APECTS REGARDING INTERNAL AUDIT PLANNING IN THE NONPROFIT ORGANIZATIONS

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Abstract

Our study refers to the planning of internal audit within the nonprofit organizations. The starting point is the hypothesis that planning of internal audit in nonprofit organizations is printed by their specific features and we want to highlight the way this influence occurs, which are the specific objectives that have to be pursued within the internal audit.

During our research, in order to test the hypothesis we studied the national legal regulations, the specific literature of the field and we realized a practical documentation by consulting the internal audit guides of a foreign nonprofit organization.

Our study reveals that in this area the legislation in force refers only to the compulsiveness of developing the internal audit activity in some specific categories of nonprofit organizations, without referring to the specific rules of organizing this activity within the nonprofit organizations. The national literature of the field is poor, but at the international level, the authors have concerns regarding the internal audit within the nonprofits.

From a practical point of view, we emphasized the specific aspects of nonprofit organizations followed while planning internal audit regarding the financial system, budgetary system, internal control system, financing sources and human resources. We concluded that each audited field is influenced by the specific features of non-profit organizations within them. These features must be taken into account when planning the audit and drawing up the specific procedures within the nonprofits in order to add value to the audited information within internal audit engagement.

Key words: nonprofit organizations, internal audit planning, financial system, budgetary system, internal control, financing, human resources

JEL classification: M42

1. Introduction and the context of the study

The internal approach of the audit, as a study area, is important because it involves maintenance measures and improvement strategies, internal policies and practices, depending on the specifics of the entity that is audited. Therefore, it is crucial to have a knowledge of the organization, its environment and the laws that are applied to it.

In time, the development of society has led to diverse situations involving specific issues and topics. Some of these cases have been solved by the emergence of some non-governmental organizations which took over some of them, thus supporting more or less the organization and management authorities in the community where they are functioning. Nonprofit organizations are non-governmental organisms which the law calls foundations, associations or federations according to their specificity.

The starting point of our study is that the internal audit planning in these nonprofit organizations depends on their specificity and we wish to highlight how this influence occurs, which specific aims are pursued in the internal audit.

From the legal point of view, the importance of planning internal audit within non-profit entities is highlighted by the legislation, which provides the organization of the internal audit for the entities that are auditing their financial statements and/or which are publicly funded for more than 50%.

Regarding the specialized literature, internal audit planning in the nonprofit organizations is hardly addressed and considering the legal requirements, we believe it necessary to treat it carefully.

The objectives followed in this paper concern knowledge of the particularities of internal audit in the nonprofit organizations and the aspects which determined them.

Therefore, we have undergone some approaches regarding the practical reality of the audit, but also the legal and theoretical aspects related to it.
The theoretical and scientific support of this study is the research in the field of internal audit in general and internal audit planning especially, because the research that has been carried out, needed an information and a documentation of the specialized literature. The object of this study were also the specialized studies in the field of nonprofit organizations, in order to know their specificity in the field of the internal audit. An important role for writing the article was played by the legislation in force in the field of non-profit economic entities, in the audit department, given that the specialized literature is rather poor in terms of approaching similar subjects as the one we have chosen.

The aim was to collect and process the information needed to define the context of the domain and identify it by using the relational approach represented by the basic concepts and operation in relation to the internal audit planning associations and foundations. During the research certain procedures were taken into consideration, such as observation, reasoning, analysis, synthesis, interpretation, comparison in order to provide a better understanding of the theoretical and practical problems of the study on this subject matter. This paper is not intended to provide a full audit mission, but to highlight the impact of the specific aspects of the nonprofit organizations on planning the internal audit mission.

2. Legal regulations regarding the internal audit within nonprofit organizations

The necessity of studying the law applicable to nonprofit organizations is required by the need to know their characteristics which may have an impact on internal audit planning.

The term “nonprofit organizations” is used to refer to those entities whose aim is not to make a profit. The Government Decree no. 26/30.01.2000 regarding associations and foundations stipulates that associations or foundations may be „natural and legal persons pursuing certain activities in the public interest or in the interest of the local authorities or, if necessary, their own private interest, non-profitable.”[9] We present their definitions in Table no. 1.

<table>
<thead>
<tr>
<th>ASSOCIATION</th>
<th>FOUNDATION</th>
<th>FEDERATION</th>
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<tr>
<td>&quot;is the legal entity formed by three or more persons who, according to an agreement, are pooling and not subject to refund material contribution, knowledge or contribution in labor with the purpose of carrying out activities in the general interest of some communities or, where appropriate, in their private prerogatives.&quot;[9]</td>
<td>&quot;is the legal entity established by one or more persons on the basis of a legal act between the living or upon death and constitutes a patrimony permanently and irrevocably affected to achieve a goal of general interest or, as the case of some communities.&quot;[9]</td>
<td>is the body established by the association of two or more associations / foundations for specific purposes</td>
</tr>
</tbody>
</table>

Source: own projection based on legal regulations and literature

The main difference which separates the association from the foundation is the patrimony. While the foundation achieves its purpose through patrimony, the association, in general, achieves its objectives through voluntary work. Another issue concerns the status of the founders who opposed to associates become an external entity.

Regarding the financial audit, Order no. 1969/2007 of the Minister of Economy and Finance, mentions in art. 3 the following: „The annual financial statements of the legal person who does not perform a public patrimony, according to the law, is obliged to have a financial auditing, which is performed by the financial auditors, who are physical or legal persons authorized by law, in compliance with accounting regulations applicable to non-profit businesses”[10]. In order to be considered of public utility, an organization must meet certain requirements such as: the work that is done must be of common interest, it must have at least three years of seniority, it must work through the development of projects and programs, and the value of patrimony assets must grow or at least preserve from one year to another. The Government Emergency Decree no. 75/1999 on financial audit, complements the aforementioned provision by requiring that beginning with the financial year of 2001, the „economic entities whose financial statements are subject to financial audit are required to organize and ensure the internal audit activity, according to the law in force.”[13] The Decree stipulates that the person responsible for the internal audit activity must also be a financial auditor.

Another act that refers to the organization of internal audit within non-patrimony entities is internal audit law no. 672/2002, republished in December 2011. The enactment provides that all public entities must organize an internal audit department and the public entity, according to the decree mentioned above, means: „the public authority, the public institution, the company/national society, autonomous company, commercial society in which the state or territorial unit is the majority shareholder and which has a legal personality and also the entity which is financed more than 50% from the public funds.”[8] Public funds are, according to the same law, the amounts granted from the state budget, local budgets, social state insurance budget, special funds, the state Treasury budget, budgets of autonomous public institutions, funds from external loans contracted or guaranteed by the state whose repayment, interest and other costs shall be provided from
public funds and external grants. Taking into account that European funds fall into the category of public funds, there are several non-profit organizations that are 50% financed from these funds, therefore, they are obliged to organize internal audit activity under the law of internal audit. (Mihălțan, 2012: 24) [5]

In Table no. 2, we present the way of organizing the internal audit according to the legal necessity of internal audit.

- Table no. 2 – The applicable law to the two categories of non-profit organizations -

<table>
<thead>
<tr>
<th>NONPROFIT ORGANIZATIONS:</th>
<th>- which are of public utility</th>
<th>- which are not of public utility</th>
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<tr>
<td>- less than 50% financed from public funds</td>
<td>• OMEF no. 1.969/2007 regarding the approval of accounting regulations for legal people without patrimony purpose published in O. M. no. 864bis/2007;</td>
<td>• Law 672/2002 regarding internal audit activity republished in O. G. no. 856/12.05.2011;</td>
</tr>
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<td></td>
<td>• OUG no. 75/1999 regarding the financial audit activity, republished in O. G. no. 649/08.31.2002;</td>
<td>• Government decision no. 1086/2013 for the approval of the General Rules concerning the internal public audit activity published in O. G. no. 17/01.10.2014.</td>
</tr>
<tr>
<td></td>
<td>• CAFR decision no. 48/2014 published in O. G. no. 529/07.16.2007.</td>
<td>It does not organize internal audit activity</td>
</tr>
</tbody>
</table>

Source: own projection based on legal regulations

As seen from the table above, we can conclude that there is no uniform law when talking about internal audit for associations and foundations. In order to organize this activity, they will apply either the legislation for commercial companies or the legislation applicable to public institutions, depending on certain parameters (the public utility status of NGO and funding methods).

3. Concepts and practices of internal audit planning

The design and implementation of internal audit is based on the trust which the person who manages the patrimony has in his staff. In these circumstances there is the possibility of a human error caused by negligence, lack of attention, judgment errors or incorrect understanding of administrator’s tasks.

In general, the concept of planning involves determining in advance what to do. In this sense, in order to plan an internal audit mission it is necessary to develop a comprehensive strategy based on understanding the organization and its operating environment (Ghiță et al., 2009: 354). [4] The planning activity involves, besides building a general strategy and approaching its nature, the timing and the extent of the internal audit that is intended to be realized (Briciu et al., 2006: 188). [1] The organization’s internal audit department has the responsibility to plan the audit activity.

The planning that will lead to significant results is realized by the internal auditors who should consider the objectives of the activity, the business risks, the effectiveness of risk management system, the management control system of the business, but also the improvement possibilities of the risk management system and of the control system (Ghiță et al., 2009: 355). [4] Thus, during the preparation and the development of the audit plan, auditors may identify a number of problems that will be considered in planning the activity.

The internal audit plan is drawn up annually by the internal audit department and there is a practice expressly stipulated by the national rules regarding the selection of missions that will be part of the plan and that is the planning process will take into account the following fundamental elements [11]:

- risk assessment associated with different structures, activities, functions, programs/projects or operations;
- the signal/suggestions criteria of the entity’s manager, namely: the deficiencies from the previous audit reports, the deficiencies from the protocols concluded after the inspections, the deficiencies recorded in the inspection reports from outside the entity, other information and indications of failures or irregularities, assessment of specialists, experts, etc. regarding the structure and the dynamics of some inherent risks, the analysis of some long-term trends about certain aspects of the operating system, assessing the impact of some changes that occurred in the environment in which the audited system evolves;
- in the case of public nonprofit organizations financed from public funds, higher than 50%, it must be taken into account the themes deducted from the annual plan of UCAAPI. The leaders of the public entities are required to take all organizational measures so that the themes ordered by UCAAPI are entered in the annual internal audit plan of the public entity realized in good conditions and reported within the specified time;
- the number of the subordinate entities, of subsidiaries or working points;
- respecting the periodical auditing, at least once in every three years;
Among all these rules there are some which must be complied with, such as: the rule of constancy, the rule of universality in applying the procedure as well as the rule of good information. Regardless the size of the organization, establishing the internal audit measures that are recommended, considering the rule of consistency with the needs of the organization, of a good organization, of integration, the rule of independent objectives, the rule of constancy, and the universality in applying the procedure as well as the rule of good information. Among all these rules there are some which must be complied with, such as:

- **The rule of an efficient organization.** The organization must be designed before and not after the circumstantial constraints have emerged, and it must be adapted to the business’ objectives, it must be verifiable and it must conduct a separation of functions (the same person cannot perform two simultaneous functions from following functions: the decision, the keeping of the stock, the control function etc.).
- **The rule of independent goals** is that the internal audit objectives must be performed independently of the methods, the procedures and the means of the business (for example bookkeeping is subject to the following four objectives: speed, regularity, sincerity and fidelity).
- **The rule of consistency with the enterprise needs** is intended to adapt the internal audit to the characteristics of the enterprise and to its environment. Otherwise, the internal audit forms a rigid assembly which does not allow to achieve the goal of efficiency.

The last rule of the three that were presented above is particularly relevant for our study. In some circumstances the nonprofit organizations develop specific needs and the auditors must know them and plan audit missions so that they meet both the general and specific needs.

### 4. Auditable activities and specific objectives pursued in nonprofit organizations

The audit for nonprofit organizations is planned taking into account the specific aspects of these entities regarding, both their organization and functioning as well as their financial activity. Therefore, there are some specific activities in the planning of the internal audit that are showing some specific elements: financial and account activity, in general, the budget activity and the internal control. The specific elements are found in the attraction and use of funding and in the human resources department. In the following, we will present the specific objectives of these activities that we recommend to be pursued in the internal audit activities of nonprofit organizations.

In the planning stage, the risks of the organization have a decisive role in the choice of the activities that will be audited, thus requiring the auditor’s increased attention. Risk monitoring in nonprofit organizations is based on the risk register, which reflects the identified risks and their level. It is desirable to consult the Risk Registry in planning the audit. The most important specific risk in nonprofit organizations is that donors could express their desire not to renew their financing contracts. Other risks may be related to fraud or financing some terrorist acts (internationally there were such cases [15]-[17]).

The internal audit of the **financial-accounting system** aims for the transactions within the organizations to be supported by documents and to be recorded in the accounting in accordance with the applicable rules. As a specific element, it is important that the internal auditor knows the relevant legislation as well as the related chart of accounts. It is important to check its correct use, and the existence of a standard system which reflects the cost centers in order to assign each transaction to the program or the activity to which it relates. Another critical issue would be finding a way to reflect the material donations. There is also a track kept on the existence and the way that are written the reports on the monthly budget execution. They must contain explanations and comments on the deviations and the necessary corrections. The external auditing contracts of the financial statements are also checked, which must be signed in time for the next reporting period. Another objective is to provide to the public the financial statements, so that the interested parties can have access to the information required.

In general, the audit of the entity’s **budget system** aims to see if the budgets are prepared in time to be brought to the attention of all departments that are involved and if they are approved by the management of the organization. The existence of a responsible for each budget separately is also checked to see if it is performed a monthly treasury budget. Some of the specific objectives of the internal audit that are pursued in nonprofit organizations are the following [14]:

- both finance and running program managers are involved in setting budgets;
- the type of budgets and budgeting methods used and the connections between the mission of nonprofit organizations and budgetary goals;
• project budgets are based on the costs of planned activities for the period they refer to;
• budget is detailed by budgetary lines which correspond to the Chart of accounts used by nonprofit organizations, which has some specific features;
• the available funds are adequately used, namely they fund operational costs they were accessed for or designated by donors.

The internal auditor should verify if a system of internal financial control is operating in the organization and if the internal control procedures are written. It is necessary to know the system of internal control procedures and also to know if they are applicable. The objective of the audit is to verify if those procedures are respected. Due to the mission of the organizations as non-profitable entities, the control systems are adapted to them and in general, their aim is: keeping accounts up to date and in line with legislation specific to the non-profit department, patrimony and personnel protection and development of anti-fraud policy, preventing and detecting errors. Taking into account the relevant legal provisions, the auditor must ensure the existence of an internal preventive financial control, which cannot be replaced by the censorial control provided by Government Decree 26/2000, since the latter is the control made after operations and controlled transactions were produced.

In most cases, the non-profit organizations attract funding on the basis of some financing agreements, whether such financing are subsidies, grants or even simple sponsorship. The financing agreements may take the form of large projects or contracts. In both cases, the organization must comply with the provisions of the agreements, respectively spending the funds for the purpose for which they were received. In this respect, the internal auditor should aim at specific targets which could cover the field of verifying the clauses of the existing funding. These objectives were to[14]:
• the existence of a signed agreement in place for each accessed grant or fund category;
• the existence of procedures regarding the process of controlling if the grant conditions are reasonable before signing agreements;
• grant conditions on procurement are known by finance staff, budget holders and procurement officer(s);
• received funds are kept for the destination they are meant for and never ‘borrowed’ for other activities with a financial deficit;
• there is compliance with the terms and conditions in grant agreements and there are financing reporting to the donor regarding that the use of funds are clear and on time.

An important aspect of funding concerns the risk that a contract with a significant funding could stop. This should be considered in planning the process to establish the applicable procedures in order to alert the donor’s intention to withdraw funding.

The financial and the accounting information generated by a non-profit organization is influenced by not only the staff’s skills in the financial department, but also the managers’ skills, the budget responsible, the program directors and the staff subordinates. The internal audit must formulate objectives regarding the human resources involved in generating financial-accounting information. These include [14]:
• the board or general meeting of associates includes someone with the financial skills needed to oversee all financial activities;
• the finance staff is qualified and they have the skills they need to carry out all financial activities;
• managers and program directors have the financial skills they need to manage and monitor budgets;
• different roles within the finance function are clearly defined and the employees know and follow their job description;
• senior staff lead by personal example in following control procedures;
• the existence and the respecting of procedures regarding the staff recruitment based on candidates’ skills;
• all staff receive the training and support they need to be updated in the legal requirements regarding their activity, to be able to carry out their financial responsibilities within the nonprofit organizations.

In accordance with the applicable law in the field, the non-profit organizations are entitled to use the human resources in their activities, who were hired based on a voluntary agreement. This must be realized under the volunteering law no. 195/2001, which provides specific clauses for such a contract. The existence of volunteers imposes a specific goal within a human resource audit, namely: the existence and the compliance of the volunteering contracts with the laws in force.

5. Conclusions
The associations, the foundations, the federations, which are named non-profit organizations are legal persons with non-profit funding. Because of this specific they have, by law, they need to comply with their needs. Mandatory legal imposition of internal audit is based on the funding method and its status, in effect those that are funded at more than 50% of public funds and/or those that have public benefit status must organize internal audit.

Internal audit planning of the non-profit organizations is realized in accordance with the legislation in the field and follows the same approach as in the case of other types of organizations. However, the aim in planning them is strongly influenced by the characteristics of non-profit organizations that generate a number of specific risks.

The peculiarities that need to be considered are related to:
- the financial accounting system – the specific aspects of the applicable rules, the existence of a cost allocation system, a way to materialize the donations, not–exceeding the budget;
- the budgetary system – involving the management of the program and the fundraising directors, of the accounting staff in preparing and monitoring budgets, which should be fit for the organization’s purpose and for the implemented programs;
- the internal control system – there were implemented some internal control policies that reflect the specific of the organization and refer to the preventive control, not only afterwards;
- the financing method – the staff needs to know and comply with the contractual clauses (where available) disclose the possible changes, especially in the case of termination of contracts on significant funding;
- human resources – the effects of cost constraints on the number of employees and their level of qualification and the existence of voluntary human resources.

We can conclude that in the audited areas there are a number of risks arising from the organization and the operation of non-profit organizations, from the financing and the human resources that are involved. All these features are generated by the social purpose of these non-profit organizations and the auditor must take all these into account when planning the audit mission.

6. References

[7]. The public audit law no. 672/2002, republished in Official Gazette, no. 856/2011.