

Outsourcing fiasco



**ASSIGN
BUSTER**

In 1995, he saw the potential for a hypermarket business in Malaysia, as there was very little competition, specially from the local entrepreneurs. Together with his wife, who had worked as a Marketing Executive in one of the international retail stores operating in Malaysia, they formed “ Mental Sad Bad”, which was located in Klan. Although the company was formed during the time when many of the companies were hit by the financial crisis 1997/1998, the business was not seriously affected due to less reliance on borrowings and the company’s effective credit facilities with their suppliers.

In addition, many of their suppliers were local partners. By, Mental Bad had become one of the leading hypermarket chains In Malaysia. Following its tremendous success in expanding its business operation, the company sought to be listed on the Second Board listing on Bursa Malaysia during the year 2000. After listing, the company became known as Mental Bad. With the listing status, Mental Bad enjoyed the benefits of fund Ralston and government Incentives.

By 2005, Mental Bad had become one of the top 20 best performance listed companies.

Today, the company has a total of eleven branches operating in Peninsular Malaysia, as well as in Saba and Karakas. Due to commitments on several big development projects In the Klan Valley, Mental Bad relocated Its quarters to Dammars. Board of Directors There are seven board members sitting on the company board, which consist of five gentlemen and two ladies.

Since the company started as a family business, most of its board members are familiarities. Data Johan is the Chief Executive Officer (CEO), while his wife, Dating Camilla, is the Marketing Director of the company.

Together they hold 56% of Mental Bad shares. The Chief Financial Officer (COOP) post is held by Data John's brother, Call, who is responsible for overseeing the financial matters. The Chairman of the company is an ex-government servant, Tan Sir Abdullah MUSM, he is also Data John's uncle. Data' Murals Mania, who is a very close friend of Tan Sir Abdullah, and Jill who is the company's Information Technology (IT) Director also sit on the board, and he has been with the company for the past ten years.

Prior to 2004, Jail was entrusted with the sole financial responsibility for the company with limited assistance from other board members. However, in January 2004, Mental Bad employed Malign Gaur, as the company's Accountant. Malign has five years experience as an auditor and graduated from a local university. Audit Committee The Audit Committee comprises four members-Jail and three other directors – none of whom have financial expertise. Dating Camilla is the Chairman of the audit committee. The Committee only meets once in a year, which is right before the Annual General Meeting (GM).

For that reason, most matters for discussion and review are approved by e-mail circulation. The Establishment of the Internal Audit function Mental Bad was listed before the requirement for the company to establish an internal audit department was made mandatory. For the first few years after their

listing, Mental Bad did not have an Internal Audit function. During a meeting with his brother Jail, in November 2007, Data Johan voiced his view concerning this matter.

Johan I seriously think that our company needs an internal audit function. Jail
Internal audit?

Why do you think so? We're operating fine all these years. No, it's not because of that (Sigh). We never had an internal audit function before, and now I heard the Securities Commission has come up with something about the requirement on internal audit. (Frowning)Him, okay, but..

. I don't want us to be left behind our competitors Just because of some silly thing like his and everybody else in the market is talking about this internal audit! Okay! Okay! One question though. What is that? 2 Who and how are we going to get this internal audit running in our company?

Do we have to have a whole new department for this? Or we just need a staff member to do the job? And do we need to get somebody new or an existing staff member from other positions? You really have a lot of questions, don't you? Well, Eve thought about it for quite some time already. For a start, let's just appoint somebody for the job. Then we'll work from there.

Alright (Smiling). Knowing you, you must have decided on something or someone already. Tell me. I'm thinking of promoting Mali.

Mali? You mean the guy from the Sales Department? Yup. Remember when we interviewed him a couple of years back?

He said he doesn't have any background in sales but he'll give it a try? Look at where he is now. He's good at his Job and he always impresses me with his brilliant ideas. Besides, how hard will it be for him to do something new – again? I think you've chosen the right guy. (Looking at his watch).

Alright then, issue solved. I have to run. I need to meet Limit to discuss our latest order. Based on Milk's impressive performance in the Sales Department, he was appointed by Data Johan to act as the new internal auditor. In addition to Milk's Diploma in Business Studies he also took two accounting papers in college.

Despite his lack of academic background in accounting and having no working experience in accounting or auditing, Mali took the role as the company's internal auditor in January 2008.

His appointment was made without consulting the Human Resource Department and he reports directly to Jail. Milk's annual remuneration amounted to RMI 50, 000. Milk's revised position in the Sales Department was filled by Samaritan, who was previously Milk's subordinate. 3 During the meeting of the Board of Directors at the end of year 2009, Tan Sir Abdullah suggested that the company establish its own internal audit unit.

This was in response to the Bursa Malaysia Listing Requirements (2009), which requested companies to establish an internal audit function. However, his suggestion was not supported by the majority of the board members, particularly Data Johan who was against the idea.

Uncle, with due respect, I don't think we need a separate internal audit department. We already have Mali working on the internal control statement. -ran sin But Johan, Mali is not qualified to do the Job!!! But, he's been giving us internal control reports about the company, which I personally find helpful.

He even assisted Samaritan when we had trouble in marketing our newly launched product end of last year.

I'm sure all of you recognize the effort that he put in for the success of our new marketing strategy. All other board members nodded in unison, and even the Chairman agreed. I don't deny his capability in that sense. What I am questioning right now is his Job as n internal auditor and whether or not he is qualified for the Job? (With a grim look) Since I was the one who gave him that position, are you also questioning my capability to choose my staff? Don't get me wrong Johan.

What I meant is, Mali doesn't have the qualifications nor does he have any experience as the internal auditor.

That's all. What he did for the past two years was practically running around, here and there assisting other managers, particularly those from Sales and Marketing Departments. I don't see anything he did in the past that actually reflects any kind of internal audit or control work. His talent could be channeled somewhere else.

Don't you all agree? Murals Johan, I will have to agree with Tan Sir on that. Mali is a good staff member. All of us know that. He's loyal and he contributes a lot to our company.

Probably in everything else.

... Except internal audit. And Just like the rest, I know you know that too.

4 On top of everything else, I'm greatly concerned with the cost that we will incur in setting up an internal audit department. Camilla I strongly agree with Jail. Since we need to have internal auditors with relevant qualifications and working experience, it will cost us even more to look for appropriate and suitable staff. The bottom line is, a new department will definitely reduce our profit for this year. I think I'll go with both Jail and Camilla.

Cost is our main concern here. Simon Me too. I agree with them.

Uncle, in hindsight, I support your concern about the Bursa's requirement, but I notice that some of our suppliers and clients don't even have their own internal audit department.

What they did was to outsource it to other companies to do it for them. After a series of discussions and serious consideration, all of the board members agreed to outsource their internal audit function and to relocate their current internal auditor", Mali to the Sales Department while Samaritan was transferred to the Purchasing Department. The board consulted on their decision to outsource their internal audit function with the company's auditor, MAC & Co.

Given their long-term association since the establishment of the company, the audit firm offered to provide the internal audit services to Mental Bertha. The board agreed in principle on the suggestion and requested a quotation.

The appointment of MAC & Co. Was finalized within a month. The audit staff who performed the internal audit work involved the same people who were involved in he audit of the financial statement of Mental Bad. This was mainly because those staff members were already familiar with Mental Bed's operations and accounting system, as well as its key risk areas.

However, most of the staff members who performed the internal audit services did not possess appropriate experience and qualifications in internal auditing, which, unfortunately, were not conveyed to the Mental Bad board members. Furthermore, since they did not have the exposure or proper guidance in this first assignment, it was a very challenging task to them. Most of the time, the 5 internal audit team had to apply their knowledge in auditing the financial statement audit, when, infant, they were dealing with the internal audit and control processes.

Despite these limitations, the auditors managed to complete the internal audit work on schedule.

Upon completion, the same partner in-charge for both the external and internal audit prepared the internal audit report and submitted it to both the Audit Committee and the Chairman of Mental Bad. After reviewing the internal audit report, Tan Sir Abdullah called the board members for a meeting. I know this is abrupt and sorry for the short notice. But this has to be discussed immediately. It's regarding our internal audit report. I know

some of you may not have received the report, but I'm sure at least Jail and Camilla have seen it.

Both of you are part of our Audit Committee anyway. May I know if there is anything of concern? I am very disappointed with what they have given us, and the way it was done and written. Most of the content of the report does not meet the Bursa requirements. I agree with you. Both Camilla and I have reviewed the report and we found nothing pertaining to our state and extent of internal control systems.

They keep on talking about our finances, which is not supposed to be covered in this kind of audit. Spot on! And to top it all, their charges are considerably higher than my expectation.

It's ridiculous!! And outrageous!! ARMS, OHO for this kind of work and report?? They must think we are morons!!! I strongly suggest we discontinue their service. Halfway through reading the report, there was only one thing on my mind – they do not know what they are doing. I have to agree with both of you.

I'm with you on this. It's obvious that they have trained for doing their usual financial statement audits but not for internal audits. We have wasted our money for this. It's definitely a mistake. What about the rest? Murals? Jill? Simon? What do you think? Well, since the three of you have read the report and have reached the same conclusion, I'm going to rely on your judgment.

Me too. Yup, me too. Well, I guess it's been decided. We have all agreed on this.

The internal audit service shall be discontinued with immediate effect. Johan, please proceed with the necessary actions. No worries. Since it's already late, it will be my first agenda tomorrow morning. Putting that aside, what should we do now? We're back to square one. We still need to have our internal audit function; anybody have any suggestions?

Before we proceed to further discussion on the options, I strongly suggest we discuss the main issue first.

Should we still proceed with outsourcing? Or do we need to establish an audit department? Jail is right. I don't want us to repeat the same mistake. We should learn from what happened before. A mistake like this is too costly. I don't think we can afford to lose more.

We have to get it right this time around. However, my greatest concern is, we have practically tried out both options. We used to have Mali as our internal auditor, and we have tried outsourcing the service.