Control Self-Assessment

The Future of Store Audits in Retail Stores

protiviti®
Independent Risk Consulting

Business Risk | Technology Risk | Internal Audit

Introduction

According to the 2003 National Retail Security Survey, produced by Richard Hollinger at the University of Florida, retailers in the United States lost approximately $33.6 billion as a result of inventory shrinkage. Additionally, in the wake of recent government regulations, particularly the Sarbanes-Oxley Act of 2002, the emphasis on internal controls compliance and documentation is here to stay. An increased attention to governance, compliance and risk management has led many retailers to implement a store compliance process in order to properly monitor the identification of issues and resulting remediation. Whether it's reducing shrink or complying with Sarbanes-Oxley, a rigorous store-level compliance process is key in protecting and substantiating company assets and reporting processes. An effective store compliance process can be properly achieved through two methodologies: traditional store audits and store self-assessment.

Traditional Store Audits

Store audits, both traditional and self-assessment, can be instrumental in establishing and maintaining a store compliance process, which provides management with the real-time information necessary to focus on identifying issues and solving problems. The traditional store audit usually consists of a store visit by internal audit or loss prevention personnel, during which a formal audit work program is completed. Performing traditional store audits alone often leads to incomplete or infrequent coverage of stores due to limited resources. Traditional audits require audit personnel to undergo training in detailed store operations, travel to store locations (often over great distances) and interrupt stores' daily operations. Traditional audits are often costly, untimely and inefficient, and typically don't accomplish placing the responsibility for controls with the proper person – the store manager.

Store Self-Audits

A store *self-audit,* also known as control self-assessment (CSA), is a cost-effective and efficient alternative for organizations to expand their store audit coverage and improve their ability to meet business objectives. Wider coverage leads to increased availability of valuable information for executive management's use in managing and monitoring operational aspects of their business. Additionally, the self-audit program raises accountability by engaging store managers, who are the direct control owners, and places overall responsibility of the controls in their hands. Store self-assessment alone does not create a complete or effective store-level audit program and should not be the only auditing effort. However, coupled with formal validation of the self-assessment results, development of remediation plans and timely follow-up on issues identified during the self-assessment, store self-audits can be the most cost-effective method of monitoring all stores on a regular basis.

What is Control Self-Assessment (CSA)?

The IIA defines CSA as "*a process through which internal control effectiveness is examined and assessed. The objective is to provide reasonable assurance that all business objectives will be met.*"[1] When utilizing CSA, which includes store self-audit and store self-assessment, a greater probability exists of store management buy-in of self-assessment results due to its participative and collaborative approach. Greater buy-in at the store level will ultimately lead to more effective and efficient audits and improved operations.

Benefits and Concerns of Control Self-Assessment (CSA)

What makes CSA, or store self-assessment, advantageous? Since it is virtually impossible to gain comprehensive, or even moderate, audit coverage of a retail chain's stores without a small army of store auditors fully dedicated to conducting store audits, it is often neither time- nor cost-effective to conduct traditional audits alone. Due to the local participation of store managers, self-assessment allows for broader, more frequent coverage than traditional store audits by internal audit or loss prevention teams. Additionally, it provides more coverage of important issues because the experts, store managers who are more intimate with store operations, can quickly focus on key risks and controls while directed and monitored by a corporate audit team.

In addition, store self-assessment is a more productive means to evaluate "soft" controls such as new hire practices, which require more cooperation and participation of a store manager than traditional audits. The store managers can quickly develop remediation plans for their specific situations, requiring corporate audit personnel to only review and follow-up with remediation plans as determined by executive management, which will allow corporate audit teams to more effectively apply themselves and allocate their time. Ultimately, self-assessment helps store managers understand and assume responsibility and accountability for effective control and risk management.

[1] Professional Practices Pamphlet 98-2, *A Perspective on Control Self-Assessment* (Altamonte Springs, Florida: The Institute of Internal Auditors), 1998, CSA Definition chapter.

Concerns

Self-assessment is not always the right tool. Example concerns and obstacles to implementing a productive store self-assessment program are provided below.

- Self-assessment can be difficult in decentralized environments, when there is rapid corporate change, high turnover or the corporate culture does not support and value communication, openness, and trust.
- An organization without clear objectives, or objectives that are poorly communicated to personnel, may struggle to implement a self-assessment process. A firm foundation must be established and clearly communicated to the store managers.
- Many organizations can be slow to adopt new methodologies, such as CSA, due to initial start-up costs and growing pains.

Establishing a Store Self-Assessment Program – Things to Consider

Before a store-level control self-assessment process can be designed and implemented, management needs to review current practices to identify and prioritize company objectives, risks, and controls to be addressed at the store level. This is often achieved as part of compliance with the annual risk assessment process. After this is accomplished, a self-assessment program can be developed and implemented to allow full audit coverage of all retail locations as frequently as necessary. This includes ongoing monitoring of results and remediation efforts. Before beginning the design and implementation of a proper store self-assessment process, management must first consider certain formidable aspects of a proper audit, such as scope, accountability, follow-up and reporting. By addressing these areas properly, management will help ensure the success of their program.

Scope of the Store Self-Assessment

The scope of the store self-audit should be established during the risk assessment process and be in line with the company's overall objectives. Many companies can begin by adapting their current traditional store audit programs. Examples of areas often included in store self-assessments are cash handling, inventory management, security, key regulatory issues, human resources, compliance with company policies and procedures and other special considerations (e.g., perishables, pharmacy compliance, lotto and lottery compliance, etc.). In addition to creating an audit scope, management should also establish accountability and follow-up protocols to effectively guide the new program.

Accountability and Follow-up

A self-assessment program alone is not enough to be considered a comprehensive and effective store audit function. The company must establish a system to validate store managers' responses, remediate problem areas, and implement a formal discipline plan to address any instances of inconsistency between results reported by the store managers and observations noted during follow-up and store noncompliance with established policies and procedures. It is up to the executive management team to determine the appropriate scope for validation, but the proper reporting of results should also be addressed when designing and implementing a self-assessment program. Internal audit and district managers are typically responsible for the validation process and follow-up on a scope basis.

Results Reporting

Overall results from a self-assessment should be compiled and summarized by the personnel *facilitating* the audit process rather than those responsible for completing it. Results from the store self-assessment and validation audits should be reported to executive management to remediate instances of noncompliance with policies and procedures as well as control gaps. The inclusion of qualitative information and recommendations is necessary to make the program effective. Oftentimes, remediation is required outside of the store environment as well as at the store level. For example, managers may discover through the self-assessment process that certain human resources requirements are not being properly communicated to the stores. Consequently, a recommendation and action plan can be developed for human resources to be implemented immediately. Again, executive management should be apprised of any issues that arise as a result of the self-assessment program, whether issues originate at the store or corporate levels.

Key Questions to Ask Before Establishing a CSA Program

Implementing a store self-assessment program can be daunting for any organization. Retail companies should consider the following questions, and more, before designing and implementing such a program.

Board Members

- Is the audit committee satisfied with the current internal control structure at the store level? Are they confident this structure can be sustained as the company grows?

- As processes change and are improved at the store level, and as new systems are implemented, can self-assessment provide adequate attention to the related impact on the internal control structure and potential disclosure implications?

- What specific steps will management take to establish "tone at the top" for this type of corporate change?
- Are board members satisfied that the current store audit program, if any, is providing adequate cost-benefit to the organization?

Management

- Who will own the store-level control self-assessment: internal audit, loss prevention, or store operations?
- How will the initial content for the audit be developed and what departments need to be involved to ensure the initial and continued accuracy of the content?
- How frequently will the store self-assessment occur? What will be the scope of follow-up? Who will monitor remediation efforts?
- Is there an overlap between the store self-assessment and the store-level testing requirements for Sarbanes-Oxley Section 404 (if applicable)? If not, how can the company best integrate these requirements?

About Protiviti Inc.

Protiviti (**www.protiviti.com**) is a leading provider of independent risk consulting and internal audit services. We provide consulting and advisory services to help clients identify, assess, measure and manage financial, operational and technology-related risks encountered in their industries, and assist in the implementation of the processes and controls to enable their continued monitoring. We also offer a full spectrum of internal audit services to assist management and directors with their internal audit functions, including full outsourcing, co-sourcing, technology and tool implementation, and quality assessment and readiness reviews.

Protiviti, which has more than 50 locations in the Americas, Asia-Pacific and Europe, is a wholly owned subsidiary of Robert Half International Inc. (NYSE symbol: RHI). Founded in 1948, Robert Half International is a member of the S&P 500 index.

For questions about topics in this white paper, or to find out more about our services, please contact:

Rick Childs	Susan Alexander
916.830.0107	916.830.0103
richard.childs@protiviti.com	susan.alexander@protiviti.com