

Impacts of Financial Management Standard Operating Policies' Implementation on the Organization's Internal Controls and Donor Aids

Author's Details:

⁽¹⁾**Naeemuddin Shaikh**-MS scholar, Department of Business Administration
Shah Abdul Latif University Khairpur ⁽²⁾**Dr. Irfan Ali**-Assistant Professor, Department of Business
Administration Shah Abdul Latif University Khairpur ⁽³⁾**Mazhar Uddin Shaikh**-M. Phil Scholar, Department
of Economics Shah Abdul Latif University, Khairpur

Abstract

Non-Governmental Organizations are dependent on the donor funding, and donor(s) demands strong internal controls. Fewer funds less sustainability more funds more sustainability.

This study investigates the impact of FMSOPs financial management policies over internal control and donor aids and why these are necessary for the organization development. For analysis primary data collected from 191 respondents and five point's Likert scale method used. Data collected from NGOs experienced staff. This study concluded that financial management standard operating policies strongly and significantly related to internal controls and donor aids. Organization assessment is the part of donor agencies before making partnerships. Therefore, it is recommended to implement the FMSOPs in NGOs for transparency and earning donors' trust.

Key Words: Financial Management, Standard Operating Policies, Internal Controls, Donor Aids, Non-Governmental Organizations

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Non-Governmental Organizations (NGOs) or Not for Profit Organization (NPO) are playing a vital role in the development of the country, especially for the developing and underdeveloped countries and work voluntarily, for the communities development and social welfare purpose. NGOs can be registered under different acts such as The Trust Act, 1882, Societies acts 1860, Local Government 2001, Companies ordinance 1984 (Section 42), Cooperative societies act 1925, Charitable endowment act 1890, Volunteer social welfare Agency and control ordinance 1961 and Income tax ordinance, 2001.

In developing and underdeveloped countries, this is not possible for the countries to closely fulfill the needs of communities by their government due to insufficient funds. This is the prime responsibility of the government to fulfill the needs of the people. NGOs provide volunteers facilities to communities and as well as the government for social welfare. On behalf of the government, NGOs work in those areas where the government couldn't pay their attention such as education, health, basic infrastructure, agriculture etc. And they work on behalf of the government in providing basic necessities in many circumstances and resolve other basic issues such as income, poverty alleviation, human rights, women empowerment etc. The government must have an explicit policy of the other country strategic interest and the encouragement of the involvement in social welfare and development (Pasha & Iqbal, 2002). This indicates that explicit financial Standard operating policies thereafter SOPs are missing.

This is very important for NGOs to develop effectively SOPs as they record and report to stakeholders fair, transparent, and actual financial reports. Reported Financial Reports figures and Audited figures results must be

same and true¹, as donors create trust on the Implementing Partners IPs the future partnerships and agreements. Preparing the SOPs is not sufficient but this is very important for an organization to implement² it within the organization. SOPs will assure the Government of Pakistan that organization working transparently.

Internal Controls detect frauds and errors (Kieso, 2010). This can be misconception that internal controls only are sufficient for the purpose of detecting and preventing fake records. According to Wilhelm (2006), Internal controls are the most important for the NGOs because NGOs need to develop trust in the communities and as well as the donor. Corruption, misappropriation, and fraud take place due to poor internal controls (Miller, 2005). Management put internal controls for the reasonable assurance of the effective and efficient operations in the organizations, reliable financial and compliances laws and regulations (Petrovits, 2011). Effective implementation and monitoring of Internal Controls ensures NGOs to meet objectives and good controls will benefit performance of the organizations, encourage management, proper financial reporting, and safeguards, deter and detect fraud and errors and reduce risk (Google, 2001).

The researcher has observed the issue of financial SOPs implementation on internal controls and tried to find out same or related research articles and dissertations on the internet and not found any on³ the internet the like, Google⁴. It may be not founded by the researcher due to access to the research articles but researcher not found, anywhere or It may be due to this area is not interesting for the other researchers. In the past and indirectly, this issue raised by Asian Development Bank in his ‘study of NGOs’ research, in 1999, Pasha and Iqbal in his research “Non-profit sectors in Pakistan: Government Policy and Future issues”, Ayesha khan and Rabia khan in their research paper “Civil Society and social change in Pakistan” for the financial dependency, Phillip Tamminga and Mansoor Raza in his case study “Reviewing the draft certification Model” in 2014 and George E. Peterson in his draft “Pakistani’s fiscal decentralization: issues and opportunities”, in 2002.

This research is important for the country and organizations for the internal controls and donor aids because NGOs supports to the government in the form of third sector organizations but organizations must keep in mind the countries interest.

Literature Review

Strong financial management, disclosure channels, and well-established policies prevent the misuse of funds. For the NGOs, financial management should be the top most priority to reduce risk while no systems in organizations will increase the risk of employee corruption (Semrau, Scott, & Vian, 2008). In NGOs, donor agencies always give pressure to achieve targets within a short period of the time and due to job insecurity staff gets advantages in the shape of Corruption. Corruption can be reduced through strong management policies and strong internal controls. Management always focuses on the targets achievement and not focusing on the misuse of funds and selection of the hired staffs. So it needs clear attention towards the organization internal controls. Properly capitalized, funded and sustainable is essential for the non-profit organizations and NGOs are an economical and legal institution and its mission is to move forward the economic and social welfare of the society (Bryce & Bryce, 1999). Effective financial management is essential for the performance of the financial

¹ NGOs Submits monthly or quarterly financial reports to donors. Donor sends auditors to its IP, to verify the financial reports which they have submitted to donor liquidation or for other funding. Audit reports and submitted reports must be same and true. This is verification tool of the Donor through NGOs Audit.

² Financial management and its governance is the big issue due to proper regulatory authority check and balances as State Bank of Pakistan (SBP) has regulations for the banking sectors.

³ Twenty points announces by the Prime Minister of Pakistan in National Action Plan on December 24th, 2014 and on the next day published in newspapers (source: <http://www.thenewstribune.com/>)

⁴ Searched in between the September 15th, 2015 to October 10th, 2015 on the internet such as Google and Google scholar

management (Su, Nuryyev, & Aimable, 2014). Total assets, fiscal performance, and fundraising positively connected with the number of individuals. Lee (2010) states that higher ratio specifies better financial management in NGOs. Greater efficiency in lower ratios (Ritchie & Kolodinski, 2003). NGOs performance depends upon the efficient management of financial resources (Green & Griesinger, 2006) and employees have progressively more recognized the importance of finance in NGO (WTO, 2007). Total contribution and fundraising cost measured by the fundraising efficiency and it specify the amount increases for each dollar of fundraising cost incurred (Green & Griesinger, 2006; Janet & Bukovinsky, 1998; Lee, 2010).

According to (Mohamed, Ab Aziz, Masrek, & Daud, 2014) significant attention required for the receipts and disbursement. Identified problems and weakness improvement increase the control over resources, relationships, accountability and financial reporting (Mohamed, Ab Aziz, Masrek, & Daud, 2014). Accountability has Internal and external dimensions. Felt responsibility is the consequences of internal motivations and expressed through individual actions and organization mission (Fry, 1995) and according to Chisolm (1995), external is an obligation to meet agreed standard behavior. In charities, trust is low at all times (Palmer & Randall, 2002). Fraud and misappropriation are common in western church (Duncan & Flesher, 2002). Amudo and Insanga (2009) states that effective internal controls for operations need monitoring.

Internal controls have a significant relationship with internal controls with operational efficiency and it improves organizational workflows the like communication, budgeting, and planning (Ochieng & Njeru, 2014). Internal controls need proper Audit and communication. Ray and Kurt (2001) states that control activities need regular monitoring and evaluation along with audit and compliances. Goodwin-Stewart and Kent (2006) states Internal Audit division needs assurance to reduce the risk. The chief accountant must establish a separate department for the record keeping (Keitany, 2000). Preventive controls used to control undesirable events and detective controls used for to identify the undesirable acts in the organizations (COSO, 1992). In other words, preventives controls are pre and the detective is post controls. Both have own importance in the organizations. Result oriented Post controls may be added in the future organization policies.

Donor community needs efforts towards the development of the human resources management (Bongani, 2013). Employee focus is better than money and welfare. Employees training and development will increase the employee's accountability and they will work according to the organization's requirement. Management review, financial and not financial controls minimize the risk in NGOs. In uncertainty situation – where no proper segregation of authorities occurs, increases the chances of fraud and errors (Maria Bruno-Britz, 2008). Approval and authority create accountable to safeguard the organizational assets. (Jie & Guoping, 2011). Dedicated and hardworking employees are safe for NGOs (Sun W. Stewart, J and Pollard & D, 2011). For one work, three members should be accountable for good internal controls (Pan, 2011). Later, the purpose of controls expanded with the concept of achieving goals and getting things done (Ming, Yang, & Wang, 2009).

According to (Accountants, 2010), public financial management is completely significant to humanizing the excellence of public service outcomes and it also guides that how funding can be used to concentrate on local and national level issues. A number of deferent models have been developed for the financial Management; the Audit Commission Model developed by the Audit commission in England, Public financial management (PFM) measurement model developed by the Public Expenditure and financial accountability secretariat and ten steps to success model by HM Treasury Financial Skills Advisory Panel (UK). These models have been developed to help the organization for the financial management improvement and assessment and how healthy their financial management functions are performing.

Researcher has recognized six main reasons; have focused on the self-regulation initiatives, rapid increase of the NGOs and its impacts on the accountability, changing in policies is the key success, NGOs defines new areas for the government, standards are very important for all countries and those who already have, must will society trust and meet higher standards in the organization's operations and need for the funding opportunities for the organization's operations (Lloyed, 2005).

NGOs has a very well record to identify the issues for the communities but they need strict ethical principals in

the form of codes and standards (Argandona, 2007). NGOs are the “Third Sector” organizations and works for the improvement of the society in the field of development sector and sustainability (Aenor, 2004). Financial suitability is not only the problem but they must be effective and efficient. Mismanagement and embezzlement of the funds in the religious organization particularly in church becoming common and this acts raised lots of questions on the organization's Internal controls and procedures (Ahiabor & Mensah, 2013). The financial failure of internal controls impacts on the institution's success.

Efficient Financial Management (FM) is the pillar for all entities but when well financial management executed (Aldaba, 2002). In recent times, importance and sensitivity of the financial governance and accountability are the main issues of the stakeholders (Zadek, 2003). A well-structured and specific financial governance feature attracts donors for funds (Hearn, 2001). Objectives of FM are to effectively utilization of resources, high transparency, accountability and long-term economic achievement (Fiador). According to Pretorius (2008), the importance of FM is to service delivery, poverty reduction and Millennium development Goals (MDGs). Projects FM and Financial analysis guidelines indicating the efficient arrangement of appropriate FM systems can be interpreted as on behalf of sound FM and good governance (Group, 2006). Proper FM and Governance is the survival of NGOs and those will survive who have proper financial systems otherwise early death of organizations (Fiador). Managers must increase the capacities of the organizations and strengthen their planning, financial monitoring and impact evaluations and these must be improved before submitting the reports as per contractual agreement (Pollock, 2003). Financial policies and procedures are critical for all organizations because it guides the staff regarding working and process and policies must be understood by all staff and governing body for implementations (ICD, 2005).

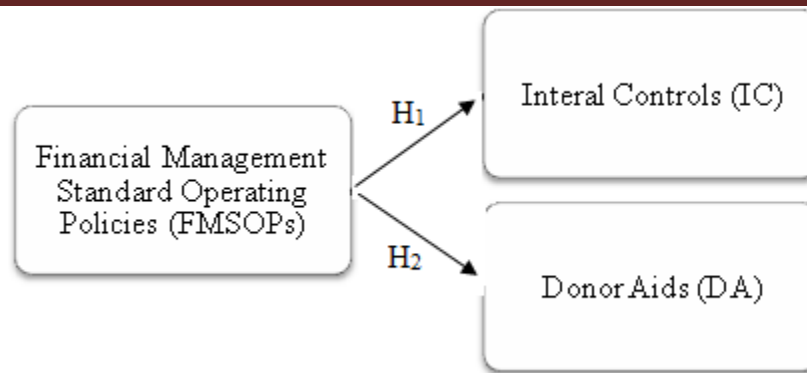
Financial Sustainability (FS) is the big issue for NGOs (Pasha & Iqbal, 2002). Donor agencies fully examine and assess the capacity of the organizations and this can be done through Internal Controls, in-depth financial management capacities and practices of the Organizations (Chene, 2013) and these can be developed in shape of Organizations SOPs for organizations systems (Chene, 2013). Financial Management Standard Operating Policies (FMSOPs) is one of the most important documents required by the donor agencies for financial assistant or grant or funds and they review it in details before funding (Chene, 2013). Some donors provide organizations own developed FMSOPs. This research will provide to readers the number of benefits the like; 1. NGOs will understand the importance of the FMSOPs, 2. Its impacts on the Organizations Internal Controls and 3. Proper funds utilization is the main objective of the donor agencies. The donor will blacklist organizations if funds not properly utilized by the Implementing partner⁵ (IP). Project documents and contracts, operational guidelines and manuals and Policy documents are the implementation instrument (Chene, 2013).

Hypothesis

H₁ Financial Management Standard Operating Policies positively affect internal control

H₂ Financial Management Standard Operating Policies positively related to Donor Aids

⁵ Implementing Partner (IP) will sign a Memorandum of Understanding (MoU) or agreement and will be responsible for the NGOs program or project activities and specified deliverable. In return, Donor agency will provide funds to IP.



Methodology

In this research, primary data collected through good structures five points Likert scale method. Questionnaire divided into four sections; Demographic, Financial Management Standard operating policies, internal control, and donor aids. Data collected from 191 respondents and questionnaire completed by the respondents. Researcher only guided regarding the questions for clarifications and all questionnaires filled in the field. Researcher completed this task in 90 days.

The questionnaire consists of four sections: First, we included only demographic related questions such as Gender, Age, qualifications, and experience and career maximum rank. For this research, this is necessary to collect this demographic information from the respondents. Second, we set financial management standard operating policies’ related questions. This section, provide us current knowledge, importance, and impacts of this subject related questions. Third we designed internal control related questions in order to know either they know the internal controls, its importance and after its implementation impacts on the organization controls. Last, we developed donor aids related questions. We wants to know the either they are dependent on the donor's aids and what will be the impacts of these control on the organization’s sustainability.

After making above mentioned question we run the reliability test of the questionnaire and got the results that qualifies the reliability test.

After running reliability test we tested the impact of FMSOP on the internal control and donor’s aid.

$$IC = \alpha + \beta_1 \text{ FMSOP} + \mu \dots\dots\dots (1)$$

$$DA = \alpha + \beta_1 \text{ FMSOP} + \mu \dots\dots\dots (2)$$

IC = Internal Control

DA = Donor’s Aid

α = Intercept

β_1 = Coefficient for IC

FMSOP = Financial Management SOPs

μ = Error Term

Results and Discussion

Table 01: Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.930	.930	29

In this research, Reliability statistics shows Cronbach's Alpha .930 for 29 items, suggest that items have relatively high internal consistency and this is acceptable.

Table 02: Correlations

		M_FMSOP	M_IC	M_DA
M_FMSOP	Pearson Correlation	1	.861**	.784**
	Sig. (2-tailed)		.000	.000
	N	191	191	191
M_IC	Pearson Correlation	.861**	1	.957**
	Sig. (2-tailed)	.000		.000
	N	191	191	191
M_DA	Pearson Correlation	.784**	.957**	1
	Sig. (2-tailed)	.000	.000	
	N	191	191	191

** . Correlation is significant at the 0.01 level (2-tailed).

Financial management standard operating policies is highly correlated with internal control (.861) and donor aids (.784). Internal control is highly correlated with financial management standard operating policies (.861) and donor aids (.957). Donor Aids is highly correlated with financial management standard operating policies (.784) and Internal Controls (.957).

Diagnostic Test 1: $IC = \alpha + \beta_1 \text{ FMSOPs} + \mu$

Table 03: Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.831	.830	11

In this research, Reliability statistics shows Cronbach's Alpha .831 for 11 items (Internal Controls), suggest that items have relatively high internal consistency and this is acceptable.

Regression

Table 04: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.861 ^a	.741	.739	.37297

a. Predictors: (Constant), M_IC

Table 05: ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	75.083	1	75.083	539.757	.000 ^a
	Residual	26.291	189	.139		
	Total	101.373	190			

a. Predictors: (Constant) M_FMSOP

b. Dependent Variable:, M_IC

According to the results, adjusted R Square (.741) shows fitness of the model and value of the adjusted R Square represents the variance of independent variable (Internal Control) with the dependent variable (Financial Management Standard Operating Policies) that is .739=73.9% (Table 04) that shows good importance on internal control and model is significant at the level of .000 (Table 05).

Table 06: Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.372	.086		4.344	.000
M_FMSOP	.800	.034	.861	23.233	.000

a. Dependent Variable: M_IC

According to the value of β of FMSOP, that is positively and significantly (.000) related to IC and both have a good relationship. According to the coefficient table, by the looking at the value of significance we can say that FMSOP predict the behavior of IC significantly because the p-value is less than 0.05 hence H_1 accepted.

Diagnostic Test 2: $FMSOP = \alpha + \beta_1 DA + \mu$

Table 07: Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.768	.767	8

In this research, Reliability statistics shows Cronbach's Alpha .768 for 8 items (Donor Aids), suggest that items have relatively high internal consistency and this is acceptable.

Regression:

Table 08: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.784 ^a	.615	.613	.45444

a. Predictors: (Constant), M_DA

Table 09: ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	62.342	1	62.342	301.870	.000 ^a
	Residual	39.032	189	.207		
	Total	101.373	190			

a. Predictors: (Constant), M_FMSOP

b. Dependent Variable: M_DA

According to the results, adjusted R Square (.615) shows fitness of the model and value of the adjusted R Square represents the variance 1in independent variable (FMSOP) change the dependent variable (DA) by 61.3% (Table 08) that shows good importance of donor aids and model is significant at the level of level of .000 (Table 09).

Table 10: Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.563	.103		5.458	.000
M_FMSOP	.715	.041	.784	17.374	.000

a. Dependent Variable: M_DA

According to the value of β of FMSOP, that is positively and significantly related to DA and both have significantly positive relationship. According to the coefficient Table 9 and Table 10 the p-value is less than 0.05 thus it is concluded that FMSOP strongly and significantly correlated to DA.

Conclusion and Future Research

Organization policies are the basic guiding principle for the staff and they get guidance from the manuals. Manuals reduce the fraud and forgery and also guides to evaluators to find out the errors (intentional and unintentional). Just drafting the book of manual is not sufficient and it needs its implementation and needs proper monitoring mechanism as authorized in the organizational manuals. External stockholders always see the organization systems and procedures through manuals and daily operations. Some organizations don't have proper manuals but they run their organizations through best practices and well qualified and experienced staff uses the best expertise to run the organization in a proper way.

Today's best practices are the future policies. In this way, donor agencies build the trust on the organization and they make partnerships with organizations whose strong internal controls are developed. Donor agencies assess the organization's systems and procedures before the partnerships or offering grants. Once organizations establish strong internal controls, its impacts on the donor funds attraction and will affect higher output in the communities in the shape of community development. In this way, the amount of corruption will be invested in the communities and for community welfare purposes. From start to end donor agencies needs trust and this can be built through satisfactory deliverables.

Future Research may continue to test the model in any other NGOs with different respondent to test the validity of the model we proposed. The questionnaire may be adopted to test its reliability.

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