6.Risk based Auditing for NGOs - 2
Oct - Dec 2008 (Released: May 2009)

# AuditAble

## In this Issue



In the previous issue of Auditable, we discussed about financial risks and the audit areas related to the same. In this issue we would learn about the ways to identify and mitigate these risks.

## Audit Objectives

While audit objectives would primarily depend on donor's perspective, the following can be used as a guide for framing objectives:

- Optimize overall financial risk to donor funds entrusted to Grantee/ Partner;
- Strengthen financial management systems of Grantee / Partner.

Should risk be optimized or minimized? At first glance it appears that risk should be minimized. However, minimization of risk would mean introduction of extensive controls which may affect the program activities adversely.

Therefore, one needs to attempt and strike a balance between financial risk and operational expediency. Because, as Pandit Nehru once said, 'the policy of being too cautious is the greatest risk of all'!

## Audit Methodology

The following program is suggested for a standard audit visit of two to four days:

1. Meeting with the Chief Functionary and key members of the team
2. Courtesy meeting with Board members
3. Discussion and review of financial systems and records -
   a. Identification and assessment of risks
   b. Suggested mitigation measures
4. Debriefing with the Grantee / Partner

Back at the office, a report should be drafted which identifies all relevant risks, along with mitigation measures, where feasible. The draft should be sent to the Grantee / Partner for their response and timeframe for implementing suggested mitigation measures. A copy of the draft report should also be simultaneously sent to the Donor Agency.

The response from the Grantee / Partner should be incorporated in the report at relevant places, along with suitable comments. The final report is then released, with one copy going to the Partner as well. During subsequent visits, implementation of the suggestions should also be reviewed.

## Assessing Risk

One of the key outputs of this audit approach is to help in identifying the specific risks in the existing systems and controls. Therefore, when the auditor comes across a single error or repeated errors, s/he needs to pause and ask whether this is due to a flaw in system design or lapse. If so, then this risk should be listed.

Listed risks are then reviewed, and assessed for their implications. This gives the auditor an idea whether the risk is significant enough for reporting.

**'The policy of being too cautious is the greatest risk of all'!**

-Pandit Jawaharlal Nehru (1889-1964)

## Reporting

All significant risks should be reported to the Partner and the Donor. During reporting, the emphasis should be on clearly identifying the risk and its implications.
Where a risk requires mitigation, and it is indeed possible to mitigate it[1], the mitigation measure should be suggested alongside. An example of Risk and Mitigation table is given below:

| Risk | Suggested Mitigation |
|---|---|
| Signing a blank cheque creates two risks:<br>1. Possible misuse of the cheque by the other signatory;<br>2. Abdication of his official responsibility (as an office bearer) by the Finance Trustee. | Partner may consider adopting a multi-tier signatory approach to deal with the problems arising due to non-availability of office bearers at the location. Accordingly, signing authority for operational needs up to a certain monetary limit, say Rs.10,000 or Rs.20,000, can be delegated to the accountant or such other person, along with an office bearer such as the Managing Trustee. Cheques above this amount would compulsorily require the signatures of two office bearers. |
| Expenses may be inflated and Donor funds diverted through use of fictitious or altered duty slips, with or without the knowledge of owner of the Taxi Service. | Risk arises at a senior management level in Partner organisation and cannot be mitigated by an accounting procedure. |
| This creates a risk that a bill may be paid or accounted twice, without the material having been printed. | Proof or sample of the material printed should be attached with the bill and voucher. Also the bill should indicate clearly the items printed, and the quantities of each item. Delivery of the items should be acknowledged on the bill by a responsible person at Partner level. |
| Classification of salary as consultancy payments can lead to wrong deduction of tax and subsequent imposition of interest and penalty. | Payments made to employees need to be treated as salary and tax should be deducted under section 192, irrespective of whether the relationship is contractual or through an appointment letter. |
| Payment of salaries in cash leaves open the possibility of the actual payments not being recorded in the register. | Partner may pay all the employees, drawing more than Rs.1500 per month, through account payee cheques or bank transfer. |
| Lack of a manual cash record weakens control over physical cash as cash cannot be tallied properly. | Partner should use a cloth bound cash book which can be used as rough cash book and should enter all the inflows and outflows of cash in this book as and when they occur. |
| Risk of loss of assets over a period of time, as physical verification and tally becomes difficult. | Partner should maintain the Fixed Assets register properly giving the following details:<br>• Open one page for each type of asset. For example: one page for computer, one page for TVS, etc.<br>• Details of assets purchased/donated<br>• Give identification marks on each asset and also copy these in the asset register<br>• Location of asset should be mentioned in asset register<br>• Mention registration number of vehicles in the asset register. |
| Actual food expenses may be claimed or accounted by accountant at inflated figures. | If printed cash memo or rubber stamped slip is not available for such expenses, then the plain paper slips should show the place (location, village) and shop's name by hand or the shop owner's name. The shop owner himself/ herself should be asked to prepare and sign these. If the shop owner cannot write then the slip can be prepared by the customer, but must still be signed (or thumb impression marked) by the shopkeeper. |
| There is a risk of booking of expenses which are not supported by adequate operational documents. | Attendance sheets and photographs should be attached with the vouchers. Further, all attendance sheets should carry the following information as a header on all pages to mitigate the risk of mixing up of sheets:<br>1. Title of workshop,<br>2. Date,<br>3. Location,<br>4. Supported by,<br>A serial number should be put against each participant's name. |
| This type of improper filing can lead to wrong assessment of income which may lead to imposition of income tax and penalty on Partner. | Partner should file a revised income tax return after consulting a CA or tax practitioner familiar with NGO taxation |

[1] By modifying or introducing a procedure or control

## Benefits

What are the benefits of this approach for the donor and the Grantee / Partner?

- Tailored coverage of risk in complex forms of Partnerships (alliances, networks etc.);
- Improved identification of risk by trained financial reviewers;
- Overall reduction of unexpected risk to Donor funds;
- Strengthened systems at Grantee's / Partner's level, enabling them to leverage funds from other donors;
- Reduced disruption of critical Partnerships;
- Improved delivery of funds to Donor's/ Partner's mission and causes.

## Training

To implement the above approach successfully, you will need to work with the Audit Team members and Team Leaders. So to begin with, they need to understand the concept of Risk-based auditing.

This essentially involves a shift from locating actual errors to identifying possibilities of errors. While this is largely a thinking exercise, it cannot be done sitting in the office. If feasible, the team should also visit the field area to familiarise itself with the organization's operating realities.

The team also needs to guard against over-enthusiasm in loading the NGO with controls and procedures. Each risk must be carefully judged for relevance and possible impact, before being listed. Also, the team will need to keep in mind that an NGO's operating and control environment is very different from a corporation.

## Worksheets

If you are planning to do these audits repeatedly or for a large number of organisations, you can invest some time in preparing automated worksheet templates using softwares such as Excel or Access. This can be used to build up a risk register. The risk register can be used as a checklist, which can generate bulk of the Risk and Mitigation table (shown above). The output can then be modified as required, before being provided as an annexure to the report. This approach can reduce costs and speed up report-writing.

The risk register can be used as a checklist, which can generate bulk of the Risk and Mitigation table. The output can then be modified as required, before being provided as an annexure to the report. This approach can reduce costs and speed up report-writing.

## Software

Computer Assisted Audit Techniques such as Spreadsheets and SQL databases are being used for quite some time now. In the Western countries, a large number of computer programs are available for risk-based auditing. Some of the audit softwares are:

- *AutoAudit for Windows®* (www.paisley.com) is a comprehensive audit automation solution to improve the productivity, efficiency and consistency of internal audit departments.
- *Reliant Auditor™* (www.reliantaudit.com): By integrating continuous monitoring with automated control testing and remediation, risk assessment, audit plan management, and a dynamic risk framework, Reliant Auditor delivers two important outcomes from an audit program: assurance in financial reporting and confidence in corporate controls.
- *PAWS - Pentana Audit Work System©* (www.pentana.com) is a solution for governance, risk and assurance needs. It is a need based tailored software, covers risk management, internal Audit, Compliance and other assurance issues that may be intrinsic to business needs.
- *ERA - Enterprise Risk Assessor* (www.methodware.com) provides a solution to manage risk related data and its associated processes as well as its reporting.
- *Planning Advisor* (www.methodware.com) is a comprehensive risk based solution that simplifies audit planning process and defines the risks that matter to the audit or business function. Also, it continuously updates the audit plan to reflect emerging issues.
- *OmniCompliance* (www.newgensoft.com) ensures timely compliance execution and assessment as well as risk assessment and controls assessment surveys.

However, most of these are primarily designed for corporate audits and are therefore not very useful for NPO audits.

### What is AuditAble:

Each issue of 'AuditAble' covers a different topic related to NGO auditing and is mailed to about 500 NGO auditors in India. AccountAid encourages reproduction or re-distribution of 'AuditAble' in professional circles for non-commercial use, provided the source is acknowledged.

**AuditAble on the Web:** Copies of past issues of AuditAble are available at www.Accountaid.net.

**Questions?:** Your questions, comments and suggestions can be sent to AccountAid India, 55-B, Pocket C, Siddharth Extension, New Delhi-110014; Phone: 011-2634 3128; Phone/Fax: 011-2634 6041; e-mail: accountaid@gmail.com.



Printed and published by Ms. Sanchita Chakraborty for AccountAid India, New Delhi. Ph. 26343128, at PRINTWORKS, F-25, Okhla Industrial Area, Phase 1, New Delhi. Ph:9810653101

**Content:** Shri Sanjay Agarwal
**Editing and Graphics:** Ms. Sanchita Chakraborty
**Designed by** Ms. Moushumi De
(For private circulation only.)