

# AuditAble

5. Risk based Auditing for NGOs - 1  
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Of late, risk-based auditing has become increasingly accepted in India. In November 2007, the ICAI came out with a useful publication titled 'Guide on Risk-based Internal Audit.' This provides some useful guidance on approaching financial audits from the perspective of risk, mainly in the context of corporate organisations and commercial operations.

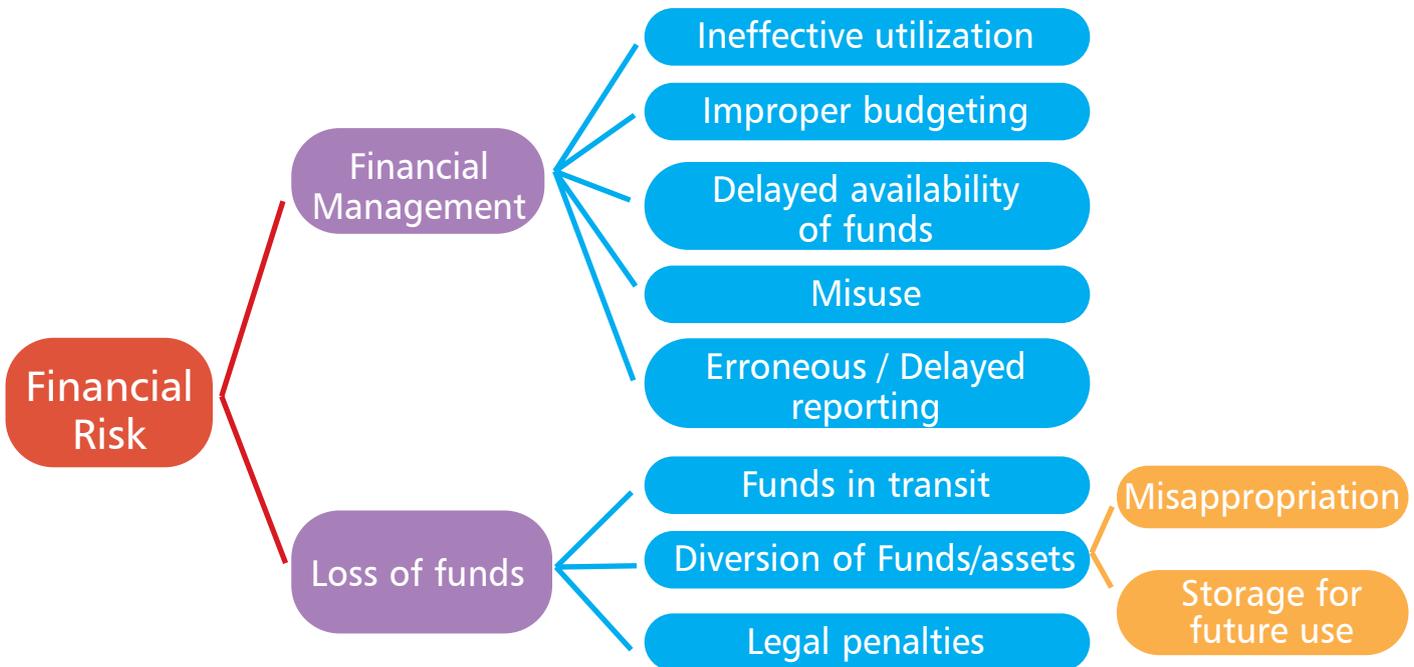
However, the approach is flexible enough to be used for NPO auditing as well. This paper presents a modified risk-based model, specifically adapted for financial monitoring needs of grant-makers.

### Financial Risk

As risk is a very wide term, the present discussion is limited to financial risk only. Further, financial risk in the context of grant-making has been defined as the risk of financial mismanagement or loss of funds/resources entrusted to an NGO.

### Risk Framework

Key elements of financial risk for grant funds are set out below schematically:



Financial Risk may be discussed under two heads: Financial Mismanagement and Loss of Funds.

Several Risks can be attributed to each of them. Let us take a detailed look at some of these.

## Financial Mismanagement

Poor planning or implementation of systems often leads to Financial Mismanagement. Several types of risks can be attributed to financial mismanagement. Illustrative examples of underlying causes are given under each:

### Ineffective Utilisation

- Excessive purchase of supplies
- Idling of human resources
- Purchase of supplies at higher prices

### Improper Budgeting

- Under or over estimation of amounts
- Insufficient detailing of line items
- Calculation errors
- Missing budget components

### Delayed availability of funds

- Delays in requesting or receiving funds from Donor agency
- Delays in release of funds to program units

### Misuse of Funds

- Use of funds for unbudgeted line items
- Use of funds for other projects or activities

## Erroneous/Delayed Reporting

- Errors in booking or reporting expenses under correct budget line items
- Advanced / delayed booking or reporting of expenses
- Financial reports not tallying with account books
- Delays in sending financial reports to donors

## Loss of Funds

The risk of loss of funds refers to a situation where funds are lost due to deliberate theft or due to penalties being imposed by the authorities. Illustrative examples are given under each risk:

### Loss of funds in transit

- Theft of cheque or draft remitted by donor agency
- Loss of cash during transit from one office to another
- Theft of cheques or drafts issued to an employee or vendor.

### Diversion of Funds/assets

- Theft of funds by showing fictitious or inflated payments to employees or suppliers
- Diversion of funds by charging same expense/ purchase to two or more donors





Poor planning or implementation of systems often leads to Financial Mismanagement which attributes to several types of risks

- Diversion of funds by making excessive recoveries from a project against overheads or for use of NGO assets (vehicle charges, conference facilities etc.)
- Diversion of assets for illegitimate personal use of employees or management

- Theft of funds by making fictitious payments to relatives of key persons
- Booking of personal expenses of the management in the project or trust accounts

#### Legal Penalties

- Tax, interest and penalties assessed due to non-compliance with TDS provisions
- Assessment of tax, interest etc. due to non-compliance with Income Tax rules
- Loss of Income Tax exemption due to non-compliance with Income Tax provisions on business-like activities [sec. 2(15)]
- Confiscation of funds / penalty for non-compliance under FCRA
- Assessment of tax / penalties / interest for not paying Service Tax
- Penalty for non-compliance with provisions of employee legislation such as PF, gratuity etc.

## Audit Areas

Based on the above delineation of risk, a list of audit areas may look like the one given below:

### Budget

- Detailing, variances, growth, analysis

### Reporting

- Accuracy, timeliness of reporting of CRY Funds
- Report format
- Internal MIS

### Utilisation of Grant Funds

- Loss or misuse
- Timeliness of disbursements
- Dependence on one source of funds
- Donation, Loan and Advances from Members

### Control Systems

- Book-keeping

### Structure

- Internal Controls
- Purchases, Bills, Stocks, Distribution
- Assets & Investments
- Cash and Bank
- Authorisation

### Payroll and HR recruitment / records

- Insurance, Welfare Funds, PF, Gratuity
- Audit: Internal / External / Tax Audit
- Accounting Standards, disclosure, quality
- Legal Compliance

### FCRA - registration, returns, banking, compliance

- Income Tax
- TDS
- Exemption, return filing, compliance
- Donations - exemption, compliance
- Society / Trust Regulation

### Governance

- Board - conflict of interest, overlap, independence
- Accounts and Finance - capacity, independence, experience

The list should be reviewed periodically and modified to keep in line with changes in risk patterns and growth in audit experience. In the next issue of AuditAble, we would learn to identify risks as well as ways to mitigate them.

.....Continued in AuditAble 6

### What is AuditAble:

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