TECHNICAL GUIDE ON INTERNAL AUDIT OF RETAIL INDUSTRY

[Disclaimer : The source of this content is icai.org. The purpose of this guide is to give a bird's eye view on the Internal Auditing aspects.For details please refer the institutes' website]

INTRODUCTION :

- Retail markets where goods are sold to the end consumers, not for resale but for consumption.
- Second largest employer in the country, after Agriculture.
- Fifth largest industry in the country.
- Organised Retailers : Who are registered under the Sales Tax , Income Tax, Corporate backed hypermarkets and retail chains.They are only 3% . Other retailers are Unorganised.
- Retail Markets : 1. Food Products 2. Soft Products 3. Hard Products
- We are not including Eretailers here.
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Retilers	India	China	Indonesia	Thailand	USA
Organised	3%	20%	30%	40%	85%
Unorganised	97%	80%	70%	60%	15%

- Distribution system : Manufacturer--→ Wholeseller/Intermediary-→ Retailer

ORDER MANAGEMENT SYSTEM : To facilitate the fraud management process

Functions :

- Must provide ability to interface with payment gateway for real time authorization
- OMS provides fraud rules engine to act on the decision of fraud
- Puts the order on hold and transition the fraud business process.

DATA WAREHOUSING SYSTEM : Related to fraud management implementation.

Functions :

- Pulls data from fraud mgt system and OMS
- Determination of direct/Indirect fraud rates
- The validity of business rules can be verified

FRAUD PREVENTION TECHNIQUES :

- On line payment authorization of D/C cards
- Address verification services (AVS)
- Use of card verification codes (CVV)
- Risk prediction model software

FACTORS LEADING TO GROWTH OF RETAILING IN INDIA :

1. Increase in the disposable income and customer aspirations.
2. Low share of organized retailers .
3. Expenditure for luxury increased.
4. Rapid e-commerce growth.
5. Pay scale of youngsters in india.

CLASSIFICATION OF ENTITIES IN RETAIL INDUSTRY:

BASED ON BUSINESS STRUCTURE	BASED ON OPERATIONS
Agency/Partnership system	Grocery shops
Dealership	Small format shops-400 Sqmt
Direct Distribution	Convinience stores

Franchising System	Specility stores
Networking/Integrator	Hypermarkets – 2500 sqmt- 40k products-50% food
Independent retailer	Supermakets – 5-10k products-70% food

SPECIAL FEATURES OF RETAIL INDUSTRIES :

a. Business process related ➢ MIS needed ➢ Forecasting of demand is crucial ➢ Branding plays a vital role ➢ Corporate strategy required ➢ High competition	**b. Supply chain management and billing** **c. Material Storage and handling** **d. Economic Conditions**

CHALLENGES FACED BY AN ENTITY IN THE RETAIL INDUSTRY :

1. Control over loss of Inventory due to factors such as Spoilage, damage etc.
2. Lack of trained workforce and required skills for retail management.
3. Overall mgt of various stores.
4. Absence of developed SCM and integrated IT mgt.
5. High cost of real estate and lack of sufficient infra.
6. Intrinsic complexity of retailing.
7. Timing of operations.

FORCES THAT AFFECT THE RETAIL INDUSTRY :

a. Threat of new entrants
b. Availability of substitutes
c. Power suppliers/Buyers
d. Rivalry

TECHNOLOGICAL UPDATES : (REFER SIA 14)

Predominant software are :

1. **POS and Inventory Management Software :**

➢ Access	➢ Active Retail
➢ WinTill	➢ Inflow of Inventory Mgt System

2. **Retail Mgt System S/W :**

➢ Chain Drive	➢ Epicore Retail	➢ Retail Pro

3. **Major Innovations :**

➢ Radio Frequency Identification	➢ E-catalogue based selling
➢ Order tracking Sysytem	➢ Mobile point of sale

LEGAL FRAMEWORK :

➢ **Ministry of Finance, GOI :** a. Deptt of Economic affairs b. Deptt of Expenditure c. Deptt of Revenue d. Deptt of Financial Services e. Deptt of Disinvestment	➢ **Department of Consumer Affairs** ➢ **Department of Food and Public Distribution** ➢ **Department of Food Processing Industry**

WHY THE NEED OF INTERNAL AUDITING EVOLVED :

1. Increased size and complexity of the business.
2. Enhanced compliance requirements
3. Focus on risk mgt and ICS

4. Stringent regulatory mandated
5. Intensive use of IT
6. An increasingly competitive environment.

MAJOR AREAS OF INTERNAL AUDITNG SIGNIFICANCE :

1. INVOICING : a. Cash Payouts b. Z Tapes c. POS

Some of the analytical procedures are :

Same stores sales	Operation margin period wise
Initial Markup	Significant fluctuations in revenue
Sales mix ratio	Revenue per sq feet

2. CASH MANAGEMENT POLICIES :

> Account reconciliation services > Balance reporting services > Lockbox
> Cheque writing > Bin mgt of PDC > Liquidity mgt.

AN INTERNAL AUDITORS ANALYTICAL PROCEDURES ARE DIVIDED IN 4 PARTS :

➢ Analysis of Structures and procedures	➢ Piloting in the stores
➢ Development of solution proposals	➢ Decision on the project

Further procedures may include :
a. Sell through rate b. Fill rate c. Open to buy rate d.Inventory T.O

SUPPLY CHAIN MANAGEMENT :

Components :

- Distribution n/w configuration
- Distribution strategy
- Trade offs in logistic activities
- Inventory management and cash flow

PAY ROLL :

- Job Rotation
- Different Shifts
- No. of bills raised/ no. of hours
- Avg employee cost per store

FIXED ASSETS :

- Ration of assets installed to area
- Asset utilization ratio
- Asset coverage ratio

DATA SECURITY :

➢ **IT security**		➢ **Physical Security**
a. Natural Calamity	b. Theft of Data	a. Instores
c. Computer Fraud	d. System Crash	b. Back office and warehouse
e. System Bugs	f. Hacking	c. Packaging and outdoor premises

OPERATING COSTS :

- Lease Expenses
- Advertisement and marketing Expenses

➢ Loyalty Program	➢ Multichannel marketing
➢ Penetration Analysis	➢ Stores maint.exp

OTHER AREAS :

- **Visual Merchandising :**
  a. Planogram
  b. Window Displays
  c. Food Merchandising
- **Managing Shrinkages**
  a. Process Laps
  b. Sysytem Laps
  c. Vendor fraud
  d. Employee fraud
- **Handling of products and disposal of damages and expiry**

MAINTENANCE OF BOOKS ,REPORTING, MGT, CONTROL AND MIS :

- Sales and Collections
- Inventory Management
- Supplier Analysis

FRAUDS :

- **Financial Reporting Frauds**
  a. Bill-and-hold transactions
  b. Channel Stuffing
  c. Side agreement
  d. Backdating- Decreasing GP, Build up aged acc. Balances, unusual spike in sales
- **Misappropriation of Assets**
  a. Cash Skimming
  b. Theft of inventory
  c. Marketing fraud
- **Unauthorized receipts and expenditure**
  a. Improper vendor allowances
  b. Bribery and corruption

SIX SIGMA :

- It seeks to improve the quality of process outputs by identifying and removing the causes of defects and minimizing variability in manufacturing and business.
- It uses set of Quality mgt methods.
- Each six sigma project within an average follows a defined sequence of steps and has quantified finance targets.
- **Six Sigma enables :**

➢ Improvement in delivery time	➢ Reduction of Logistical costs
➢ Lesser Inventory costs	➢ Improvement in final product

- **It uses a methodology known as DMAIC i.e**
  DEFINE Opportunities
  MEASURE Performance
  ANALYZE Opportunity
  IMPROVE Performance
  CONTROL Performance