Deep dive into Audit & Assurance, Fraud, Ethics, Accountability and Transparency

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Audit and Assurance

Audit is a Systematic and independent primarily through examination of financial records, transactions, and processes to assess their accuracy, transparency, and compliance with regulations and accounting standards. It is conducted through an internal team or an independent external auditor. The goal is to ensure the reliability and validity of financial information and to identify errors/irregularities and the effectiveness of internal controls.

Assurance is a broader term which enhances the reliability and credibility of various information, including financial and non-financial data, processes, and systems. Audit is a subset of Assurance. Assurance provides independent and professional opinions that reduce information risk (risk from incorrect information) and is broader than Audit. Examples include financial statement audits, compliance audits, IT audit, Sustainability audit and assessments of internal controls and systems.

Rationale for Audits

Financial audits and reviews are governance tools used to provide assurance to an organization's management and stakeholders that the resources and assets of the organization are being used judiciously for the intended purpose. Audit is a more thorough examination that provides a higher level of assurance, while a review is a less intensive assessment with a lower level of assurance. An audit verifies the accuracy of financial statements while a review assesses whether the statements seem plausible and reasonable.

The priority of the audit process is to improve continuously on implementation of the financial and administrative policies. It is also an opportunity to identify and enhance financial control and documentation. A second priority of the auditing process is to identify gaps in policies or areas with substantial control risks so that such risks may be mitigated. A third priority is to establish independently that all personnel are handling financial affairs with integrity.

Why we don't like audits

- Disrupts routine work to attend to audit.
- Auditors ask for lot of information which needs to be located and shared.
- Auditors point to mistakes in work.
- Auditors make wrong observations/opinions or misunderstand things is what we think.

How should we approach Audit

- Audit should be welcome, it is a constructive activity for the organization.
- Audits create a sense of wanting to improve post audit and working on removing findings in future.
- Cooperate with auditors so that the audit process results in appropriate findings and recommendations.
- Mutual understanding of auditor-auditee is critical to success of an audit assignment.
- Successful audit is like a badge of honor.
- Audit should not be looked at negatively but as an opportunity to improve operations and organization.
- Audit builds trust in various stakeholders.

Types Of Audits

- **Statutory:** Mandatory under Income Tax Act, FCRA, Societies Registration Act and Other Statutes. Mostly involves certifying figures are correct.
- **Donor:** Provides assurance to donors that funds allotted applied as per contract and laws of land.
- **Internal:** Provides Independent assurance to Management that policies are being followed, legal and contractual liabilities are met, assets are protected etc..

Audit Process

- Period/Reporting Period for audit.
- Management Representation Letter (MRL) Management Letter (ML).
- independent auditor report and qualifications if any, Unique Document Identification Number (UDIN) no from UDIN portal of ICAI.
- Action Taken Report (ATR).

Audit process - Before Audit begins

- Organize your records and systems for easy review by anybody, whether superior management or donors or auditors.
- Obtain a copy of 'Scope of Work' from the concerned before audit begins to understand your role in it.
- Auditors send a list of data or information required in advance. Keep such information ready or provide it to auditor beforehand.
- Appoint a staff as point person for the auditors, the point person should be from the department being audited and has a fair idea about the rest of the operations in the organization.
- For onsite audit, keep a designated place where the auditors may work and keep the records.
- Read the Management Representation Letter provided to Auditor.

Audit Process - During Audit

- Schedule opening meeting: except for internal auditors, other auditors will be outsiders and will need orientation about the organization, business, policies and procedures, projects etc... The better orientation you provide the less chances of misunderstandings at a later stage.
- Understand what the auditor wants from you.
- If they want to undertake field trips, decide when and where they want to go and organize things accordingly.
- Designate point person for clarifications with a timeline for response. Clarifications are not final observations.
- Provide Clarifications to the auditors as per schedule.
- Ask the auditor to share draft observations as soon as possible. Prepare response for the closing meeting.

Audit Process - After Audit

- Hold a closing meeting at the end of the audit. It is not necessary to provide all responses at the time of Closing meeting but it is necessary that all observations are disclosed and discussed in the closing meeting. The Closing meeting is to understand the observations.
- Management Letter and Responses.
- Prepare an action plan after the Final Report is received and allot responsibility for implementing the action points.
- Review the action plan periodically until implementation or next audit.
- Action Taken Report (ATR) before next audit cycle.

Awareness of Fraud

What constitutes fraud?

- Fraud is an intentional act, often illegal, used to gain an unfair advantage or cause harm.
- It typically involves misrepresenting information, concealing facts, or using misleading tactics to deceive others for personal gain.

- Elements of Fraud: 1. Deception 2. Intent 3. Materiality 4. Harm to Organization.
- Red Flag: A signal that indicates something unusual and not normal.
- Prevent fraud through: 1. Internal Controls 2. Awareness training (deference) 3. Detection through Audit 4. Whistleblowing mechanism (report wrong doing without fear of retaliation).
- It is intentional, if not then it is an error.

Types of Fraud

Corruption is misuse of entrusted power for personal or organizational gains.

- Conflict of Interest.
- **Purchase**: Bid Rigging, Un-necessary sole-source justifications, Restriction in solicitation documents to restrict competition, Providing advance information to contractors, procuring goods which are not required.
- **Sales**: Product substitution, Non tracking of service deliverables, Issuing credit for false customer claims and returns.
- **Others**: Bribery, kickbacks, extortion etc..

- **Embezzlement**: Theft of Cash upon receipt and after accounting for it (Cash larceny).
- **Skimming of Cash**: Removing cash before the organization has accounted for it.
- **Fraudulent Payments**.
- Missing checks forged and paid for bogus transactions.
- Payee name altered.
- Check not released to the intended payee but diverted for a forgery resulting in un-cleared checks in bank reconciliation.
- Diverting advances to personal use.
- Exchange of currency at a higher rate (black market) and showing on books the exchange was made at official rate and pocketing the difference.
- Fraudulent write off and pocketing proceeds etc..
- Attempts to overvalue/undervalue net worth or net income through:
  - Timing differences.
  - Fictitious/Understated revenues.

    - Concealing/ overstating liabilities and expenses.
    - Improper valuations and disclosures.

Fraud Red flags Examples

- **Behavioral**
- Extremes of arrogance or meekness.
- Slow in work.
- Advocating honesty, loyalty and faithfulness.
- Spending habits not commensurate with the known sources of income.
- One or two key employees dominating the company.
- Key employees having close relationship with vendors.
- Employees having outside business interests conflicting with their job duties.

Fraud Red flags

- Disorderliness: accounting/filing etc.
- Disaster situations.
- Good systems but left in autopilot mode; no proper oversight.
- Sudden profits in loss making business or vice versa.
- Incomplete information/ absence of records.
- Situations which are TGTBT (Too Good to be True).
- Existence of orphan funds (like a donation drive for a disaster or helping a staff etc.).
- Excess knowledge than the position warrants.
- Absence of rotation of duties.
- Several non material observations together creating material effect.

Ethics, Accountability and Transparency

Ethics

Ethics is a system of moral principles. Ethics means doing the right thing in the right way. Ethics is concerned with what is good for individuals, organizations and society (moral philosophy). Organizations should have written Code of Ethics covering all legal and contractual requirement of Ethics under various laws. Need to share and train employees and other stakeholders the Code of Ethics. It includes corporate governance, bribery, discrimination, fiduciary responsibilities.

Common examples of Ethical violation usually protected by Law

- **Discrimination**: based on age, gender, race, religion, disability, and more. Common instances of discrimination include firing employees when they reach a certain age or giving fewer promotions to people of ethnic minorities.
- **Harassment**: is often related to racism or sexism. This can come in the form of verbal abuse, sexual abuse, teasing, racial slurs, or bullying.
- **Unethical Accounting**: Showing more or less profits than they actually are.
- **Health and Safety**: Organizations may decide to cut corners to reduce costs or perform tasks faster failing to take workers' safety into account can lead to psychosocial risks (like job insecurity or lack of autonomy), which can cause work-related stress.
- **Privacy Violation**.
- **Abuse of Leadership Authority**.
- **Nepotism and Favoritism**.

Ethical Dilemma

Ethical Dilemma is a situation where individual is faced with a choice between two or more courses of action, none of which are morally ideal or completely satisfactory. In these dilemmas, a decision must be made but all options potentially violate ethical principles. The challenge lies in weighing competing moral values and making a choice that minimizes harm and adheres to ethical standards.

Examples:

- Knowledge of Fraud but not reporting due to lack of courage or fraudster being a friend.
- Promote a product by misrepresenting it or hiding its negative health effects, official assets for personal use, accepting gifts or other benefits not allowed by policy.
- Dealing with vendors who are related.

Accountability

Accountability means being held responsible for actions and the outcomes. It involves taking ownership of responsibilities, delivering on commitments, and being transparent about both successes and failures. It fosters a culture of Ownership. An organization's accountability extends to its members, employees, and community. In a wider sense, accountability implies a willingness to be judged on performance, to accept and learn from mistakes. Accountability builds trust of stakeholders.

Examples of Accountability

- An employee meeting deadlines on a project and being responsible for its quality.
- A company being transparent about its financial performance and reporting it accurately.
- A manager providing constructive feedback to employees and holding them accountable for their performance.
- Organization addressing concerns raised by customers and implementing changes to improve their experience.

Tranparency

Business transparency is the process of being open, honest, and straightforward about various company operations and sharing such information with all stakeholders concerned. It involves disclosing relevant details, decisions, and actions in a clear and accessible way, fostering trust and accountability. This can include sharing financial data, operational processes, company goals, and even challenges. A transparent workplace can lead to stronger teams, increased engagement, and a culture of trust and respect. It builds trusts of all stakeholders. Transparency builds business advantage. It helps informed decisions.

Examples of Business Transparency

- **Disclose your Plans**: Even if they don't pan out, it's safer to inform Staff about potential changes rather than spring it on them last minute. For instance, one of the best tips for relocating your office is to talk to your staff. Work with them to organize the move and loop them into the details.

- **Organization Culture**: Having a Coaching culture is better than Command and control culture in organizations, which is important towards individuals feeling valued and comfortable within their roles.
- **Follow Up on Promises**: Stick to your word. Though it's a challenging thing to do as your company expands, it's worth it to stand by the promises you make.
- **Bring Your Whole Self To Work**: Build trust with your employees by bringing your whole self to work. Don't put on a façade; let people see the real you. You can form relationships with everyone in your company when you talk about your life. This will allow others to do the same, creating a culture of trust in your workplace.

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