

MSME & INTERNAL AUDIT

Internal audit function has potential to improve operating efficiency and improving the health of the organisation for achieving long-term sustainability for MSMEs

What is MSME?

Micro, Small and Medium Enterprises (MSME) constitute the backbone of an economy in maintaining an appreciable growth rate and in generating employment opportunities. This sector has been regarded as engine of economic growth and social development in many developed and developing countries. Contribution of MSMEs to the Indian economy in terms of employment generation, containing regional disparities, fostering equitable economic growth and enhancing export potential of the country has been quite phenomenal. Despite some infrastructural deficiencies and challenges like flow of institutional credit and inadequate market linkages, this sector has registered remarkable success about increase in number, quantum of investment, scale of production and overall contribution to national GDP.

A lot of articles have been written in recent times depicting the trends in terms of role of Internal Auditors and increasing expectations of various stakeholders from the Internal Auditors. However, much of this information essentially provides perspectives on roles played by internal auditors in large organizations, which already have established systems and processes. The audit departments in these companies are fairly evolved with independent Charters and reporting to the Board Audit Committees.

In this article we are trying to assess whether the same concepts can be applied for even smaller enterprises or whether the role of Internal Auditor in such setups can be tweaked in order to meet the demands of the organisation.

Typically, MSME has following challenges:

-  Lack of Adequate Capital and Credit
-  Poor and Inadequate Infrastructural Facilities
-  Inadequate Access and Marketing Linkages
-  Lack of Skilled Human Resources
-  Lack of Access to New Technology
-  Dilatory and Cumbersome Regulatory Practices

What is Internal Audit?

Internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations.

It is needless to emphasize that profit making is the primary motive of any entity in the business. Internal auditing helps an organisation accomplish this objective by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Every entrepreneur aspires to see that his firm remain healthy and growing. However, raising concerns for business failure among MSMEs have been prompting the promoters to appreciate the need for appropriate risk management and internal audit.

Why Internal Audit for MSMEs?

Investment in internal auditing can add value to an organisation via operating efficiencies, safeguarding assets, more reliable financial statements, and realizing an organisation's goals and objectives leading to reward to stakeholders.

It is obvious that in the MSME space, the stakeholders are closely associated with the business. Promoters are largely focusing on the targets and performance.

All entrepreneurs are so obsessed with such a continuous routine that they remain oblivious to certain vital elements that have a positive impact on a firm's operational performance and sustainability.

Further, MSMEs tend to have characteristics such as fewer financial controls, more related-party transactions, lower accuracy of accruals and provisions, etc. People within the organisation tend to avoid examination of such issues for obvious reasons.

The scope of Internal Audit:

There is no structured scope to deliver internal audit. Organisation need to be free to choose what works for them according to the nature of what they do, how the organisation is structured, the way processes operate, their financial circumstances and the risks to their strategic objectives. The scope of internal auditing within an organization cover:

- Effectiveness and efficiency of operations.
- Reliability of financial and management reporting.
- Compliance with laws and regulations.

- Safeguarding of Assets

Some of the roles an auditor can play are as follows:

- Act as a bouncing board to the management on key risk management decisions
- Assist in identifying areas of cost and manpower optimization.
- Keeps track of key developments in the field of economy, commerce and legislation and tracks its potential impact on the company
- Bring pragmatic approach to implementing systems and processes
- Help in deploying tailor-made best practices that are suitable to the needs of the organization

Internal Audit and Managing Risks:

With a risk management focus, internal audit can move beyond its monitoring role to help influence and improve how risks are managed before they become challenges. Businesses today are knowledge-intensive and such orientation creates processes and theme that is very complex. So is the gamut of risks and magnitude of impact.

The success of MSMEs in overcoming these challenges has been achieved largely due to the overwhelming spirit of entrepreneurship displayed by the promoters of these organizations. However, often during adverse economic crises or situations beyond comprehensions of these promoters, the organisation fail in risk mitigation and lose the considerable value of the business.

During times of such distress, an internal auditor who got a better view of the business can chip in with valuable advice.

Independence – Critical to the success of Internal Audit:

Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.

Business Owners should encourage the internal auditor to engage in the job fearlessly and it is necessary to effectively carry out the responsibilities of the internal audit activity.

It is very important for MSMEs because many a time the employees in MSMEs are somehow related to promoters or may be associated with them for a long time. Thus there could be chances of embarrassment or at least he may find difficult to bring all the employees on board. Promoters should prevail upon the employees & partners and make them understand that such an examination is important for the sustainability of firm and brings common good.

Key Challenges and Insight for the auditor conducting audits of MSMEs:

1. The auditor of a small business is required to be as proficient in all relevant standards as the auditor of a large, listed entity. Keeping up with changing requirements and maintaining the required knowledge base can be challenging. However, having complete knowledge of relevant auditing standards, coupled with experience in making good professional judgments, is essential for audit efficiency.
2. Simpler businesses do not necessarily mean an easier audit. Small businesses tend to have particular characteristics that require increased attention, for example, fewer financial controls, more related-party transactions, inappropriate books closure (i.e., accuracy of accruals and provisions), and can be subject to some complex taxation requirements.
3. Having fewer, more experienced professionals involved in the audit can bring many benefits and efficiencies to the audit process. Experienced auditors often have an in-depth understanding of the Industry / sector and business processes which allows them to work quickly and effectively, performing the right amount of work and avoiding over documentation.
4. The downward pressure on MSME audit fees is largely due to the market viewing the audit opinion as highly standardized. On the other hand, the audit process is labor intensive, and auditors are subject to initial and continuing knowledge advancement requirements, so the challenge for many auditors is how they can grow audit revenues while maintaining audit quality.
5. Smaller clients are ready to pay for audits that they perceive add value. Also, small businesses are willing to pay their auditors for good business advice. It is pertinent the auditor must learn how to operate with a "Trusted Business Advisor" model.
6. Evolving markets and new services will require practitioners to make significant investments in skills and technology, as well as to move away from the traditional practice model and develop new ways of operating. This innovation is essential to maintaining profitability in light of fee pressure on MSME audits and the need to provide other value-added services in order to grow revenue.

Conclusion:

All MSMEs are spiritedly focusing on increasing the business. MSMEs over the years have assumed greater significance in our growing national economy by contributing to employment generation and rural industrialization. This sector possesses enough potential and possibilities to pushbutton accelerated industrial growth in our developing economy and well-poised to support national programme like 'Make in India'

Even then they are all carrying an unspoken desire that their firm remains sustainable and that effective controls are in place and operating properly. Internal Audit can help them to attain this goal. There are studies that have argued that the effective internal audit functions improve the overall health of the organizations.