility where services are designed or good is delivered (1). This reduces the issues of theft and corruption in these organizations but does not stop the occurrence of the same as there are many challenges faced that vary according to both the internal and external environments of organizations.

Challenges of Financial Management in NGOs

Inadequate funds, while there is so much to do, there is little to work with, and this creates a shortage in the financial planning resources that NGOs work with. NGOs mainly depend on donations, which may vary greatly depending on how individuals are willing to give. This creates a great challenge in the financial management processes of these organizations. Unlike typical business organizations, NGO funding is limited and limits the number of resources set aside to enhance the internal controls put in place (5).

Ineffective self-sustainability, self-sustainability in NGOs involves coming up with the necessary activities to raise funds for an organization. NGOs diversify their sources of revenue to act as backups in cases where sources of revenue are low. Some ways that non-profit organizations raise revenue is by re-investing the already existing revenues in financial markets to earn returns. Other ways are by opening business or income-generating ventures to generate extra funding to raise more revenue for their activities. However, this comes with many challenges, including intense competition from profit sector organizations including often inefficiencies in NGO management of public-private ventures due to the system and processes that are not set up to function in a 'bottom line approach'. Even though there are multiple ways to enter a market, this requires strong marketing skills that need more financing and investment and often a different skill set and employees that can help manage the process. Due to this, self-financing often is challenging for most NGOs.

Another reason that hinders private sector expansion by an NGO sector is the risk of forgetting the organization's mission

and concentrating more on profit maximization for the sake of internal co-financing. Given these challenges, many NGOs choose to invest their limited resources in money markets and other financial instruments to yield returns that will help foster their mission.

International NGOs have their operations in different environments. For this reason, the risk factors of corruption vary from the region, the complexity of the work environment, staff skillset, internal policies, including the level of funding that NGOs receive and the requested 'burn rate by donors'. For example, an NGO operating in a country with high corrupt practices is exposed to an increased challenge of engaging in corrupt practices and complies with the culture in these countries. However, in countries where corruption practices are observed, there will be low cases of bribery or corruption. In the first case, they go against Foreign Corruption Practices Act (FCPA) as all dealings should be corruption free. However, this contradicts the primary role of the humanitarian sector. It includes taking up all the necessary steps to ensure that the needs of individuals are well taken care of. In some developing countries, corrupt practices may have been normalized, which can hamper organizations' activities that do not go along with such local customs. According to the ethical standards of all non-profit organizations, giving out any money in exchange for a service that should be free or to access a service that should not be accessible or prohibited is bribery.

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EFFORTS TO IMPROVE FINANCIAL MANAGEMENT AND INTERNAL CONTROLS IN THE HUMANITARIAN SECTOR

Internal control policies create an environment of trust and accountability, including any financial reports that are ultimately developed. In the event of any discrepancy, it is noticed at an early stage and mitigated. According to (3), the management takes up the sole role of implementing internal controls in an organization.

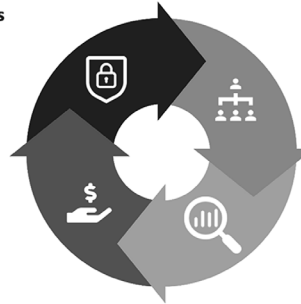
Internal controls in an organization

To foster trust and accountability of an organization, transparency is a must and required. One of the most common ways that transparency of an organization is shown to its

stakeholders (donors and communities intended to benefit from aid delivery) is by openly disclosing their financial statements on a more project-by-project basis. In a non-profit organization, the issue of ethics is a significant concern, and negative goodwill can seriously hamper the organization's cash flows. NGOs often blame the security, risk factor, and operating environment for the way they operate and disclose their financials and impact. This is also compounded by a few receiving large government or private sector donors. (7)

Information Controls

- Systems security
- User controls and authorization
- Data security and systems use



General Internal Controls

- Segregation of duties
- Delegation of authority
- Code of conduct
- Ethical concerns and how to handle them
- Define roles and responsibilities

Financial Controls

- Cash management
- Payroll management
- Internal expenses audit.

Follow ups

- Audit procedures
- (Both internal and external audits).

Figure 2: Types of controls

For easier processes, every organization should have controls that enable them to account for any form of assets they receive, how it is used and how it is finally delivered and how delivery is managed with communities. Measuring procurement transparency and spending rate (with all supporting procurement and financial document) is just a 4% work, while the rest has to be matched with community needs assessment, organizational systems, policies and procedures, organizational culture, community and beneficiary communication, and beneficiary engagement, including beneficiary satisfaction. Private sector companies often go out of business overnight if their customer or client base is dissatisfied with the services provided; NGOs often or rarely experience such 'backfire'. Through extensive reporting, they often close a project and move on to the new project priority and discussion with donors. In many instances, also donors encourage NGOs to 'quickly submit a final project report' as the grant end period has ended, and everybody involved may want to close the project and 'move on.

This creates a clear flow of how liquid assets like cash are held and used. Some of the controls that non-profit and non-governmental organizations use include the following:

(1) Definition of roles and responsibilities

Definition of roles and responsibilities in an organization includes clearly stating the exact duties individuals take up. They help determine how duties are taken up and the people to consult in case of an issue. One of the major ways that duties are defined in organizations is by departmentalization. This is beneficial in the structure of an organization, and the efficiency realized from the same. For example, in the finance department, only experts in finance are designated to work there. Similarly, in departments like IT, only qualified and well-equipped IT personnel are allowed to work there. This leads to the efficient performance of activities in an organization.

(2) Segregation of duties and responsibilities

Although duties should be well defined in an organization, it is essential to separate them in a way that separates the control of activities. For example, NGOs can ensure that no one individual sees it to completion when handling a particular activity. An example is during the procurement of goods. A perfect example of segregation is when one individual takes care of the ordering process, another oversees the check-off process, and another takes care of the payment process.

Although ethical conduct is expected from all employees, full trust cannot be awarded to them, and control measures are used. Moreover, key definitions of roles and responsibilities of individuals are essential and used to enhance teamwork and provide transparency and clear segre-



gation of duties. Improving internal controls and financial management systems are crucial aspects of an organization that improves stakeholder and donor trust and ensure that funds are used for the intended purposes.

(3) Code of Ethics

International NGOs are equipped with working personnel from various cultural, geographic, and educational, including professional backgrounds. This brings forth differences in work ethics. However, for organizations to be successful, it is essential to integrate the work ethics and funds management functions regardless of where the funds are managed or how an NGO receives funds. One of the most used tools to incorporate mutual understanding is a code of ethics that clearly states what is expected of everyone within the organization.

A well-laid out code of ethics in an organization helps ensure that every employee is a way of integrating ethics into the organization's culture, from management through all staff. Such a code often outlines the policies of the organization and the repercussions of not following them.

(4) Information systems controls

Consolidated information systems are available that enable organizations to consolidate all their information and grant different access rights to their employees. This promotes better management and auditing as all the activities carried around the organization can be carried out from one place while at the same time dividing how they can be taken up.

(5) Compliance with Anti-Corruption Bodies

International organizations have a vast operating environment and, hence varying ethical environments. This brings forth a risk of bribing foreign officials to be able to conduct activities in various geographical environments. The Foreign Corrupt Practices Act (FCPA) is one of the largest foreign anti-corruption practices in the world. Although it does not apply to NGOs and non-profit organizations, most NGOs are compliant as it implies good governance and transparency in these organizations. This promotes the general reputation of the organization and the desire to improve donor funding ultimately.

CONCLUSIONS

Financial management and internal controls in an organization come forth with multiple benefits. They support general operations and provide accountability and a degree of sustainability. When the financial capacity of an NGO is safeguarded, the funds available are directed towards achieving the organization's or program's goals and objectives. Internal controls reduce the risk of funds mismanagement, improve the legitimacy of NGOs, and consequently, may lead to improved or increased funding for organizations. However, internal control shows only a small part of work operations. The other part, which is often overlooked in favour of clean financial reports, shows whether an NGO has done a proper assessment of community needs; its overall organizational systems; the structure of its policies and procedures; its organizational culture; its community, and beneficiary communication and engagement, including how beneficiary's satisfaction is established and measured. And, finally, what happened with the resources beyond financial reporting, invoices, and the number of different offers received for good services.

FINANSIJSKI MENADŽMENT I INTERNA KONTROLA U NVO UNAPREĐUJU UPRAVLJANJE HUMANITARNIM FONDOVIMA

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REZIME

Nevladine organizacije dobijaju sredstva iz više izvora, uključujući vladine agencije za finansiranje, dobrotvorne fondove, udruženja i pojedince, verske entitete i organizacije. Iako međunarodne nevladine organizacije igraju ključnu ulogu u pozitivnom uticaju na živote pojedinaca, postoje dokumentovani slučajevi krađe, korupcije i prevare koji ograničavaju efikasnost ovih organizacija. Iz tog razloga, važno je osmisliti prakse finansijskog upravljanja koje će obezbediti da prikupljena sredstva budu usmerena u zadate svrhe za koje su namenjene.

Ključne reči: pribavljanje sredstava, korupcija, nevladina organizacija.