

Early Warning System



**RISKS
AHEAD**

Early Warning Signals : A wake-up call

Time has aroused for the auditor to look beyond financial transactions. Frauds happening at different levels, irrespective of the corporate governance, raises the need for the study of early warning signals (EWS) and Red flag accounts (RFA). Intensity of the fraud is measured upon the level at which it is carried out. Finally, fraud is a fraud and auditor need to be vigilant by all means.

EWS is a matter of experience and exposure. Distinguished constitutional bodies are raising their concerns from time to time. They have tried to narrate their expectations as well.

Team YKT Talentica has put on the efforts to pen down the 100 EWS for the business at financial, operational, management and Information Technology level. The listed EWS are applicable to almost every business entity irrespective of their constitution.

Initially, this subject was taken for internal quality training purpose but subsequently, it is decided to publish the article for the benefit of the fraternity and business entities as a whole.



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Sr. No.	EWS	Function
1	Credit period of payables is lesser than credit period of receivables	Financial
2	Receivables are outstanding for more than reasonable period	Financial
3	Working capital ratio is less than 1:1	Financial
4	Working capital ratio is good but the money is blocked in long-term receivables and dead stock/ non-moving stock	Financial
5	Bankruptcy of top debtors, unique creditors, lenders	Financial
6	Constant insufficient availability of raw material against the orders in place/hand	Financial
7	Consistent diversion of Funds	Financial
8	Consistent statutory non-compliances	Financial
9	Non-payment/constant delayed payment of statutory dues	Financial
10	Over-booking of income under the blanket of accrual	Financial
11	Large outstanding from the inter-connected companies on account of large number of transactions with them	Financial
12	Significant movement in the inventory, disproportionately higher than the growth in turnover	Financial
13	Significant movements in receivables, disproportionately higher than the growth in turnover	Financial

Sr. No.	EWS	Function
14	Increase in borrowings irrespective of good cash and cash equivalents	Financial
15	Majority of the transactions are with related parties	Financial
16	Not meeting the disclosure requirement in the report, irrespective of the material discrepancies	Financial
17	Frequent change in accounting policies to manipulate the financials	Financial
18	Non-routing of the transactions through the account of the lender	Financial
19	Heavy cash withdrawals from the loan account	Financial
20	Frequent cash (hard-core cash) deposit to the loan account	Financial
21	Financial Expenses more than operational expenses	Financial
22	Maintenance of two books of accounts	Financial
23	Regular monthly investments exceed the monthly profit of the business entity	Financial
24	Secretarial compliance for name-sake	Financial
25	Consistent reimbursement of expenses to related parties on account of routing of the transactions through related party	Financial
26	Improper cross charging of the expenses among related parties	Financial

Sr. No.	EWS	Function
27	Majority of revenue is coming by offering over ridding commission	Financial
28	Over dependence on few debtors	Financial
29	Lack of proper investment of profit	Financial
30	Defunct treasury management	Financial
31	Improper revaluation of assets resulting in inflated financials	Financial
32	Positive cashflow on account of sale of investments	Financial
33	Lending on the basis of income coming from other sources rather than operational business income	Financial
34	Majority of lending to one group or their related parties	Financial
35	DP not supporting the loan limit	Financial
36	Devaluation of collateral value of Assets	Financial
37	Excess provision during annual closing	Financial
38	Return on Investment is lesser than operational IRR	Financial
39	Disputed title to the assets of the business entity	Financial

Sr. No.	EWS	Function
40	Re-borrowing to repay the previous borrowing	Financial
41	Under-invoicing or over-invoicing to manipulate the turnover	Financial
42	Frequent devolvement of LCs and BGs	Financial
43	Concealment or falsification of documents	Financial
44	Inconsistencies in the different reports generated internally and statutorily	Financial
45	Fund mismanagement – Buying fixed asset out of short-term borrowings	Financial
46	Lack of harmony in the accounting system	Financial
47	Lack of implementation of maker-checker	Financial
48	Poor CIBIL of KMPs or KMPs under continuous financial stress	Management
49	Banks/FIs/ Lenders denial to offer funding to existing/ continuing businesses	Management
50	KMP leaving the organization on account of policy decision & not financial decision. Frequent changes in management.	Management
51	Reduction in the stake of the promoters/ directors	Management
52	Frequent withdrawal of profit by the management	Management

Sr. No.	EWS	Function
53	Lack of audit independence	Management
54	Excessive lime-light for management	Management
55	Over-whelmed proud feeling of KMP on business success	Management
56	Non-support to audit function by management / Audit for the name-sake/ Denial or postponing of information to the auditor	Management
57	Improper remuneration policy for management & specifically for founders	Management
58	Micro-management by top level managers	Management
59	Devaluation of business investments	Management
60	Theft of business ideas among KMPs and starting of competitive business	Management
61	Investors moving the business decision	Management
62	Business non-adoption to the change in consumer behavior	Management
63	Key personnel indulging in the mal-practices and/ or taking the disadvantage of the position	Management
64	Untimely huge growth in the assets of the founder	Management
65	Rivalry among key personnel of the entity	Management

Sr. No.	EWS	Function
66	Distrust of the investors / backing-out of the investor/s	Management
67	Exorbitant commitment from the management to stake-holders	Management
68	Running the business on investors' money beyond reasonable period though the terms of investor's covenant are met	Management
69	Higher managerial personnel influencing the work of vendors	Operational
70	Excessive production capacity of the fixed assets for the material for which market is not easily available	Operational
71	Outdated operational Fixed Assets in the competitive market	Operational
72	Sudden change in government policies with respect to main business product.	Operational
73	Poor work Culture	Operational
74	High employee attribution/labor turnover	Operational
75	100% smooth functioning of the organization	Operational
76	Lack of focus on financial self-dependency and consistent dependency on borrowed funds	Operational
77	Non-co-operation between management and employees	Operational
78	Easy acceptance of say of labor union without soft fights	Operational

Sr. No.	EWS	Function
79	Lack of standard operating procedures	Operational
80	Excessive dependence on single person for handling the department	Operational
81	Major change in life-style of employees	Operational
82	Guarantees exceeds the asset and investment portfolio	Operational
83	Handling of important functions by one person, lack of decentralization (Multi-Function-Handler)	Operational
84	Non-meeting the object clause of MOA	Operational
85	Market seeking plan of the competitor. Sale at lower price by competitor who is a long-term player. Eg. Jio	Operational
86	Raid from the statutory departments	Operational
87	One of the business processes is manual when all other processes are automated	Operational
88	Non-responding to/ under-rating the queries/ objections/ notices raised by the constitutional bodies viz. RBI, IRDA, MCA etc.	Operational
89	Non adherence to SOPs. Ratification of the Act shall not be the consistent feature	Operational
90	Circumstances warranting the employee's involvement in fraudulent activities	Operational
91	Under-insurance or over-insurance of business considering the location and nature of business	Operational

Sr. No.	EWS	Function
92	Tampering with the audit trails	Operational
93	Non-strengthening of the internal controls considering the nature and size of the business	Operational
94	Non-complying with the investor's covenants	Operational
95	Lack of uniformity in the accounts maintenance for the geographically spread business entity	Operational
96	Business challenging the industrial practice	Operational
97	Weak IT architecture and infrastructure	IT Security
98	Insufficient cyber-Security	IT Security
99	Insufficient back-up plan, disaster recovery plans and business continuity plans	IT Security
100	Leakage of information through social engineering	IT Security

- Early warning signals can be used as a preventive measure. Extendible version of EWS is detection.
- The above list is not exhaustive. It will keep on evolving and list will grow with the passage of time. Above list is collated on the basis of experience.
- RBI has narrated the 45 EWS via notification issued in 2016.