Top Priorities for Internal Audit in Retail

Assessing Retail Industry Results from the 2012 Internal Audit Capabilities and Needs Survey
INTRODUCTION

Late last year, a brief but noteworthy “Occupy Amazon” campaign materialized among a vocal collection of small retailers. This reaction to another competitive salvo initiated by the online retail behemoth reflects the frustrations many traditional retailers, both large and small, have experienced while adjusting to a new competitive landscape.

The terrain for retailers is unfamiliar as well as uneven – pitted with new risks (the threat of becoming a showroom for the online competition, for example), newly empowered customers and the relatively new need to provide a seamlessly consistent customer experience across physical, online, mobile and social channels. Retailers continue to adjust to these and other factors that have created a “new normal.”

Add to these challenges the need to intensify existing cost-reduction efforts, and it becomes clear why some retailers are preoccupied with the competition, as a Consulting magazine article describes:

To compete with Amazon, a technology company that invested heavily in fulfillment and logistics during its early years (and was bashed by skeptical Wall Street analysts for doing so at the time), traditional retailers, which may currently invest 1 percent to 3 percent of revenue in their IT infrastructure, must find ways to cut more costs to fund technology upgrades as well as projects designed to create singular customer experiences.¹

Given this environment, it is not surprising that many retailers are using the word “transformation” to describe their largest operational initiatives. These efforts and the sizeable changes being delivered pose new challenges for internal audit functions. New opportunities for fraud arise during periods of intense change, when new and traditional risks also tend to intensify.

About the Survey

Each year, Protiviti conducts its Internal Audit Capabilities and Needs Survey to assess current skill levels of internal audit executives and professionals, identify areas in need of improvement and help stimulate the sharing of leading practices throughout the profession. This year, survey respondents answered close to 200 questions in the following categories: General Technical Knowledge, Audit Process Knowledge, Use of Technology in Auditing Business Process Controls, and Personal Skills and Capabilities. The results, which are based on information provided by all respondents (who numbered more than 800), are contained within the master report (available at www.protiviti.com/IAsurvey).

In each category, respondents were asked to assess, on a scale of one to five, their competency in the different skills and areas of knowledge, with one being the lowest level of competency and five being the highest. They were then asked to indicate whether they believe they possess an adequate level of competency or if there is need for improvement, taking into account the circumstances of their organization and the nature of their industry.

The retail industry findings of Protiviti’s 2012 Internal Audit Capabilities and Needs Survey indicate that internal audit functions and their leaders are playing key supporting roles in a variety of strategic demands while working diligently to increase the efficiency of risk management activities and core business processes.

Specifically, the retail industry survey findings suggest that internal audit’s activities over the next year will center on four overarching priority areas:

1. Increasing the use of technology to audit key business process controls (e.g., HR records management, IT asset management) more effectively
2. Addressing and managing existing and emerging risks holistically
3. Enhancing efficiency through technology-enabled auditing
4. Nurturing internal collaboration and networking externally

In all, the results from respondents in the 2012 Internal Audit Capabilities and Needs Survey present a picture of retail internal audit functions that are prioritizing their activities and deploying their skills in order to balance tactical requirements with strategic contributions – much as retail organizations as a whole must balance cost-reduction efforts with the development and execution of new customer experience strategies.

RESULTS AND ANALYSIS

Within the retail industry, the power some well-known competitors wield is taking a back seat to the influence that newly empowered consumers wield. Today, customers can compare prices and services at the swipe of a smartphone screen. And well-connected customers can immediately broadcast their retail experiences related to prices, service and satisfaction via their extended social networks.
This shifting power equation has driven many retailers to strengthen their focus on the customer’s experience. Creating and maintaining a truly differentiated customer experience requires investments in technology and data analytics. These transformative initiatives don’t come cheap. To fund these activities, many, if not most, retailers are taking significant costs out of other parts of the business through process improvement initiatives, greater use of outsourcing and other changes – all of which affect the internal audit function.

On the efficiency front, internal audit functions must continue to do more with less. This pressure affects many loss prevention programs, which face resource constraints (and some retailers continue to suffer higher losses, as a result of cutbacks in this area). On the transformation front, periods of flux often give birth to new and/or heightened risks, as well as a growing potential for fraud.

To support the enterprise in its drive to reduce costs while transforming and fostering greater customer experience innovation, retail internal audit functions are striving to add value by focusing their efforts on the following four key areas:

1. Increasing the Use of Technology to Audit Key Business Process Controls (e.g., HR Records Management, IT Asset Management) More Effectively

Internal audit’s use of technology represents an important tool in its mission. By leveraging technology to audit business process controls, internal auditors can help increase the efficiency and effectiveness of business processes, freeing up resources throughout the business to devote more time to developing additional efficiency improvements, as well as new services and other innovations.

To assess the extent to which internal audit is leveraging technology in its audit work, respondents were asked to assess, on a scale of one to five, the degree to which their organizations use technology to audit 36 business process controls, with one indicating no use and five representing extensive use. For each area, they were then asked to indicate whether they believe their level of use is adequate or requires improvement, taking into account the circumstances of their organization and industry.

<table>
<thead>
<tr>
<th>“Need to Increase Use of Technology” Rank</th>
<th>Areas Evaluated by Respondents</th>
<th>Degree of Technology Use (5-pt. scale)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (tie)</td>
<td>HR records management</td>
<td>2.5</td>
</tr>
<tr>
<td></td>
<td>IT asset management</td>
<td>2.9</td>
</tr>
<tr>
<td></td>
<td>Facilities leases/improvements</td>
<td>2.6</td>
</tr>
<tr>
<td>2 (tie)</td>
<td>Compensatory time off/vacation tracking</td>
<td>2.9</td>
</tr>
<tr>
<td></td>
<td>Access controls</td>
<td>3.4</td>
</tr>
<tr>
<td>3 (tie)</td>
<td>Obsolete/expired inventory</td>
<td>2.8</td>
</tr>
<tr>
<td></td>
<td>Construction analysis</td>
<td>2.3</td>
</tr>
<tr>
<td></td>
<td>Purchasing/purchase orders</td>
<td>3.4</td>
</tr>
<tr>
<td></td>
<td>Supplier management</td>
<td>3.0</td>
</tr>
<tr>
<td></td>
<td>Vendor negotiation and setup</td>
<td>2.8</td>
</tr>
<tr>
<td>4 (tie)</td>
<td>Data/telecom costs</td>
<td>2.8</td>
</tr>
<tr>
<td></td>
<td>Book and physical inventory differences</td>
<td>3.3</td>
</tr>
<tr>
<td></td>
<td>Inventory master control</td>
<td>3.3</td>
</tr>
<tr>
<td></td>
<td>Capital/operating leases</td>
<td>2.6</td>
</tr>
<tr>
<td></td>
<td>Receiving</td>
<td>3.2</td>
</tr>
</tbody>
</table>
The results suggest that there is significant potential for improvement in the area of technology-enabled auditing. In fact, internal audit functions within retail organizations appear to lag behind other departments in terms of using technology (for more on this topic, see “Special Section: How Internal Auditors Are Using Technology” in the master 2012 Internal Audit Capabilities and Needs Survey report). This is the case across all major industries. The overall responses to this survey show that a majority of internal audit functions are not using a software tool to administer their audit processes; among those that are, many are not leveraging these tools to their fullest extent.

Within the retail industry, internal auditors indicated that they want to increase their use of technology to support activities that specifically relate to the potential for fraud in the organization; the proliferation of technology (approved technology as well as employee-owned gadgets and applications) throughout the organization; and other risks with potentially major bottom-line impacts.

In light of the proliferation of new technologies in organizations today, it is incumbent upon the IT organization to keep careful track of devices, tools, software and other technologies that have been deployed throughout the organization to potentially thousands of employees. As a result, it is therefore incumbent upon the internal audit function to audit and test controls related to the policies for these tools and devices, including security and privacy, change control, and data integrity. Physical security is equally important. When “little” gadgets disappear, significant financial losses can result, or worse; in the event of a security or data breach that occurs due to ineffective IT asset management, potentially devastating regulatory noncompliance and/or reputation damage can occur.

In terms of fraud, retail internal audit professionals clearly are looking to do a better job of capitalizing on technology-enabled auditing to monitor controls over areas more prone to fraudulent activity, such as access controls, HR records management, and book and physical inventory differences.

The high “Need to Increase Use of Technology” rankings for auditing business processes such as purchasing/purchase orders, vendor negotiation and setup, inventory master control, and receiving represent further indicators of ongoing fraud-related concerns among internal auditors and their organizations, and the power and leverage of using technology to assist them.

Vendor negotiation and setup, for example, typically requires the entering of vendors into a company’s enterprise resource planning (ERP) system. This key transaction makes those vendors “go live” and allows for disbursements of funds to those organizations, albeit with the requirement of various approvals. It is possible that certain payments could be unauthorized or even fraudulent.

The survey results suggest that a continuing desire to increase the use of technology in auditing business process controls is a certainty.

2. Addressing and Managing Existing and Emerging Risks Holistically

Within the General Technical Knowledge category, retail internal auditors indicated that they are wrestling with a wide range of familiar and emerging risks across several domains.

While many of the familiar risks relate to fraud (fraud risk management), information technology (IT governance), efficiency demands (Six Sigma) and overall governance (corporate governance standards), the two top improvement priorities relate to relatively new challenges: social media applications and cloud computing, respectively.
Social media applications and cloud computing have opened up a new world of unknowns in terms of security breaches, privacy vulnerabilities and other risks. Most areas of the organization, including internal audit, are in the process of figuring out how to manage and monitor these technologies and the related risks effectively.

Table 2: General Technical Knowledge

<table>
<thead>
<tr>
<th>“Need to Improve” Rank</th>
<th>Areas Evaluated by Respondents</th>
<th>Competency (5-pt. scale)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Social media applications</td>
<td>2.8</td>
</tr>
<tr>
<td>2</td>
<td>Cloud computing</td>
<td>2.8</td>
</tr>
<tr>
<td>3 (tie)</td>
<td>Fraud risk management</td>
<td>3.8</td>
</tr>
<tr>
<td></td>
<td>IIA Practice Guide: Assessing the Adequacy of Risk Management</td>
<td>3.0</td>
</tr>
<tr>
<td>4 (tie)</td>
<td>Six Sigma</td>
<td>2.6</td>
</tr>
<tr>
<td></td>
<td>IT governance</td>
<td>3.2</td>
</tr>
<tr>
<td></td>
<td>IIA Practice Guide: Auditing the Control Environment</td>
<td>3.1</td>
</tr>
<tr>
<td>5 (tie)</td>
<td>Country-specific enterprise risk management framework</td>
<td>2.9</td>
</tr>
<tr>
<td></td>
<td>Corporate governance standards (or local country equivalent)</td>
<td>3.6</td>
</tr>
<tr>
<td></td>
<td>GTAG 16: Data Analysis Technologies</td>
<td>3.1</td>
</tr>
<tr>
<td></td>
<td>Reporting on Controls at a Service Organization – SSAE 16/AU 324 (replaces SAS 70)</td>
<td>2.9</td>
</tr>
</tbody>
</table>

In addition to learning as much as possible, as quickly as possible, about social media and cloud computing use throughout the organization, retail internal auditors confront numerous governance, risk and compliance (GRC) challenges.

Consider one key priority for internal auditors in retail organizations – reporting on controls at a service organization. For years, internal audit teams and/or their compliance partners simply had relevant vendors complete SAS 70 audits. SAS 70 gained new importance as an internal controls tool (related to financial reporting) following the passage of Sarbanes-Oxley. The standard later gained use as a data privacy and security tool (a use that the AICPA questioned) as cloud computing began to flourish. Last year, however, the American Institute of Certified Public Accountants (AICPA) replaced its long-standing SAS 70 auditing standard.

Due to this standard change, many internal audit functions within retail organizations must now invest time in figuring out which components of SSAE 16 – Service Organizational Control (SOC) audits are most relevant, and in place, for numerous individual vendor situations: SOC 1 Type I and Type II audits, which most resemble SAS 70 audits, or SOC 2 or SOC 3 audits, which relate to data privacy and data security risks.

To be sure, this issue represents only one of many improvement priorities within the many different areas in internal audit’s purview.
Bulging internal audit workloads, as well as the rapid rise of “big data” in retail and the need to manage this information effectively and in accordance with federal and state laws and regulations, may help explain why country-specific enterprise risk management (ERM) frameworks figured as a top priority. This suggests that internal audit functions (and their retail enterprises), in response to issues and challenges resulting from “big data” management, want a better understanding of these frameworks as they look to manage their GRC requirements in a more integrated, and therefore more efficient, manner.

Indeed, other important improvement priorities survey respondents selected – such as Six Sigma – confirm a prevailing shift toward a more efficient and overarching approach to risk management.

Not surprisingly, survey respondents rate their competency on newer GRC priorities lower than they rate their competency on more familiar GRC priorities. For example, retail respondents rated their competency in IIA Practice Guide: Assessing the Adequacy of Risk Management higher than they rated their social media applications competency.

These General Technical Knowledge improvement priorities drive home the fact that internal auditors in retail intend to strengthen their knowledge of emerging GRC areas while simultaneously sharpening their ability to address existing risk areas in a more integrated and efficient manner.

3. Enhancing Efficiency Through Technology-Enabled Auditing

Consistent with findings from the past several years of the Internal Audit Capabilities and Needs Survey, continuous auditing, continuous monitoring and computer-assisted audit tools (CAATs) figure as top priorities for chief audit executives and their internal audit functions within the retail industry. Continuous auditing and CAATs consistently have been ranked among the top areas identified as in need of improvement since 2008. This is a strong indicator of the rapid evolution and rising prevalence of technology in business today. However, many retail organizations still have not fully embraced the use of technology tools as part of their audit processes, which suggests there may be lack of training in these areas for their internal auditors.

Furthermore, the use of these and other technologies and technology-fueled audit approaches (e.g., statistically based sampling) enables internal auditors within retail organizations to review or test vast amounts of data on a daily basis. This efficiency is extremely important during a period in which many retailers continue to seek ways to reduce costs while also freeing up resources for more strategic endeavors.

The survey results also show fraud – and more specifically, fraud: fraud risk, fraud: auditing and fraud: fraud detection/investigation – remains a top improvement priority of internal audit functions within the retail industry.

These survey results indicate that retail companies are looking to their internal audit functions to devise efficient and cost-effective ways to monitor these activities and review and analyze this data on a continuous basis. Fortunately, there are a variety of auditing technologies available to accomplish this. The key is to enable internal audit team members, through education and training, to use them effectively and efficiently.
Table 3: Audit Process Knowledge

<table>
<thead>
<tr>
<th>“Need to Improve” Rank</th>
<th>Areas Evaluated by Respondents</th>
<th>Competency (5-pt. scale)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Continuous auditing</td>
<td>3.6</td>
</tr>
<tr>
<td>2 (tie)</td>
<td>Continuous monitoring</td>
<td>3.6</td>
</tr>
<tr>
<td></td>
<td>Enterprise risk management</td>
<td>3.6</td>
</tr>
<tr>
<td>3</td>
<td>Interviewing</td>
<td>3.8</td>
</tr>
<tr>
<td>4 (tie)</td>
<td>Computer-assisted audit tools (CAATs)</td>
<td>3.4</td>
</tr>
<tr>
<td></td>
<td>Fraud: fraud risk</td>
<td>3.8</td>
</tr>
<tr>
<td></td>
<td>Fraud: auditing</td>
<td>3.8</td>
</tr>
<tr>
<td></td>
<td>Fraud: fraud detection/investigation</td>
<td>3.8</td>
</tr>
<tr>
<td></td>
<td>Quality Assurance and Improvement Program (IIA Standard 1300): Ongoing Reviews (IIA Standard 1311)</td>
<td>3.4</td>
</tr>
<tr>
<td></td>
<td>Quality Assurance and Improvement Program (IIA Standard 1300): Periodic Reviews (IIA Standard 1311)</td>
<td>3.5</td>
</tr>
<tr>
<td></td>
<td>Report writing</td>
<td>4.1</td>
</tr>
<tr>
<td></td>
<td>Resource management (hiring, training, managing)</td>
<td>3.8</td>
</tr>
<tr>
<td></td>
<td>Statistically based sampling</td>
<td>3.4</td>
</tr>
</tbody>
</table>

The bottom line is that there is an ongoing movement in the internal audit profession away from manual, time-intensive and, in many ways, inefficient auditing (relative to today’s demands) and toward technology-enabled auditing practices that facilitate reviews of virtually every transaction and piece of data on a continuing basis, when warranted. Of particular note, recent reports of alleged bribery and corruption risk in the retail industry, together with an increasing focus from the U.S. Department of Justice on fraud cases, have sent a strong signal that corruption risk can affect global companies in all industries, including retail and consumer products manufacturers with retail outlets. A key strategy for identifying, managing and monitoring fraud risk is the use of technology-enabled auditing. Yet with new technologies and innovations being introduced at a rapid rate, CAATs and continuous auditing, as well as continuous monitoring, very likely will continue to rank as top priorities for internal audit functions in future capabilities and needs surveys.

4. Nurturing Internal Collaboration and Networking Externally

Respondents were asked to assess, on a scale of one to five, their competency in 24 areas of personal skills and capabilities (again, with one being the lowest level of competency and five being the highest). For each area, they were then asked to indicate whether they believe their level of knowledge is adequate or requires improvement, taking into account the circumstances of their organization and industry.

A quick glance at the top priorities under Personal Skills and Capabilities indicates that internal auditors within the retail industry remain committed to elevating their performance in three ways:

1. Forging stronger, more collaborative relationships with the audit committee of the board of directors (as well as other corporate directors and the executive leadership team)
2. Developing select skills related to technology, time management and relationship-building
3. Strengthening their function’s overall capabilities through outside networking and practices-sharing
### Table 4: Personal Skills and Capabilities

<table>
<thead>
<tr>
<th>“Need to Improve” Rank</th>
<th>Areas Evaluated by Respondents</th>
<th>Competency (5-pt. scale)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (tie)</td>
<td>Dealing with confrontation</td>
<td>3.6</td>
</tr>
<tr>
<td></td>
<td>Presenting (public speaking)</td>
<td>3.7</td>
</tr>
<tr>
<td>2 (tie)</td>
<td>Developing outside contacts/networking</td>
<td>3.7</td>
</tr>
<tr>
<td></td>
<td>Negotiation</td>
<td>3.5</td>
</tr>
<tr>
<td></td>
<td>Persuasion</td>
<td>3.8</td>
</tr>
<tr>
<td>3 (tie)</td>
<td>High-pressure meetings</td>
<td>3.6</td>
</tr>
<tr>
<td></td>
<td>Strategic thinking</td>
<td>3.7</td>
</tr>
<tr>
<td></td>
<td>Time management</td>
<td>3.7</td>
</tr>
<tr>
<td></td>
<td>Using/mastering new technology and applications</td>
<td>3.6</td>
</tr>
<tr>
<td>4 (tie)</td>
<td>Developing audit committee relationships</td>
<td>3.5</td>
</tr>
<tr>
<td></td>
<td>Leadership (within the internal audit profession)</td>
<td>3.4</td>
</tr>
<tr>
<td></td>
<td>Leveraging others’ expertise</td>
<td>3.7</td>
</tr>
<tr>
<td></td>
<td>Personnel performance evaluation</td>
<td>3.8</td>
</tr>
</tbody>
</table>

In terms of board relationships, survey respondents noted they remain committed to improving their collaboration with audit committee members. In a more personal context, the skills development priorities support and align with other survey results. For example, making greater use of CAATs, continuous auditing and other technology-driven auditing approaches represent top functional improvement priorities, while using/mastering new technology and applications mark top personal skills improvement priorities. Many of these improvement priorities – such as leadership, persuasion, high-pressure meetings, dealing with confrontation, and negotiation – also reflect the ongoing evolution of the internal audit function. Few, if any, effective internal audit departments operate in a silo today. A growing number of functions have embraced an “immersive role” as they work closely with business partners to address threats and opportunities throughout the enterprise.

**IN CLOSING**

From a personal perspective, it is no longer sufficient for internal auditors in the retail industry to step out of the old silo mindset and into a new, more immersive role. Instead, internal auditors in retail appear eager to ensure that their collaborations with all of the different parts of their organizations are as strong as possible so that they can thrive in their new roles.

From a functional perspective, internal audit can no longer simply work through a list of tasks and activities each year. Instead, the function’s work has become less task-focused, more collaborative and more strategic. And the quality of this collaboration matters, just as the experience of a retailer’s customer matters, perhaps more so than ever before.
ABOUT PROTIVITI

Protiviti (www.protiviti.com) is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit. Through our network of more than 70 offices in over 20 countries, we have served more than 35 percent of FORTUNE® 1000 and Global 500 companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies.

Protiviti is a wholly owned subsidiary of Robert Half International Inc. (NYSE: RHI). Founded in 1948, Robert Half International is a member of the S&P 500 index.

About Our Consumer Products and Retail Services

Protiviti serves consumer products and retail companies around the world by helping them identify, measure and manage the risks inherent in their industry. Our experts have the skills, talent and experience to detect red flags, pitfalls and – most important – opportunities.

Protiviti’s professionals specialize in making risk management capabilities and infrastructure practical and value-adding for consumer products companies and retailers. We help assess capabilities, identify areas for improvement, and collaborate closely with teams to implement solutions. Our team of consultants has previous experience with many leading companies across all sectors of the consumer products and retail industry. And our team is well versed in the relevant business and industry-specific issues that organizations confront in their day-to-day operations. We provide solutions that address the root causes of these challenges – not just the symptoms.

Contact

Rick Childs
Managing Director
+1.916.830.0107
richard.childs@protiviti.com
The Americas

United States
Alexandria
Atlanta
Baltimore
Boston
Charlotte
Chicago
Cincinnati
Cleveland
Dallas
Denver
Fort Lauderdale
Houston
Kansas City
Los Angeles
Milwaukee
Minneapolis
New York
Orlando
Philadelphia
Phoenix
Pittsburgh
Portland
Richmond
Sacramento
Salt Lake City
San Francisco
San Jose
Seattle
Stamford
St. Louis
Tampa
Washington, D.C.
Woodbridge

Australia
Brisbane
Canberra
Melbourne
Perth
Sydney

China
Beijing
Hong Kong
Shanghai
Shenzhen

Canada
Buenos Aires*
Kitchener-Waterloo
Toronto

Brazil
Rio de Janeiro*
São Paulo*

Chile
Santiago*

Mexico
Mexico City*
Monterrey*

Peru
Lima*

Venezuela
Caracas*

Europe

France
Paris

Germany
Frankfurt
Munich

Italy
Milan
Rome
Turin

The Netherlands
Amsterdam

United Kingdom
London

Middle East

Bahrain
Manama*

Oman
Muscat*

United Arab Emirates
Abu Dhabi*
Dubai*

Asia-Pacific

India
Bangalore
Mumbai
New Delhi

Indonesia
Jakarta**

Japan
Osaka
Tokyo

Singapore
Singapore

South Korea
Seoul

* Protiviti Member Firm
** Protiviti Alliance Member