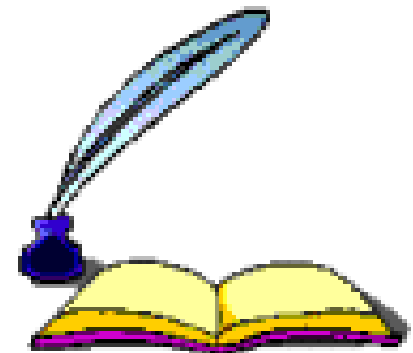




INTEGRATED APPROACH TO INTERNAL AUDIT

Outcomes

- Approach towards internal audit
- How different areas can be integrated into internal audit program
- Areas requiring special attention
- Multi dimensional scrutiny of transaction during audit



CHANGING SCENARIO IN INTERNAL AUDIT

FROM
ROUTINE
ACTIVITY



CONSULTING
ACTIVITY

FROM COST
CENTER



VALUE CENTER

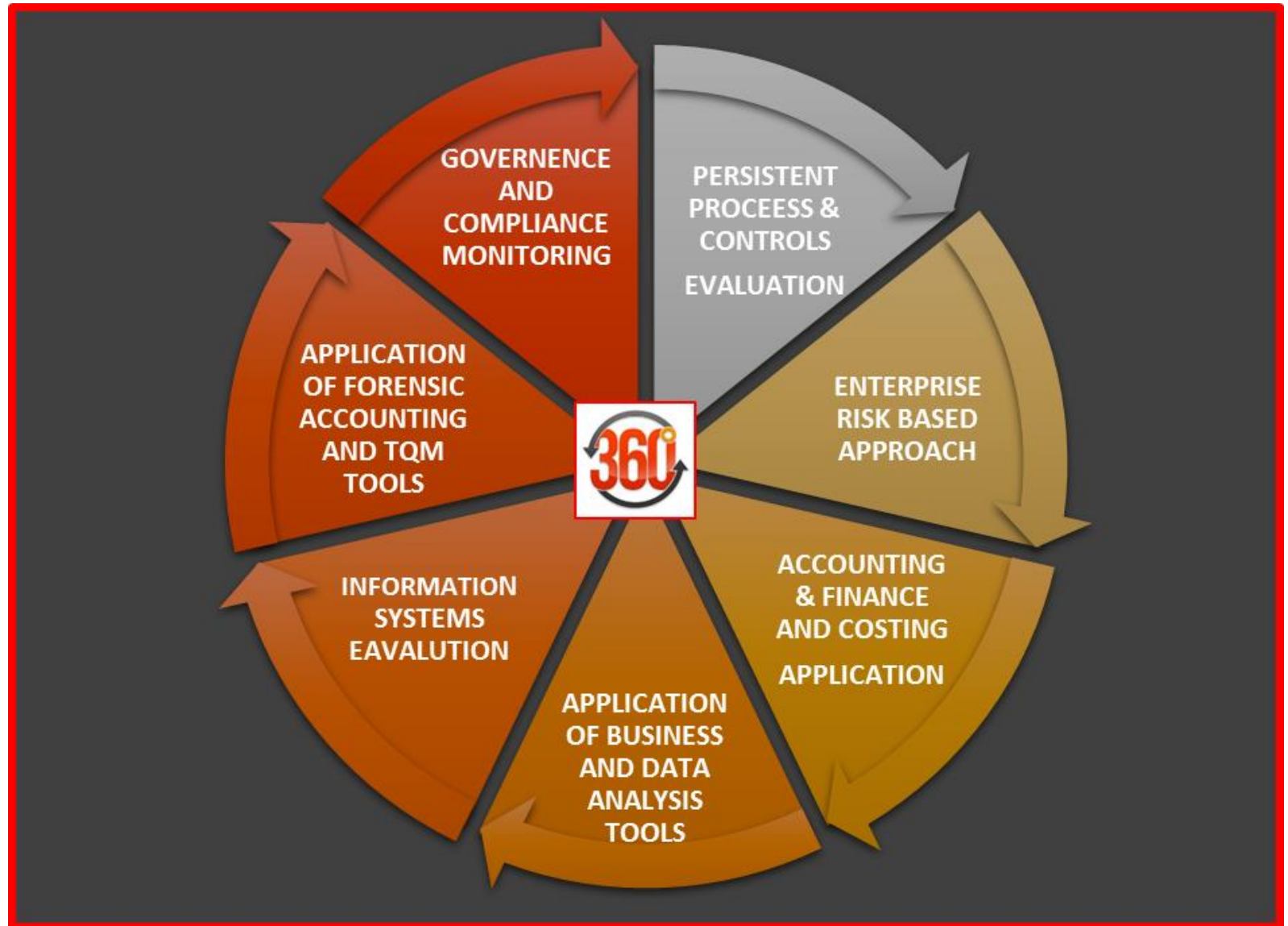


APPROACH

- NOT TO FIND FAULT BUT TO CREATE VALUE
- ADOPT SYSTEM BASED APPROACH
- INTERNAL AUDIT BY OBJECTIVES: OPERATIONAL AND STRATEGIC
- SEE WHAT IS IMPORNTANT TO BUSINESS IN GIVEN SITUATION
- RISK BASED THINKING



Integrated Approach



WHAT TO LOOK INTO INTERNAL AUDIT

- RISK MANAGEMENT
- PROCESS EFFECTIVENESS
- INFORMATION SYSTEMS
- PERFORMANCE MEASUREMENT
- ACCOUNTING
- COMPLIANCE
- SUPPLY CHAIN MANAGEMENT
- EFFECTIVENESS OF MIS FOR DECISION SUPPORT
- EFFECTIVENESS OF COSTING SYSTEM AND COST ANALYSIS
- FORENSIC AUDIT
- BUDGETING
- BUSINESS INTELLIGENCE THROUGH DATA ANALYSIS
- ASSISTANCE IN STRATEGIC PLANNING
- RECORDS MANAGEMENT
- POLICIES AND PROCEDURES
- RESOURCE MANAGEMENT

ISSUES IN SME'S

- Competition- survival
- Liquidity – cash flow problems
- Pricing
- Delays in operations
- Incompetency in functions
- Staff size limitations
- Overdependence on person
- Management's involvement in daily operations
- Concentration of business

ENTREPRENEURS CONCERN

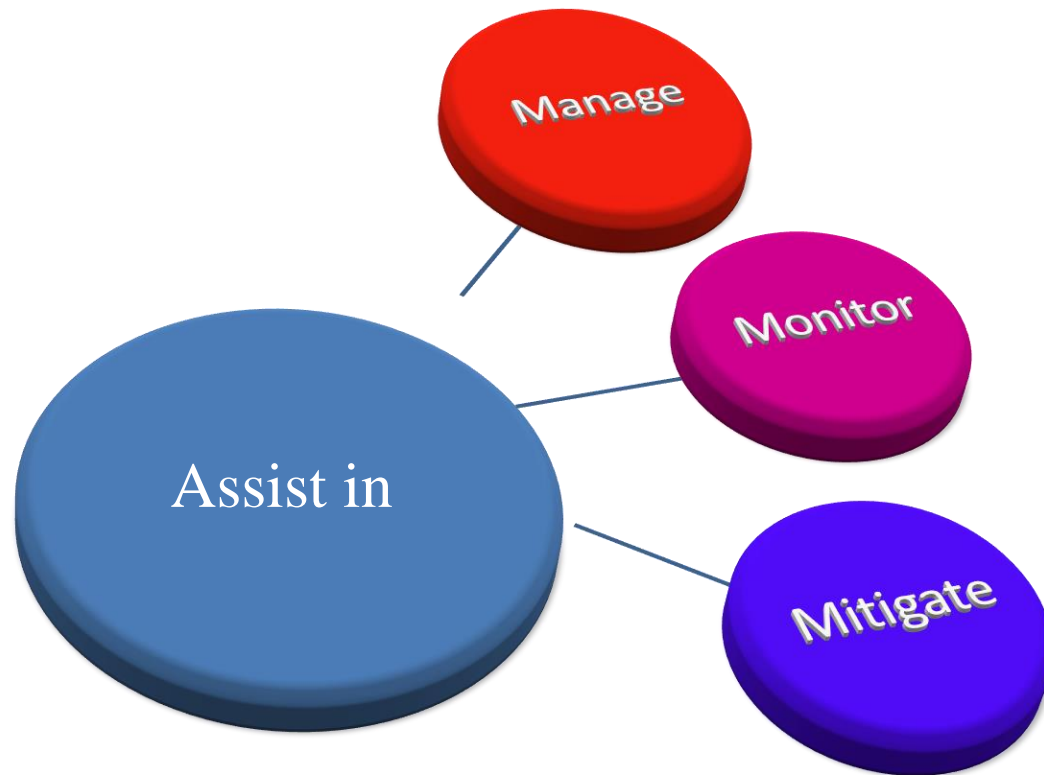
OPERATIONAL:

- Revenue and Profit
- Cost control
- Efficiency
- Compliance
- Process improvements
- Effective MIS

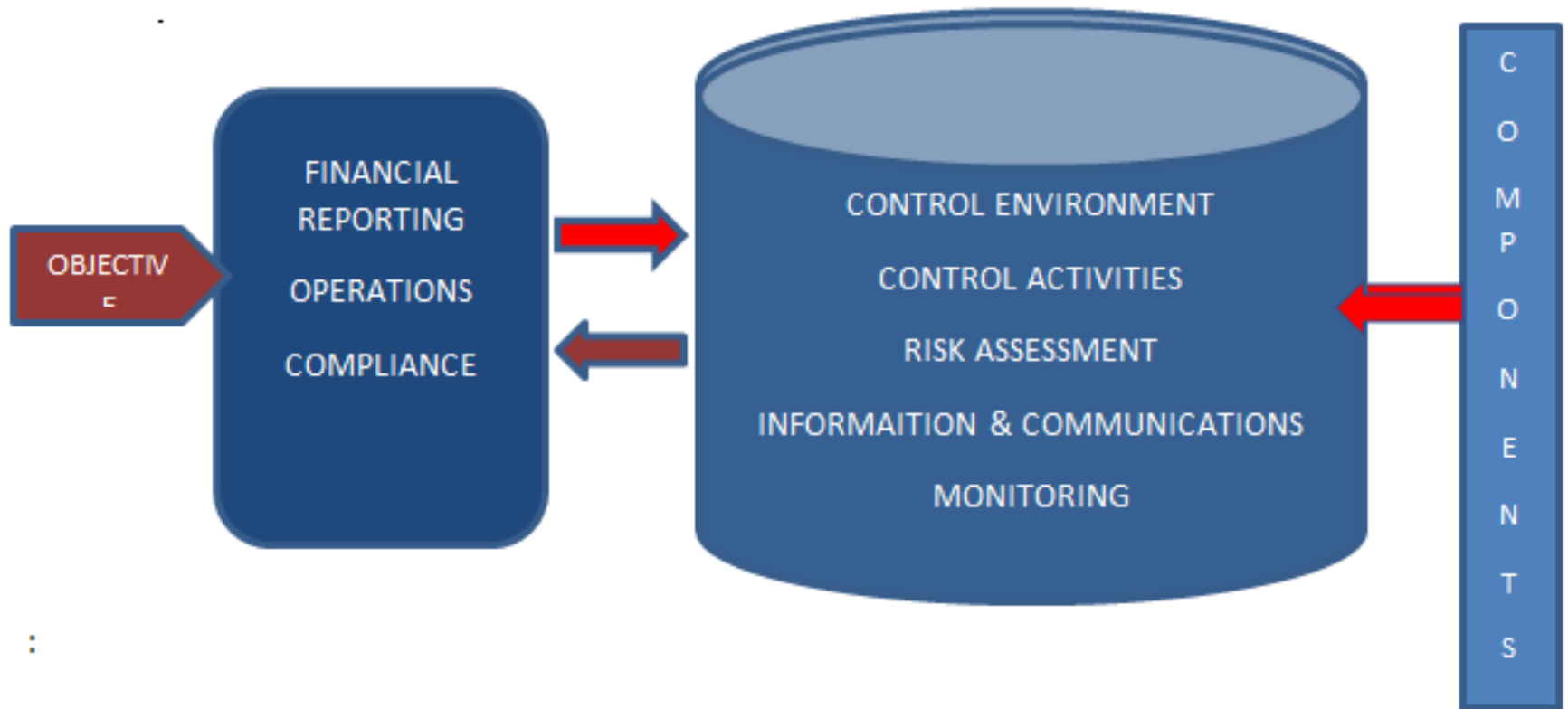
STRATEGIC:

- Productivity
- Business expansion/growth
- Employee empowerment
- Ethics and Values of the organization

Internal audit in SME



Internal Controls



Internal Controls

```
graph TD; A[Internal Controls] --> B[Entity level controls]; A --> C[Process and transaction level controls];
```

Entity level controls

Process and transaction
level controls

Internal Control Evaluation

```
graph TD; A[Internal Control Evaluation] --> B[Test Design]; A --> C[Test Effectiveness]
```

Test Design

Test
Effectiveness

THINK ON INTERNAL FINANCIAL CONTROLS

Tools of Internal Controls

- Reconciliations- of party balances
- Validations- Input controls
- Authorisations- for transactions processing
- SOD/organisational structure- based on delegations
- Physical security/controls- safeguarding of assets
- Review– of performances, controls
- Verifications-of assets and liabilities
- Access controls- safeguarding
- Confirmations/ acknowledgements ---**fraud risk**
- Monitoring of controls
 - Internal Audits
 - Separate external Evaluations
 - Rotations
- Supervision– on compliance of laws

Internal Control (Examples)

- Single Level (MIGO/MIRO) (Design)
- Master Data updation (Design)
- Signing of JV's (effectiveness)
- Bio metric against SAP (Manual Intervention)
(effectiveness)

RISK BASED APPROACH

MANAGING RISKS

- 1) Business and Operational Risk (Continuity & Disruptions)
- 2) Technological Risk- Inadequate technology, failure.
- 3) Financial Risks- Credit, liquidity, Interest rate
- 4) Political and Social Risks
- 5) Human Resources Risk- Improper succession, competency , retaining, improper placements
- 6) Legal Risk- Non compliance, regulatory
- 7) Marketing Risk- competition, Pricing
- 8) Environmental Risk – sanctions, restrictions
- 9) Supply chain risk

Monitoring accounts function

- Proper accounts chart
- Accounting process should be **accurate**
- Accounting process should help **MIS**
- Accounting Process should help **Compliance** (Tax, labour laws, corporate laws etc.)
- Accounting process should help **Governance**
- Accounting process should help **analysis**
- Accounting process should help controls- **expense reporting**
- Accounting process should support assets (**proper segregations, cost**)
- Accounting process should support **finance function**.

PROCESS EFFECTIVENESS

- PROCESS DEFICIENCIES (STRATEGIC & OPERATIONAL)
- OPERATIONAL INEFFICIENCIES
- ANALYSIS OF CONTROL ACTIVITIES
- ANALYSIS OF CONTROL ENVIRONMENT

Strategic process

- Planning
- Growth
- Employee empowerment
- Directing
- Budgeting
- Control
- Policies

Operational Process Deficiencies

- Cover Functional processes lapses : (few ex)
- Signed un-cancelled gate-pass
- CN/DN , Unapproved CN, CN not given to customers
- Unrecorded material at site
- Unrecorded assets – received free of cost
- Deficient vendor selection processes
- Rates contracts made but **no purchases made**
- Inadequacy in HR management (ex Bonus payment)
- Invoices without customer acknowledgement

INFORMATION SYSTEMS

- GENERAL IT CONTROLS
- APPLICATION CONTROLS (Input/process/output controls)
- INFRASTRUCTURE CONTROLS
- DATABASE CONTROLS

IT (Examples)

- Access Controls (Lenient IT Controls)
- Poor DR system
- Employee's Email ID in vendor creation
- Customer Master data updation and creation with single control
- Different employee same bank account
- Server security issues



MIS

Internal Audit should see the entire MIS system to ensure proper information of **exceptions** is generated for decision support

Examples:

- Advance paid but material not received
- Pending PO's
- Quality deviation from vendors
- Party wise Sales Return
- AMC- T&C not adhered
- Pending Indents
- Rate Contracts made but no purchases made
- Un-renewed credit limits
- Infant delinquencies in account receivables



Common Opportunity frauds

- ✓ Vendor frauds
- ✓ Accounts receivables
- ✓ Accounts payables- fake payments
- ✓ Use of company's resources
- ✓ Frauds in tendering process
- ✓ Inflating expenses
- ✓ Unmoved credit balances
- ✓ Fixed asset (Asset received free of cost)
- ✓ Unsettled advances
- ✓ Scrap
- ✓ Warranties

Techniques

1. Analysis of Trends of significant transactions
2. Proportional Analysis- Industry average
3. Logical Analysis- (Extremely stable GP's)
4. Inter firm Comparisons
5. Even Amounts
6. Relative size factors
7. Ben ford's law
8. Ratio Analysis

- **Behavioral and other red flags**

- ✓ Employee won't take a vacation.
- ✓ Egoistic employee
- ✓ Living beyond means
- ✓ Unexplained variances.
- ✓ Complaints.
- ✓ Rounded amounts on checks/documents.
- ✓ Missing reports/documents.
- ✓ Failure to investigate reconciling items.
- ✓ One employee "does it all".
- ✓ Duplicate payments or payment on photocopy.
- ✓ Using "exemptions" to use particular vendor over and over.



Identifying the Red Flags in transactions

- Purchases

- Alteration in invoices
- Invoices from same vendor in **consecutive** sequences
- Invoices with address matching an employee's address
- Multiple companies with same address

- Inventory

- Large differences bet actual inventory and its records
- Unexpected increase in inventory turnover but **decrease in gross profit %**
- Unexplained adjustments to perpetual inventory records
- Missing inventory scrap that has resale value

Accounts receivables

- Lack of accountability for invoice numbers issued.
- Lack of segregation of duties between the following:
 - Processing of accounts receivable invoices and posting to sub ledger
 - Posting to accounts receivable sub-ledger and cash receipts
- Frequent **undocumented and/or unapproved adjustments, credits, and write-offs** to accounts receivable sub-ledger.
- Low turnover or slow collection cycle for accounts receivable.
- Dramatic increase in **allowance for doubtful accounts** in view of positive economic events and stringent credit policies.
- **No reconciliation** of accounts receivable **sub-ledger to general ledger** control account.
- Insufficient supervisory review of accounts receivable activity as well as customer account aging schedule.

- Accounts payable

- Account payee cheques are the genesis of frauds
- Payee's receipt not obtained
- Vendor s without valid GST no.
- Invoices for unspecified consulting or other vaguely defined services
- Vendors with company names consisting only of initials. Fraudsters often use their own initials when setting up dummy companies (e.g., NDA for Enterprises").
- Invoices with even amounts with no taxation included or having other anomalies
- Invoices from old stationeries

• Cheque Tampering Schemes

Cheque tampering occurs when an employee prepares or alters a company cheque so that he or she can fraudulently use company funds. Here are several common methods.

- Stealing blank or counterfeiting cheque
- **Forged signatures**
- Intercepting signed cheques (Eg: PSU Case)
- **Altering payee and amount information on cheque**
- Fraudulent cheque written by authorized signers
- Forced bank reconciliations

PERFORMANCE MEASUREMENT

WE TEST: ARE YOU PERFORMING?

- KEY PERFORMANCE INDICATORS IN
 - PURCHASE
 - SALES
 - ADMINISTRATION
 - HUMAN RESOURCE
 - SUPPLY CHAIN
 - ACCOUNTS AND FINANCE
 - INVENTORY AND STORES

KPI's

- Number of customers lost during the period (Marketing)
- Conversion rates of marketing campaigns (Marketing)
- Number of customer complaints (Sale)
- Reduction in machine downtime (Machinery)
- On time delivery (Dispatch), promise Qty and dispatch qty
- Inventory accuracy
- Time taken to fill vacancy (HR)
- Delays in preparation of Credit Note for Sales Return
- Unsolved incidents (IT)

PRODUCTIVITY : Areas of wastes in operations

- Transportation-(Operating cost, delivery time)
- Inventory, (Non moving/slow moving, - go for root cause)
- Waiting (for all resources)
- Over-Production
- Defects
- Rework
- Duplications
- Redundant activities
- Delay
- Use of resources (Men, Machine, material, Money)



Cost Analysis

- Sunk cost (AMC's)
- Avoidable costs (Penalties, Interest, transport on mat return, demurrages)
- Fixed and Variable cost (must know the nature & relativity)
- Direct cost /Indirect cost (**See cost accounting standard**)
- Functional cost (Admin, S&D, Factory cost)
- Controllable costs
- Cost of non conformity with std. /rework/rejections
- Measurement of Non value adding costs (**set up cost**)
- Preventive /breakdown cost
- Cost reduction and benchmarking
- Expense Reporting

Data Analysis

- Unclaimed warranties
- Truck Inward Vs Gate entry (10 vehicle out in 1 min)
- Cash discount given to overdue customers
- Item sold at cost price & below
- Unloading time (same product/ qty)
- Purchase of non moving items
- Billing errors
- Using statistical methods like standard deviation, correlation, etc.

Compliance & Governance

- Factory Act
- Employee standing order
- **Apprentice Act**
- PF
- ESIC
- CARO
- Disclosure in Financial Reporting- R/D, Forex/CSR
- Accounting polices- Revenue/Inventory
- Labour Welfare


In nutshell, Internal Auditor must target

- Revenue/Income drivers (Direct & indirect)
- Cost drivers (Direct & Indirect)
- Value drivers
- Exceptions in transaction
- Expectation of management
- Major risk areas
- Performance audit

Value additions

INTERNAL AUDIT CAN NOW **ENSURE:**

- ✓ Strengthening **financial reporting**
- ✓ Strengthening of **Internal control framework**
- ✓ Prevention of **Fraud**
- ✓ Empowering **Business processes** & re-engineering
- ✓ Assist **Risk Management** all across enterprise
- ✓ Enhance **Operational Efficiency** & Cost Controls
- ✓ Initiate **Performance measurement** of all functions
- ✓ Assist framing of **Policies** & Documentation thereof for adherence & **Training** to new employees
- ✓ Improve **Business Intelligence & MIS**
- ✓ Impose **Compliance management** and tax planning

A blue wavy banner with a white border, containing the text "AWARDING VALUE TO BUSINESS IS NEVER BY MERE CHANCE, IT IS RESULT OF KNOWLEDGE AND APPLICATIONS WORKING TOGETHER".

AWARDING VALUE TO BUSINESS IS NEVER BY
MERE CHANCE, IT IS RESULT OF
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