

## **CHAPTER 1**

### **INTRODUCTION**

#### **1.1 Research Background**

Nowadays, there are many non-profit organizations (NPO) appear in our society. A non-profit organization is an organization which its main function is supporting social or public issues such as poverty, religion, education, health, politics and social without primary attention to accumulate profits. The examples of non-profit organization can be foundation, public charity, membership organizations, public clinics, religious organizations and trade unions.

As the main characteristics of non-profit organization is not accumulating profits, they depends on the sum of donation collected to finance their business practices. According to PSAK 45, non-profit organizations obtain financial resources from donations, membership fees, fundraising and other contributors who do not expect any compensation from the organization (IAI, 2004). As a result, the measurement of the amount of donations as organization's revenue and cash flow is a matter.

Non-profit organizations can also obtain their financial resources from the allocation of state budget, grants from charitable foundations, public donations, local and international financial institutions funds through partnership program. However, non-profit organization has a limited financial resource so they must manage their organizational funds effectively and efficiently to be able

to run their social program, such as enhancing people health care, reducing poverty, advocating human rights.

A non-profit organization has been the target of increased scrutiny over governance, accountability and compliance (Jacob, 2014). Any kinds of intentional and unintentional errors and mistakes that happen in any organization can and does happen at nonprofit organizations (Nelson, 2010). Therefore, a non-profit organization needs an internal audit function within their organization.

Some problems might be appeared in managing non-profit organization fund, for instance, they find difficulties in measuring their financial and non financial performances, experiencing in a misuse of fund and a lack of human resource skills. Those problems challenge their efforts in elevating their productivity and efficiency in order to achieve their organization's goals. Moreover, global non-profit organization, such as Green Peace; Worldwide Fund (WWF); Association Internationale des étudiants en Sciences Economiques et Commerciales (AIESEC); Technology, Entertainment, Design (TED) and Save the Children, tends to have a big operation and also involve a lot of funds inside the organization.

The unit of internal audit in non-profit organization helps the management to achieve its organization's objectives. It should have a systematic approach to evaluate the implementation of internal control's policies and procedures. Its existence in nonprofit organizations aims to improve the efficiency and effectiveness of management and to enhance the quality of governance and to fulfill organizations' accountability to stakeholders. The scope of the internal

audit function covers all stages in the activities of the organization (Boynton, Johnson, & Kell, 2003).

The AIESEC (Association Internationale des étudiants en Sciences Economiques et Commerciales) is a global not-for-profit organization which concern on leadership development and student exchange. AIESEC located in 124 countries. AIESEC also have an office in Indonesia which called as the AIESEC Indonesia. This organization is a non-profit organization that its financial resources from the collection of membership fees.

As the AIESEC depends on the membership fee to run its programs, it has a limited resources. Therefore, the AIESEC needs to manage its fund through the implementation of internal control when it is operating its business. The role of internal audit unit in the AIESEC is also important as it has a responsibility to conduct its task in ensuring the compliance of internal control system when the AIESEC management do its business. This situation is also applied in the AIESEC in Indonesia. The size of AIESEC Indonesia is big so it has national committee and local committees. A national committee has responsibility to ensure the local committees do their operation based on national committee' strategic planning. Therefore, AIESEC Indonesia established internal audit committee in 2013 to ensure there is no fraud happened in the organization because it against the value of the organization.

Conducting an effective internal audit process in non-profit organization is important to increase the accountability of the organization. The higher the

accountability, the more trust their stakeholders give to them which will impacted the amount of fund for the organization.

Non-profit organization might understand the importance of the internal audit function within their organization, but, they do not know how to do an internal audit in their organizations because there is no specific regulation on how a non-profit organization should implement the internal audit process. Thus, this study aims to define an internal audit implementation in non-profit organization to give guidance on how to implement an internal audit process in non-profit organization.

As the implementation of internal audit process will define the effectiveness of internal audit function, therefore, it is necessary to conduct further research on how the internal audit process is implemented in a non-profit organization, does the internal audit process in accordance with the regulation/existing theory. Thus, this study focuses on how is the implementation of internal audit process in non-profit organizations. The implementation of internal audit in AIESEC Indonesia is used as a case study.

## **1.2 Research Question**

According to background, researcher formulates research question about how does a non-profit organization apply internal audit process?

## **1.3 Research Objectives**

1. To enrich accounting literatures in the subject of public sector accounting, particularly in non-profit organization

2. To enrich studies in the implementation of internal audit in non-profit organization

#### **1.4 Research Contributions**

The contributions that can be obtained from this research are:

1. This study will contribute an empirical study in the area of internal audit application in a non-government organization, especially non-profit organization
2. This study also will develop some lessons that would be beneficial for non-profit organizations to improve their performance management
3. This study could be a guidance for non-profit organization to conduct internal audit process

#### **1.5 Research Systematic**

The systematic can be breakdown as follow:

##### **CHAPTER 1: INTRODUCTION**

In this chapter, will explain the background of the research, research questions, research objectives of conducting this research, and research contributions that can be given throughout this research.

##### **CHAPTER 2: THEORETICAL REVIEW**

This chapter will figure out theories related to this research that consists of definition of internal audit, the function of internal audit, implementation of internal audit process, internal audit in non-profit organization, research framework and prior research.

### **CHAPTER 3: RESEARCH METHODOLOGY**

This chapter will describe the method used in this research which is qualitative method. Primary data is obtained by conducting observation and interview in the research object. Secondary data is obtained by documentation which collecting several documents related to internal audit process.

### **CHAPTER 4: RESULT AND DISCUSSION**

This chapter will provide the organization's profile, internal audit committee, and implementation of internal audit in AIESEC Indonesia as research object of this research. Analysis of the internal audit implementation in non-profit organization will be discussed in this chapter.

### **CHAPTER 5: CONCLUSION AND SUGGESTION**

Conclusions about this research based on the result and discussion in previous chapter will be written in this chapter. Suggestions are following after conclusions.