MicroSave Briefing Note #164
Using Score-based Audit for Improving Organisational Effectiveness

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July 2015

Introduction
More often than not, Internal Audit Reports focus on a few glaring issues that are discussed during board meetings and then taken up by senior management. The flaw in such an approach is that usually, the Board does not have a holistic understanding of the overall performance of the organisation. To take appropriate action, it is necessary to be aware of the performance of units and sub-units – a shortcoming which is compounded by the fact that it is very difficult to get a snapshot comparing different units and sub-units of an organisation.

To add to this, the consolidation of multiple audit reports into an organisational level audit report is often a challenge for the audit department. This is mainly because of the large volumes of data that come from different levels and regions of the organisation. Consolidating them into a coherent report that highlights key issues and gives a comparative picture of the different operational levels requires a lot of time and effort. This problem gets even more pronounced for bigger microfinance institutions (MFIs), where operations are spread across many branches in different geographies.

MFIs can overcome these challenges by using a Score-based Audit tool, which is designed using audit-checklists. This Note highlights the advantages of using the Score-based Audit tool, the types of audit tools to be used, designing a methodology and the procedure to use it.

Advantages of Using Score-based Audit Tool
In addition to an internal audit report, an MFI should also use a Score-based Audit tool to offset the inherent drawbacks of traditional reporting, as well as to improve the management decision-making process in the following areas:
- To distinguish between high, medium and low performing branches/areas/regions/divisions based on their respective audit scores.
- To identify reasons for underlying low-performance in particular branches, areas, regions, divisions as well as the organisation as a whole.
- To design a suitable strategy and action plan for low-performing branches, areas, regions, divisions and the organisation as a whole.
- To improve the staff performance appraisal systems by linking them to audit scores achieved during the year of appraisal. For example, Branch Manager's performance appraisal can be linked in part to the branch audit score, while Area Manager and Regional Manager's appraisals can be linked to area and regional audit scores respectively.

Hierarchy of Audit Tools:
Audit tools can be developed to suit the needs of different organisational levels. For example, an organisation with operations organised under branch, area and region may choose to use three types of Audit tools for different levels of auditing.

Type of Audit Tool	Audit Analysis Report
Branch Level Audit Tool	Branch Audit Analysis Report
Area Level Audit Tool	Area Audit Analysis Report based on consolidated scores of the Branches
Region Level Audit Tool	Region Audit Analysis Report based on consolidated score of Areas under the Region
Organisational Level Audit Tool	Organisation Audit Analysis Report based on consolidation of scores of Regions

Steps to Design a Score-based Audit Tool:
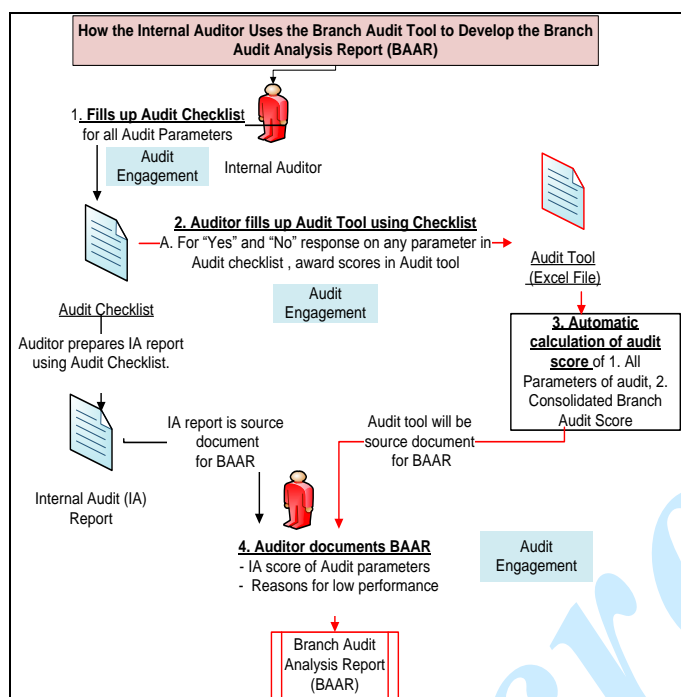**A. Design of Audit Tool of Unit/Branch**
1. *Fix the Scope of Audit*: The first step would be for the Board and senior management to fix the areas (or attributes) of audit that they think are critical for the organisation. For example, some audit attributes could be: cash verification; loan disbursement; loan repayment; delinquency management; code of conduct; etc.

2. *Design Audit Checklist*: Once audit attributes are finalised, the audit department should develop a detailed checklist for each audit attribute. The checklist should also define the "sample size" and "means of verification" for each audit parameter.

3. *Design Score-based Tool*: The audit checklist can then be copied onto software like MS-Excel, which has the provision to score each item based on audit observations. To ensure uniformity, scores are assigned and fixed for compliance and non-compliance for each item in the checklist.

4. *Score Calculation of Audit Attribute*: Formulae-based logic is applied so that attribute-

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wise score can be calculated based on field observation. Further, additional formulae-based logic can be built to consolidate the results at different organisational levels (branches, areas and regions).

5. **Audit Score:** The audit score of a branch can be calculated by consolidating the audit scores of all the attributes of the branch level audit.

   Branch level scores are then consolidated at different organisational levels to arrive at performance scores of each of these levels.

How to Use Branch Audit Tool to Prepare Branch Audit Analysis Report (BAAR)

Branch Audit Analysis Report (BAAR) contains the following:

1. Audit score based categorisation of branches/areas/regions as low, medium and high performing units.
2. Explanation of the audit scores.
3. A strategy and action plan to improve low performing areas of the branch.

Preparing the Audit Report:

Once the scores of audit attributes of individual branch/area/region are calculated and consolidated to arrive at the audit score of the entire organisation, the organisation audit analysis report is prepared. This report is prepared on the same lines as the BAAR. The report identifies high-performing, medium-performing and low-performing branches, areas and regions. Additionally, it may also contain detailed explanations

and reasons for poor performance, and the corrective steps that should be taken in order to improve.

Examples of Organisations using Score-based Audit Tool along with Benefits derived:

Name of Organisation	Benefits
Sonata India Private Ltd. (Uttar Pradesh, Bihar and Madhya Pradesh, India)	• Performance appraisal and decision making on promotion of Operations staff members including Field Officer, Branch Manager, Area Manager, Regional Manager, and Divisional Manager
	• Designing of a clear strategy and action plan based on the performance of branches, areas, regions, and divisions
Sambandh Finserve Pvt. Ltd. (Orissa, India)	• Improvement in course design for training, planning and execution by HR as low performing audit attributes are taken into consideration
	• Improvement in efficiency of Monitoring and Operations staff as they can focus on attributes with poor performance

Conclusion:

Score-based audit gives an objective angle to the entire audit process, while individual audit scores provide a quick snapshot of performance across different operational units of the organisation.

Moreover, the tool enables auditing to be a standardised process across the organisation, thus facilitating accuracy and greater transparency in comparing staff performance. Accordingly, incentives/remuneration for the staff can be determined based on audit performance of the staff members.

Audit scores for different attributes and for different organisational levels allow institutions to focus on their weak areas so that they can comply with the standards that they have set. Score-based audit also improves the focus of monitoring and compliance management.

Overall, a score-based internal audit and the use of MS-Excel or similar software to consolidate and analyse scores helps to improve compliance, remove bias and standardise results for assessing performance, thereby increasing organisational efficiency.