

Micro Finance Audit

Client Description

- The client is a fast-growing A+/A1+ non-banking finance corporation in India.
- By allowing lenders in remote areas of India to increase the volume and lower the cost of borrowing for low-income and financially excluded families and businesses, their activities are now benefiting over 15 million individuals.
- They boast 9 years of track record of excellence.

Business Challenge & Drivers

The typical and largest challenges they faced involved under-writing by client groups and dealing in large amounts of cash outside branch locations. Furthermore, their client base was very varied, which meant varied kinds of risks would be incurred.

- The traditional risk lay in the very fact that financial transactions were being mediated for low-income households for a specific type of credit need that is short-term and unsecured.
- They faced systematic risks in terms of force majeure (rainfall failure) and political interference (introduction of laws that reduced MFI repayments dramatically).
- The idiosyncratic risks came internally to each entity and comprised mainly of operations and credit risk, and dilution of group formations and meetings.
- Being operations intensive, a few weak links in some processes were manifesting as fraud and operational failure.
- Some of the cash disbursements and collections were taking place in remote geographies, so cash movement was difficult to track, which in turn had the potential to turn into fraud.

Solution Approach

Evolution:

- Many dialogues with the audit head were orchestrated to learn the client's policies.
- The audit was broken down into segments – collections, GRTs, disbursements, document validation etc. – and parameters for each segment were defined.
- A point system was defined based on the bottoms-up approach for each parameter, thereby analysing individual risk in the process.
- The audit cycle and coverage were defined.
- Various formats for reporting – such as the internal formats for the audit staff to gather data – were finalised.



(Name withheld to maintain confidentiality)

“SmartAudit Pvt. Ltd. formulated a system for MFIs to ameliorate their operations and managerial decisions.”

Brokerage Audit

- Clarity on regulatory framework, and jurisdiction of State governments, vis-à-vis non-bank financial institutions, was critical in mitigating the political risk.
- At the institutional level, this was managed by building a closer connect between the institution and customer groups so that there was resistance to local political interference that constrained the MFI's business activities.

Employment of the SmartAudit Rating System:

- Early Days –
 - In the field, when the staff recognised a red alert it was immediately brought to the notice of the CEO/audit head via e-mail.
 - A process was then developed to handle the alerts.
- Alert – [yellow, orange or red]
 - Some centres posed a higher risk of non-payment for reasons like disorganised meetings, internal quarrelling and late payments. There were risks ranging from ones that could be handled but needed more attention to ones that were detrimental to the overall health of the MFI.
 - Dilution of group formation and meeting norms are early warning signs of process deterioration that trigger concerns about credit quality.
- Complete Alert Cycle –
 - This final step culminated in jotted down a list of non-recommended centres.
 - Branches with a history of fraud were penalised in the risk-scoring model and the frequency of audit linked to the risk score.

Technology – Sarvagya Audit Business Intelligence System

This method was very useful to better operations and improve managerial decisions since the client had multiple branches.

- The web based method facilitated report entry (audit staff), approval (audit manager), online client approval and incorporation of client comments from anywhere.
- Ratings were done hierarchically by the field development officer, branch, and area and division managers, and the workflow was followed-up with ops.
- The comparisons of ratings between two audit periods were calculated.
- This dramatically minimised input errors.
- Using data mining and statistics, the attendance percentages across centres and the difference in percentage between regions was studied.
- Cash movements were monitored by setting cash retention limits for branches, and deviations were approved and recorded. Reconciliation of cash through MIS in the branches' bank accounts was important in scrutinising floating and idle cash.

Brokerage Audit

Impact

- The cultural shift towards continuous audit meant that senior staff understood the importance of audits, and field level staff knew that they are being continuously audited and, thereby, followed company policies rigidly.
- It helped client establish process to tackle the alerts.
- It identified gaps which tend to be fewer in older branches compared to newer ones, and used reason for training and recruitment.
- The process helped spot frauds before they happen or before they got worse.
- A monthly executive summary was made for top-management and the audit committee.

Key Highlights

Benefits realized with the SmartAudit's audit intervention:

- By evaluating the strength and thoroughness of the organisation's adherence to regulatory guidelines, SmartAudit could appraise a threat at its inception.

Comprehensive end-to-end solutions

- Transparent and efficient solution
- Technology driven
- Audit BI - reporting layer for comprehensive reporting
- Enhanced decision making
- 360 degree feedback process

Garnered Credentials

- Audit is SmartAudit's core competence
- Proven track record
- Time tested practices
- Wide range of services offered
- Reliable infrastructure to ensure business continuity
- Demonstrated high quality of deliverables

Expertise

- Complete knowledge of audit processes
- More than a decade of experience with the MFI industry
- Over a 100 professionals in the audit area

Experienced Team

- Team with proven experience in processes and systems
- Highly experienced staff with over 25 years of combined experience

Brokerage Audit

Savings

- Low cost solution with both qualitative and quantitative benefits
- Highly scalable to accommodate growth
- Saves valuable person hours
- Savings on paper – greener planet
- Long-term borrowing, with hedging and diversification of funding sources, enabled them to mitigate interest rate risk.

Conclusion

Currently, SmartAudit continues to deliver the Smart999 standard, which translates to PAR less than 0.1%.

SmartAudit was able to deal with the volume of work and deliver the quality promised given the skill and experience of its team:

- Deep industry knowledge
- Thorough understanding and implementation of the audit processes
- Allowing the MFI to concentrate on their core competencies without worrying about tangential concerns.
- The concept of the Audit Based Rating System filled a gap in the Micro Finance industry.
- Quantification of audit observations immediately helped them put a finger on areas that needed to be improved.
- The wholesome audit capabilities contributed to the overall financial health of the institution.