



## Improvement of Audit in Non–State Non–Profit Organizations

Mekhriddin Sulaymonovich Khojiev

PhD, Associate Professor, Tashkent Institute of Finance, Uzbekistan

E-mail: [dj.msx@mail.ru](mailto:dj.msx@mail.ru)

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### **Abstract**

In the context of innovative development of the economy, making decisions on the interaction of individuals and legal entities with non–profit organizations, as well as assessing the risk of investments, contributions, grants and other targeted sources of financing for the activities of non–profit organizations is impossible without providing reliable financial (accounting) statements. Auditing such reporting should distinguish between non–state non–profit organizations (NSNPOs). Therefore, this article discusses the differences between audit between commercial and non–profit organizations in solving urgent problems in Uzbekistan. And also, the procedure for the main activity of auditing in non–governmental non–profit organizations is recommended.

**Keywords:** *Commercial Organizations; Non–State Non–Profit Organization; Mandatory Audit; Voluntary Audit; Audit Union; Audit Firm; Target Financing; Organization’s Budget; Program Budget; Targeted Receipts; Targeted Financing*

### **Introduction**

The development of a system of non–state non–profit organizations (NSNPOs) – a social partner of state bodies and business structures, is one of the effective mechanisms for maintaining a balance of interests of all social strata and groups in society, checks and balances that guarantee stable, progressive development of society.

A non–state non–profit organizations (NSNPOs) is a self–governing legal entity created on a voluntary basis by individuals and legal entities that does not pursue the generation of income (profit) as the main goal of its activities, engages in additional business activities within the framework of the charter and does not distribute the income (profit) received between its participants (members) [8].

According to the approved basis, the principles “From the Action Strategy to the Development Strategy” of the Development Strategy of New Uzbekistan for 2022 –2026 and the State Program for its implementation in the “Year of Ensuring Human Interests and Development of the village” according to the following main priority areas. This is an increase in the effectiveness of social partnership, a doubling of the amount of state support for non–governmental non–profit organizations and other civil society institutions in the form of subsidies, grants and social orders, as well as a seven–fold increase in the amount of funds allocated to public funds for supporting non–governmental non–profit organizations and

other civil society institutions under the Councils of People's Deputies<sup>1</sup>.

It is these key tasks that should become the starting point for making serious adjustments to the main directions and priorities for deepening economic reforms [3]. Depending on the type of exercised constitutional rights, the purpose of creating an association follows accordingly.

## ***Research Methodology***

In the organization of audits in the implementation of scientific research, the audit of the use of targeted revenues and funds from commercial activities in the NSNPOs, as well as performing analytical operations during the audit, studying the opinions of economists on obtaining evidence, expert evaluation, monitoring processes, systematic approach to economic events and processes, comparative analysis suggestions and recommendations were given in the relevant directions.

## ***Literature Review***

The organizational and legal aspects of accounting and auditing in non-state non-profit organizations have been studied by some foreign economists. Among the scientists of the CIS countries, certain issues of organizing an audit in non-state non-profit organizations are disclosed in the works of Ya.V. Sokolova, G.Yu. Kasyanova "Accounting as the sum of the facts of economic life", T.V. Yuryeva, L.V. Egorova "Accounting and auditing in non-profit organizations: theory, methodology and practice" and L.V. in non-profit organizations, etc. [7].

The issues of the theory of general auditing in non-state non-profit organizations and its organization, as well as methodological aspects, including some general properties of accounting in NSNPOs, were studied in the scientific works of A.A. Karimova "Audit", N.Yu. Zhurayeva "Financial and management accounting", Sh.U. Khaydarova "Methodological guide for accounting of NSNPOs" and others [7].

Due to the lack of development of a special audit system for distinguishing between commercial and non-profit organizations in non-state non-profit organizations, general audit regulatory documents are used. Therefore, it is necessary to develop and improve the audit in non-state non-profit organizations and the preparation of audit reports.

## ***Analysis and Results***

As practice shows, the largest number of disputes, conflicts, doubts about the correctness of reflection and spending of participants' funds arises in homeowners' associations, garage, dacha cooperatives. Society members want to know exactly where and how the funds they raise are spent (which is a completely fair requirement).

From all of the above, the conclusion follows that it is necessary to legislate the conduct of a mandatory audit for all forms of NSNPOs or a similar audit. The author of the article assumes how many dissenters will be with the designated position. However, later in this article, what seems to be the most painless way to solve this acute problem is proposed.

So, let's see in what other cases NSNPOs resort to the services of auditors. Grantors can initiate an audit to confirm the accounting (financial) statements of those non-profit organizations that received

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<sup>1</sup>"The development strategy of the new Uzbekistan for 2022–2026" of the Republic of Uzbekistan, No. PF–60, January 28, 2022.

grants from them. In this case, the audit will have the status of an initiative audit, and the funds for its implementation are included in the cost estimate for the project, which is financed by the grantor.

Any NSNPO can conduct an initiative audit. Including those NSNPOs for which an audit is not mandatory [11]. This raises the question of funding.

Since the funds of NSNPOs, as a rule, are limited, the involvement of an auditor for an initiative audit is very problematic. Not to mention the services accompanying the audit: setting up accounting, advising on tax and other issues, drafting project budgets.

By virtue of Article 2 of the Law of Uzbekistan “On non–state non–profit organizations”, a non–state non–profit organization is created to protect the rights and legitimate interests of individuals and legal entities, other democratic values, achieve social, cultural and educational goals, satisfy spiritual and other non–material needs, carry out charitable activities, for other public benefit purposes.

According to Article 39 of the Civil Code of the Republic of Uzbekistan (hereinafter referred to as the Civil Code of the Republic of Uzbekistan), a legal entity is an organization that owns, manages or manages separate property and is liable for its obligations with this property, can acquire and exercise property and personal non–property rights on its own behalf, bear duties, be a plaintiff and a defendant in court. Legal entities must have an independent balance sheet or estimate [2].

The law divides legal entities into types: commercial and non–commercial. A non–state non–profit organization acquires the rights of a legal entity only from the moment of its state registration with the justice authorities, as required by Article 21 of the Law of the Republic of Uzbekistan “On non–state non–profit organizations” [3].

An NSNPO is a legal entity, the term of which, as a general rule, is not limited. Non–profit organizations have two main differences from commercial enterprises:

1. Clearly formulated purpose (mission) of creation;
2. A ban on the distribution of funds received in favor of the founders (members, participants) of the organization.

The fundamental classification criterion is the purpose of the activity: whether the activity is aimed at making a profit or not. In accordance with article 40 of the Civil Code of the Republic of Uzbekistan:

- An organization pursuing profit as the main goal of its activities is a commercial organization;
- Not having profit–making as such a goal–by a non–profit organization.

At the same time, there is no criterion in the law by which it is determined when an activity aimed at making a profit is considered the main one, and when it is not. Article 40 of the Civil Code of the Republic of Uzbekistan defines only one sign of the distinction between commercial and non–commercial organizations. Its content does not contain the second sign of distinguishing between commercial and non–commercial organizations – the possibility of distributing profits between the participants of the organization.

This second distinctive feature of a non–profit organization was introduced by law by the norm article 2 of the Law “On Non–State Non–Profit Organizations”, which prohibits NSNPOs from distributing income (profits) received between participants (members).

NSNPOs is a self–governing organization created on a voluntary basis by individuals and (or) legal entities, which does not pursue the extraction of income (profit) as the main goal of its activities and

does not distribute its income (profit) among its participants (members).

Thus, the legislator laid down economic aspects as the basis for the criterion for distinguishing between commercial and non-commercial organizations.

Table 1. Interdependence of NGO organization based on forms property and statutory purposes<sup>2</sup>

Types of NSNPO	Goals of the NSNPO organization	The procedure for organizing NSNPOs
Consumer cooperatives	Satisfaction of material (property and other needs of participants)	Voluntary association of citizens and legal entities into participants is considered consumer cooperation. This association is organized on the basis of the association of property values (shares)
Public and religious organizations (associations)	Satisfaction of spiritual (religious) and other non-material needs	Voluntary organization based on the interests and universal needs of citizens
Public funds	Implementation of charitable, social, cultural, educational or other socially beneficial activities by citizens and (or) legal entities	Organized on the basis of voluntary association of property shares
Institutions	For management and socio-cultural tasks or other activities	Organized by the owners and provided financially in whole or in part
Non-state non-profit partnership	Achieving success in the activities of NSNPOs based on the unification of partner participants	Organized on the basis of membership of legal entities and (or) individuals
Autonomous non-state non-profit organization	Provision of services in the development of education, healthcare, culture, physical culture and sports, as well as other social spheres	Organized on the basis of voluntary property shares by legal entities and (or) individuals
Associations and Unions	Bringing the business activities of commercial organizations into conformity, as well as the expression and protection of common property interests	Organized by commercial organizations on the basis of mutual agreement by concluding contracts
Self-governing bodies of citizens	Implementation of the activities of the gathering of citizens of the mahalla in accordance with the legal electoral guarantees of citizens, the constitutional rights of self-government of citizens in cities, villages, auls.	It is carried out by local state authorities in accordance with the initiative of citizens' self-government bodies on the organization, unification, division, liquidation of the mahalla, as well as the definition and change of its boundaries

The study of information in the process of scientific research showed that non-state non-profit organizations are connected not only by the property relations of the founders, but also by the property form, goals and objectives defined in the Charter, as well as the degree of responsibility of the participants. state registration, receives the status of a legal entity, rights and obligations.

<sup>2</sup>Compiled on the basis of author's scientific research.

The study of information in the process of scientific research has shown that non–state non–profit organizations are connected not only by the property relations of the founders, but also by the property form, goals and objectives defined in the Charter, as well as the degree of responsibility of the participants. State registration for NSNPOs has a defining legal significance. Because an organization that has passed state registration receives the status of a legal entity, rights and obligations.

One of the features of the audit of non–profit organizations is the specifics of the sources of their financing and the formation of property. To fulfill their mission, NSNPOs seek financial resources by:

1. Receiving targeted funds for statutory activities;
2. Conducting business activities that generate income.

This activity must comply with the statutory goals of the NNO, and the profits received from such activities, after paying all necessary taxes, should be used to solve the statutory tasks of the NSNPO [4].

Non–state non–profit organizations can carry out entrepreneurial activities only insofar as it serves the achievement of the goals for which they were created, and corresponding to these goals.

We emphasize that the second of these requirements imposes certain substantive restrictions on the nature of the activities that can be carried out by a particular non –profit organization in the framework of entrepreneurial activities, and which, at the same time, should not be considered as the main one. This classification is conveniently represented by the following scheme (Figure 1).

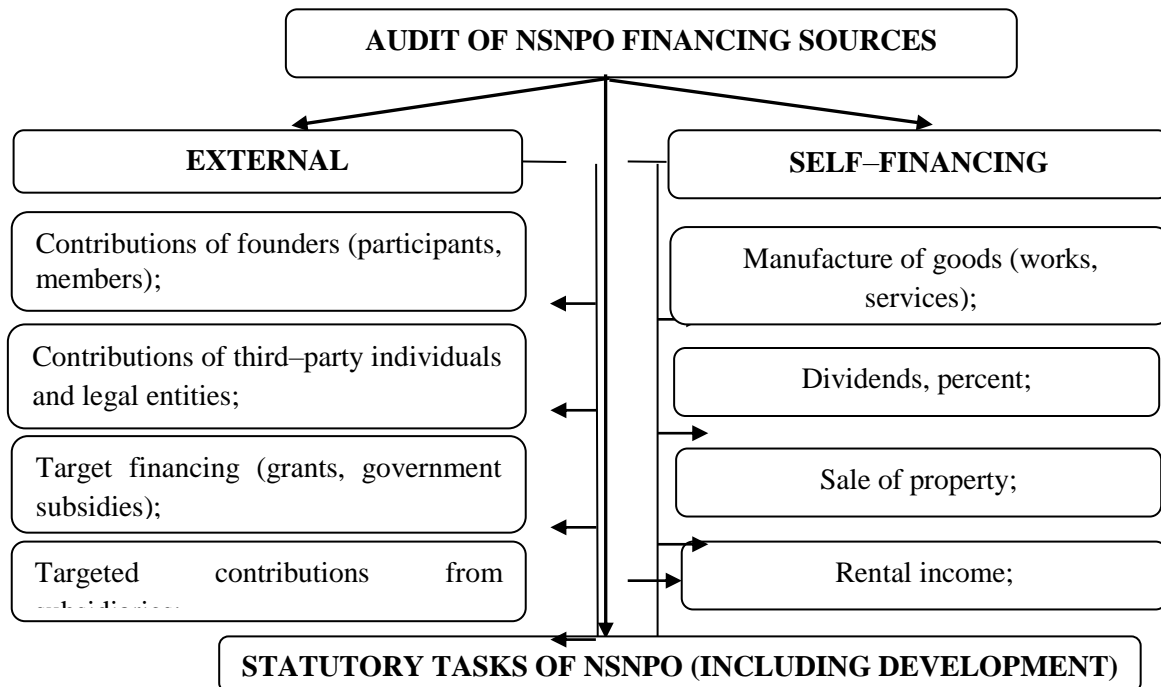


Figure 1. Audit of NSNPO funding sources

From the above diagram, we see that the sources of self–financing, as well as external sources, are aimed at solving the statutory tasks of NSNPOs.

An important conclusion follows from this: the specifics of the activities of NSNPOs determine the features of the organization of their finances.

During the audit, note all the property of non-profit organizations, all the money and other funds received by them, including profit from entrepreneurial activity, can only be used for certain purposes and in this sense are targeted [4].

The criterion for dividing legal entities into commercial and non-commercial organizations is based on an analysis of the legal nature of the relationship between the persons who created the legal entity and the said legal entity itself.

In such a situation, the auditor is recommended to conduct a separate audit in the following areas:

- The nature of these relationships;
- What are the obligations of the founders to the legal entity;
- The consequences of the transfer of property to a legal entity for the implementation of its activities;
- Target legal capacity;
- Lack of authorized fund;
- The special nature of the relationship with the registration authority.

If a commercial organization is established, property consequences arise when the founder leaves it. For example, by virtue of Article 22 of the Law of the Republic of Uzbekistan “On Limited and Additional Liability Companies”, when a participant withdraws, he must be paid the actual value of his share. In addition, the founders of an LLC have such a right upon liquidation.

According to Part 5, article 36 of the Law on “On Non-State Non-Commercial Organizations”:

The property remaining after the satisfaction of creditors’ claims cannot be distributed among the participants (members) of the organization, as well as members of the governing bodies or employees of NSNPOs and is used in the prescribed manner.

This rule should contain exceptions for institutions, since the latter does not acquire the right of ownership to the property of the owner assigned to it, but exercises possession, use and disposal on the basis of the right of operational management.

To do this, in order to start auditing the main activity and form the statutory fund in the special chart of accounts of NSNPO, it is recommended to enter analytical accounts as part of the group of accounts (4890) that take into account other receivables (Table 2).

Table 2. Audit of the account taking into account transactions related to the formation of the statutory fund and the beginning of the activities of NSNPOs<sup>3</sup>

<b>4800</b>	<b>Debt accounts of various debtors</b>	<b>A</b>
4890	Indebtedness of other debtors	
4891	Debts on entrance fees of founders and members	
4892	Debts of founders and participants on membership fees	
4893	Debts on the introduction of fixed assets (including shares of founders and members)	
4894	Debts on the introduction of intangible assets (including the share of founders and participants)	
4895	Debts on other earmarked receipts	

<sup>3</sup>Compiled on the basis of author’s scientific research, 2023.

Particular attention is recommended during the audit that the accounts will be used in the process of organizing and registering NSNPOs, reflecting the formation of the announced authorized capital.

In the preliminary balance sheets of any legal entity, the obligations of the founders in the authorized capital for membership shares are reflected in the active part of the balance sheet. The statutory fund of an organized NSNPO is formed from the founder's shares. A scientific study has shown that NSNPOs do not define the right of founders (participants) to their property or to own it [10].

Thus, non-profit organizations, unlike commercial ones, belong to the category of legal entities to which the founders do not have property rights (except for institutions in terms of property assigned to them by the owner). An analysis of the issue of distinguishing between commercial and non-commercial organizations will not be complete without assessing their legal capacity.

An NSNPO can carry out any type of activity that is not prohibited by law and that corresponds to the goals provided for by its founding documents. Certain types of activities can be carried out by NSNPOs only on the basis of licenses. The list of these types of activities is determined by the legislation [2].

At the same time, the legislation contains a number of prohibitions regarding the implementation by non-profit organizations of their activities, which are *unusual for commercial organizations*.

In particular, during the audit, *NSNPOs* cannot aim at forcibly changing the constitutional order, undermining the sovereignty, integrity and security of the Republic of Uzbekistan, infringing on the constitutional rights and freedoms of citizens, propaganda of war, social, national, racial and religious hatred, encroaching on the health and morality of citizens, the formation of *NSNPO* paramilitary associations.

The issue of non-profit organizations carrying out entrepreneurial activities aimed at making a profit deserves special attention. *An NSNPO, in accordance with the law, may engage in entrepreneurial activities within the limits corresponding to its statutory goals*<sup>4</sup>.

It should be noted that *the concept of entrepreneurial activity*, which is contained in the Law of the Republic of Uzbekistan "On guarantees of freedom of entrepreneurial activity", *does not contain a criterion expressed in the systematic implementation of entrepreneurial activity*. For example, the Civil Code of the Russian Federation contains such a criterion.

In addition to engaging in entrepreneurial activities of the NSNPO itself, the law allows the creation of legal entities that are subjects of entrepreneurial activity - commercial organizations. In which the NSNPO acts as a founder, under Article 7 of the Law of Uzbekistan "On Non-State Non-Commercial Organizations" grants the NSNPO the right to create entrepreneurial structures to perform statutory tasks.

## **Conclusion**

Based on the above considerations, we propose the following when solving actual problems of audit discrepancies between commercial and non-profit organizations:

1. It should be noted that the registration bodies of commercial organizations – the bodies of justice and inspections for the registration of business entities under the *khokimiyats* of districts (cities) are not entitled to control their activities. Their function is limited to registration without exercising control.

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<sup>4</sup>Law of the Republic of Uzbekistan "On Non-Governmental Non-Commercial Organizations", No. 763-I of 14.04.1999, Article 31.

2. The bodies of registration of non–state non–profit organizations–bodies of justice are granted the right to control. Based on this, it is recommended by the founders that all *NSNPOs*, regardless of their organizational and legal form, undergo a mandatory audit at the end of each year, indicating in the charter of the *NSNPO* an annual audit of financial and economic activities. In addition, it is the responsibility of the NGO to coordinate with the registration authority the activities carried out with the provision of this authority with access to the authority to the activities carried out by it.

Failure to comply with these requirements is interpreted as a violation of the procedure for carrying out the activities of *NSNPOs* and entails measures of administrative responsibility established by law. For commercial organizations, the legislation of the Republic of Uzbekistan does not provide for such a format of relations with the registration authority.

3. In our opinion, the main criterion for distinguishing between commercial and non–commercial organizations is the target legal capacity, *NSNPO*. Since it is aimed at the joint implementation by citizens of their constitutional rights in the spiritual non–material sphere.

4. In order for the results of external audit to be positive in *NSNPOs*, it is proposed to create an effective internal audit system. It is more important for *NSNPOs* to receive a positive audit report as a result of external audits than for the activities of commercial organizations, because the transparency and influence of the activities of *NSNPOs* creates the basis for the inflow of new grants and subsidies, which are their main “capital” and “dividends” in the form of donations and increases financial independence.

At this point, the auditor will especially check whether they can conclude agreements on joint activities, if the subject of the agreement does not pursue the purpose of carrying out entrepreneurial activities.

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