

## Internal Audit & Loss Prevention in Charities

Charities have existed for a long time and as time has progressed there has also been some advancement in the manner that charities have used the media and other forms of advertisement and promotion to attract more and more donations. However, in the sophisticated world today where corruption is rampant in certain sections of society and where white collar crimes are becoming increasingly abundant day by day there is cause for concern that charities also be regulated. The Charities Act of 2006 in the United Kingdom has defined a charity to be an institution that has been designed and established as a charitable organization and for such purposes (Great Britain). A charitable purpose may be many but the broader ones that are defined by the Act are those purposes which would help in prevention of poverty, for the advancement or religion, education health and other forms of good that would help an individual to help improve their way of life.

Charities have existed in every nation across the globe. Some are making headways in the elimination of starvation in the African nation while others are working to provide health care. Many charities are established for the purpose of the promotion of religious activities. Now there has been concern over the amount of corruption that has been on the rise in charities and that a lack of any impartial auditing in charities has led to rampant corruption. In the United Kingdom a Bribery Act 2010 has been enacted in order to minimize the risk of bribes taking place (Ministry of Justice). Bribery was already considered to be a crime after the enactment of the Corruption Acts 1889 -1916 and the common law also provided some stiff obstacles. The law was, however, outdated and needed a reformation and due to the seriousness of the offence on the rise at a daily basis there was a need to improve on the law that was outdated, fragmented

and needing attention. Bribery is considered by the legal system to be a serious offence that has very damaging implications for those who are involved and certainly does harm to the morals and ethics of a person or a business which is considered to be involved. Reform of the law has helped countries to be better prepared to tackle the issue of corruption in a time when international corruption is on the rise. This law has helped to better allow the police and prosecutors along with the courts to take on bribery whether it is at a national level or international. According to transparency international corruption adds about 10% to the total cost of a company's business transaction (Transparency International UK) and that acts such as those passed forth by the United Kingdom parliament are strong barriers against corruption.

The Foreign Corrupt Practices Act in another important legislation that was passed (FCPA Enforcement). In 1998 the United States of America's congress along with some thirty plus countries got together and aimed to launch a fight against acts of bribery and corruption of foreign officials which mostly looked to include government officials. This was due to the rampant use of official authority by government officials in high up posts as well as high ranking army officers in order to gain more power and money through acts of corruption. This legislation has had quite an effect on the manner that businesses are done in the United States as well as in other nations. Those institutions that fall under the banner of finance have been more effected than others as they are now expected to mean a tough criterion in order to be allowed to make global financial transactions. Not only this but they must also be able to show to the authorities that they are placing a number of checks on their system. These institutions are also charged with a heavy burden of having reliable information on their customers and be sure that all transactions done are legal and that they are taking due diligence to avoid any fault on their part. This act not

only extends to the citizens of the United States or to businesses that are registered in the country but also to those institutions that are bringing their business to the country.

In recent years there has been deep concern over where the money that is sent to charity is being spent. This concern is over a number of reasons such as bribery and corruption but a misuse of funds is also in the minds of all who are connected to such organizations. Terrorism is now a major issue and many of the countries have suffered their fair share of terrorist related incidents. Terrorist organizations are making use of Islamic charities in order to fund their operations and this is perhaps even unknowing to those who donate (Looney). The idea of charity and giving alms is quite stringent in the Islamic faith being one of the five pillars and so families' give charity to organizations that disguise themselves as charities in order to inject money into terrorist cells. According to Robert Looney there is a system of money laundering that takes place in cases of Islamic charities and he explains:

*“The criminal phenomenon of money laundering can be described in practical terms. In the case of terrorist financing through the exploitation of charities, however, only the theory is clear: it is the reverse of money laundering. While money laundering is concerned with laundering assets of illegal origin and bringing them back into legal economic circulation, charity-based financing of terrorism is concerned with using legal assets for an illegal activity, namely terrorist attacks. In other words, with money laundering the illegal activity can be located at the beginning of the process whereas in terrorism financing the entire process is reversed.”* (Looney)

Similar exploitation of money is not restricted to the donations, rather as previously mentioned; there have been cases where government individuals and officials

become involved. In Israel the late Prime Minister Ariel Sharon was questioned along with his son over the transfer of about US\$ 1.3 million to his party during elections (Transparency International). There were fraud cases that related to the Salvation Army which was in the center of a scandal in 1993 (Boggan). The charity was responsible for the loss of around six point two million British pounds and it was said that only one million of the total amount was recovered. A case such as this may be rare and one out a hundred but the chances of embezzlement, corruption, fraud and bribery stand to be reckoned with when there are no body set up to counter such acts. Another case that was brought to the front regarding the misuse of charities was that of the Sherburn Hospital Charity where the charity was being used as a front for the benefit of two of the major employees (Plummer).

Introducing auditing of charities by groups that are impartial to the charity and have no connection to it can help to stem out these issues of not being able to readily check and observe where money is being spent. Internal audits are tools that are available to companies as well as charities to check the risk that they are taking and are also seen to be somewhat of a self-assessment tool. Audits help to provide data to an organization about the risk management and other important factors such as health and safety as well as data protection. In the case of a charity an audit committee would typically be expected to overlook the risk that the charity is taking and make an assessment of whether it is to be taken or not and how best to manage the limited resources that charities have.

Growing inflow into charities has led to a cry by many to place checks on the situation and regulate the charities as per law. In England there are bodies such as the Charity Commission which is an independent regulator of the work that is done by various charities

(Charity Commission). Some charities are certainly doing their best to be beneficial to others but there are some that are not as transparent as one would like and so if a complaint is made then the Charity Commission takes a look into that organization. Any causes of concern are reported and these may be due to a number of reasons which include any unauthorized benefits that the charity trustee may be getting or if there is some wrongful manner used to gain or dispose of land that belongs to the charity (Hopt and Hippel).

Currently there is no real law that requires any charity to have some form of mandatory internal audit of their institution to provide a picture of their financial situations. There may be certain states or countries that are growing wary of this loophole and are looking for ways to fill in the gap. The state of California in the United States has now made it a mandatory process to have an audit in a charity that has revenues flowing in that are in excess of two million. Not only is this lack of auditing a cause for concern there is even a serious lack of introducing a form of independent auditing committee even. Many organizations and institutes will have an audit committee which will chair a member of the charity itself whether it is the chief financial officer or the chief executive officer. Such chairing of members of the charity present in the committee itself will make it harder for the committee to be unbiased and tough on the charity and their practices. There are even some groups that are calling for an independent audit committee to be presiding over the issues of the charity so that it is free from any bias and as strict as possible or required for the sake of the charity. A Panel on the nonprofit sector (Hopt and Hippel) has recommended that charities have an audit committee that chairs some individuals who are knowledgeable in the financial aspects of business.

Auditors should be selected by organizations keeping a few key factors and points in mind. There should firstly the audit firm that has been chosen should have enough resources in

its pool to complete the audit without any problems. This makes for a logical and effective manner of proceedings. Secondly the firm should have ample experience in performing audits for charities so as to do their job well and not cause trouble later for the charity. The firm should have a sound reference from others over the quality of work supplied. Any plans for a future feature to be installed in the charity should be assessed by the firm in a well organized manner and then implemented. One key factor that the charity should keep in mind is that the auditing firm should be independent of the charity and not affiliated with it in any way. Any affiliation or link that is present between the firm and the charity will more likely lead to speculation over the transparency and the bias of the report. There may even be cases where re-auditing may be required which can lead to unnecessary use of resources, both in terms of time and money on behalf of the charity and can even cause embarrassment.

There need to be internal forms of control that charities need to explore in order to downsize any loss prevention. This can be done by implementing certain rules such as all cheques in excess of a certain amount need to be signed by more than one board member in order for it to be put through. There can even be a bar placed on the amount of goods or cash that belongs to the charity that can be removed from its premises. In the technological age today there can even be computer checks that can be used to keep a tight leash on the budget of the charity and its resources and their conditions. Loss prevention can keep a charity from losing resources and keep it out of bad press (Futter).

Internal auditing and loss prevention needs to be a feature that should be a part of every charitable organization and its lack of is a cause of concern. There are legislations that are being designed such as the bribery act and so forth to limit the misuse of power, authority and the generosity of people. Charities are now, in a manner of speaking, businesses and in 2009 there

was a total of US\$ 303.74 donated to charities in the United States (Charity Navigator). These need to be observed and money needs to be accounted for as well as other goods as people donate in good faith that what they are giving is going to a cause and not into pockets of individuals. Though scandals in charities are rare there are cases which cause problems for the entire group of charities and to do things in a legalized manner is perhaps better. Countries and states in America are slowly moving towards introduction of laws that require auditing in charities and perhaps this is best and charities should take initiative before the law forces them to do so in the end.

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