Technical Guide on Internal Audit of Retail Industry

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Foreword

The Institute of Chartered Accountants of India (ICAI) constituted the Internal Audit Standards Board (IASB) to develop the knowledge, skills and expertise of members in the area of Internal Audit. The Board has been issuing Standards on Internal Audit (SIAs) as these standards go a long way in strengthening the position and building up the performance benchmarks for internal auditors. Apart from issuing SIAs, the Board also issues industry specific Technical Guides to equip the members with requisite skills to carry out industry-specific internal audits.

I am pleased to note that the Board is issuing "Technical Guide on Internal Audit of Retail Industry". This publication would help the members to understand the intricacies of retail industry and provide guidance on internal audit of retail industry.

I congratulate CA. Charanjot Singh Nanda, Chairman, Internal Audit Standards Board, ICAI, CA. Gyan Chandra Misra, Vice Chairman, Internal Audit Standards Board, ICAI and all members of the Board for this initiative of bringing out this publication.

I am sure that this Technical Guide would be of immense use to readers working in Retail industry as internal auditors.

February 3, 2023 **CA. (Dr.) Debashis Mitra**

New Delhi President, ICAI

Preface

The retail industry has a tremendous contribution in boosting the Indian Economy by increasing employment, enhancing exports and giving small scale industries the opportunity to sell their products at competitive prices. Retail industry faces challenges like market competition, economic status of the country, new trends, technological achievements and political stability. Internal auditor helps the management in facing these challenges and in growth by analysis of market penetration, expansion along with diversification, technology adopted.

Considering this, the Internal Audit Standards Board, ICAI is issuing this publication "Technical Guide on Internal Audit of Retail Industry". This publication would help the members to understand the intricacies of retail industry and provide guidance on internal audit of retail industry.

The Technical Guide is divided into various parts. The guide provides glossary of terms pertaining to retail industry. This guide deals with the scope and objective of the Guide and overview of retail industry in India. The Guide also explains scenario in the Indian retail industry and challenges faced by an entity operating in this industry. It gives an overview on various aspects like, statues applicable to educational institution, applicability of Accounting and Auditing Standards, and Standards on Internal Audit. This Guide also deals with finance and accounting features of retail industry. The Guide deals with the internal audit aspect of retail industry It explains overall approach of internal audit with reference to Standards on Internal Audit issued by the Board, and the procedures to be undertaken by the internal auditors with regard to peculiar aspects related to retail industry, like, invoicing, cash flow, payroll, operating costs, fixed assets, procurement of material, sully chain.

At this juncture, I am grateful to CA. M. Guruprasad, CA. Kaushik Raghunandan for sharing his experience and knowledge and preparing the draft of the Technical Guide.

I would like to thank CA. (Dr.) Debashis Mitra, President, ICAI and CA. Aniket S. Talati, Vice President, ICAI and CA. Gyan Chandra Misra, Vice Chairman, IASB for their continuous support and encouragement to the initiatives of the Board.

I must also thank my colleagues from the Council at the Internal Audit Standards Board, viz., CA. Chandrashekhar V. Chitale, CA. Vishal Doshi, CA. Durgesh Kumar Kabra, CA. Piyush Sohanrajji Chhajed, CA. Purushottam Khandelwal, CA. Priti Salva, CA. Sridhar Muppala, CA. Prasanna Kumar D., CA. Cotha S. Srinivas, CA. Ranjeet Kumar Agarwal, CA. Rohit Ruwatia, CA. Abhay Chhajed, CA. Anuj Goyal, CA. Prakash Sharma, CA. Sanjay Kumar Agarwal, CA. (Dr.) Raj Chawla, CA. Hans Raj Chugh, CA. Pramod Jain, CA. (Dr.) Sanjeev Kumar Singhal, Shri Deepak Kapoor and Shri Chandra Wadhwa and co-opted Members, viz., CA. Anil Kumar Jain, CA. Sapna Govindalal, Gandhi, CA. Viswanath K., CA. Vivek Choudhary, CA. Nagesh Pinge, CA. Venugopala Rao P., CA. Satish Patel, CA. Sunil Kumar Mehta, and Special Invitee, CA. Pradeep Tyagi for their vision and support and their invaluable guidance and also their dedication and support to the various initiatives of the Board. I also wish to express my sincere appreciation for CA. Arti Bansal, Secretary, Internal Audit Standards Board, ICAI, Mr. Harish Dua, Advisor, Internal Audit Standards Board and her team for their efforts in giving final shape to the publication.

I am sure that this Guide would be of immense use to readers working in Retail industry as internal auditors.

February 5, 2023 **CA. Charanjot Singh Nanda**

New Delhi Chairman

Internal Audit Standards Board, ICAI

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Glossary

Anchor Store	A major retail store used to drive business to smaller retailers. These larger department stores, or grocery stores are generally part of a retail chain and are the prominent business in a shopping mall.
Aspirational Products	Good quality and high-priced lifestyle products.
Bar Code	A series of vertical or horizontal parallel lines forming a code that is optically read and interpreted by a bar code scanner. Used on envelopes and forms for rapid entry of data and for sorting. Bar coding may be an indication that the inventory is computerised.
Brick and Mortar	Brick and mortar store refers to retail shops that are located in a building as opposed to an online shopping destination, door-to-door sales, kiosk or other similar site not housed within a structure.
Broad Banding	In a broadband pay structure, the numbers of salary grades are consolidated into fewer, but broader, pay ranges. Broadband pay structures encourage the development of broad employee skills, because non-managerial jobs are appropriately valued and skill development is rewarded.
Bundled Pricing	Involves a retailer providing a number of services for one basic price, most often seen in mobility service packages.
Cannibalism	The impact that a new location will have on an existing store's sales in a chain corporation.
Chain Store	One of a number of retail stores under the same ownership and dealing in the same merchandise.

Chargebacks	The retailer's invoice for claims against a vendor resulting from items such as damaged merchandise, cooperative advertising costs, adjustments, and the recovery of transportation charges for improperly routed merchandise. Chargebacks are usually shown on the vendor's invoices.
Cooperative Advertising	Advertising paid for jointly by the advertiser and its wholesalers or retailers. For example, the landlord of a strip mall may collect a percentage of advertising from each tenant. This is used for advertising that will benefit all of the tenants.
Customer Loyalty Program	A customer loyalty program is a structured and long-term marketing effort which provides incentives to repeat customers who demonstrate loyal buying behaviour.
Do It Yourself (DIY) Stores	Modern, usually large-format stores specialising in the sale of construction materials, finishing, decoration and garden products.
Drug Store and Cosmetics Shops	Outlets whose key offering is made up of cosmetics, toiletries, hygiene products, accessories, and possibly also household chemicals.
Electronic Article Surveillance	Involves attaching specially designed tags or labels to products to curb shoplifting.
E-retailing	It is usually referred to an Internet retailing, covers retailing using a variety of different technologies or media, mostly the internet. Products are chosen via. a published catalogue and payments made through credit cards and secure payment gateways.
Fast Moving Consumer Goods (FMCG)	A group of products sold quickly at a relatively low cost, usually referring to food (excluding fresh food) and cosmetics/ toiletry items.

Flag Ship Store	The Flag Ship Store refers to a store located at retailer's primary location – A store in a prominent location, a chain's largest store, the store that holds or sells the highest volume of merchandise, a retailer's most well-known location, a chain's first retail outlet, or the store location in a chain which carries the most high- priced merchandise catering to the most upscale customers.
Footfall	The number of shoppers entering a store or shopping mall.
High Street	A place or locality in a major city or principal street of a small town, which would be the main point of purchase from well-known shops stocking high quality, apparels, and non- apparels.
Horizontal Price Fixing	An agreement between two or more parties, generally considered to be competitors, to set, maintain, and charge a specified price for a particular product. This is considered to be a collusion to artificially set prices at a certain level, rather than allowing the free market to organically drive price levels.
Internet Auction Platform	An internet service through which products can be sold and auctioned via internet.
Keystone Pricing	A pricing method of marking merchandise for resell to an amount that is double the wholesale price.
Kiosk	A small stand-alone structure used as a point of purchase. This can be either a computer or display screen used to disseminate information to customers or may be a free-standing, full-service retail location. Kiosks are often found in malls and other high-traffic locations.
Layaway	The act of taking a deposit to store merchandise for a customer to purchase at a later date.

M-Commerce (Mobile Commerce)	M-Commerce is the buying and selling of goods and services through wireless handheld devices such as cellular telephone and personal digital assistants (PDAs), known as next-generation e-commerce. M-Commerce enables users to access the Internet without needing to find a place to Plug-in.
Mazur Plan	Retail store management technique under which all retail activities are divided into four functional areas: merchandising, publicity, store management, and accounting and control.
Merchandising	In the broadest sense, merchandising is any practice which contributes to the sale of products to a retail consumer. At a retail in-store level, merchandising refers to the variety of products available for sale and the display of those products in such a way that it stimulates interest and entices customers to make a purchase.
Mystery Shopping	A quality checks system employed by companies. Dummy customers are sent into stores to check upon quality of service, behaviour, and knowledge of store employees, etc.
Never-out List	Never-out List used when a retailer plans stock levels for best-sellers. Items accounting for high sales volume are stocked in a manner that ensures they are always available.
Niche Retailing	Niche Retailing enables retailers to identify customer segments and deploy unique strategies to address the desires of those segments.
Open-to-Buy	The difference between planned purchases and the purchase commitments already made by a buyer for a given time period, often a month. It represents the amount the buyer has left to spend for that month and is reduced each time a purchase is made.

Order Lead Time	The period from the date an order is placed by a retailer to the date merchandise is ready for sale (received, price-marked, and put on the selling floor).
Parasite Store	An outlet that does not create its own traffic and that has no real trading area of its own.
Percentage Variation Method	An inventory-level planning method where beginning-of-month planned inventory level during any month differs from planned average monthly stock by only one-half of that month's variation from estimated average monthly sales. Beginning-of-month planned inventory level (at retail) = Planned average monthly stock at retail x ½ [1 + (Estimated monthly sales/ Estimated average monthly sales)]
Perpetual- Inventory Unit-Control System	Keeps a running total of the number of units handled by a retailer by ongoing record-keeping entries that adjust for sales, returns, transfers to other departments or stores, receipt of shipments, and other transactions. It can be done manually, use tags processed by computers, or rely on point-of-sale devices.
Planogram	Visual description, diagram or drawing of a stores layout to include placement of particular products and product categories.
Point of Sale (POS)	Point of Sale (POS) refers to the area of a store where customers can pay for their purchases. The term is normally used to describe systems that record financial transactions. This could be an electric cash register or an integrated computer system which records the data that comprises a business transaction for the sale of goods or services.
Point-of- Purchase (POP) Display	Point-of-purchase displays, or POP displays, are marketing materials or advertising placed next to the merchandise it is promoting. These items are

	generally located at the checkout area or other location where the purchase decision is made.
Power Centre	A shopping site with (a) up to a half-dozen or so category killer stores and a mix of smaller stores or (b) several complementary stores specialising in a product category.
Power Retailer	The status reached by a company that is dominant in some aspect of its strategy. Consumers view the company as distinctive enough to become loyal to it and go out of their way to shop there.
Precision Retailing	Using data in information systems to make refined merchandising decisions store by store.
Predatory Pricing	Involves large retailers that seek to destroy competition by selling goods and services at very low prices, thus causing small retailers to go out of business. The practice is restricted by federal and state laws.
Pre-marking	A system in which the manufacturer, rather than the retailer, marks merchandise with the retail price.
Prestige Pricing	Assumes consumers will not buy goods and services at prices deemed too low. It is based on the price-quality association.
Price Comparison Website	A specialised website comparing the prices of products across various internet stores.
Price Guarantees	Protect retailers against possible price declines. If a retailer cannot sell an item at a given price, the manufacturer pays it the difference between planned retail and actual retail selling prices.
Price Lining	A practice whereby retailers sell merchandise at a limited range of price points, with each price point representing a distinct level of quality.

Primary Trading Area Encompasses 50 percent to 80 percent of a store's customers. It is the geographic area closest to the store and possesses the highest density of customers to population and the highest per-capita sales.

Product/ Service Mix The number and kind of products and services a general merchandise retailer will offer.

Product Breadth The product breadth is the variety of product lines offered by a retailer. Product breadth is also known as product assortment or merchandise breadth.

Product Depth Product depth is the number of each item or particular style of a product on the shelves. Product depth is also known as product assortment or merchandise depth.

Pull Policy A promotional policy aimed at building strong consumer demand for a product.

Push Policy A promotional policy aimed at markets with the intention of getting retailers to stock a product in order to build supply in the marketplace.

Regression Model A computer site-selection model that develops a series of mathematical equations showing the association between potential store sales and various independent variables at each location under consideration.

Retail Information System Anticipates the information needs of retail managers; collects, organizes, and stores relevant data on a continuous basis; and directs the flow of information to the proper retail decision makers.

Sales Floor The sales floor is the location of a retail store where goods are displayed, and sales transactions take place.

Same-Store Sales A statistic used in Retail Industry analysis. It compares sales of stores that have been open for a

	year or more. This statistic allows investors to determine what portion of new sales has come from sales growth and what portion from the opening of new stores. Same store sales are usually released by retail companies on a monthly basis. This is also known as “comps”.
Sliding	A loss prevention term referring to the act of a cashier passing merchandise around the cash register barcode scanner without actually scanning the item.
Specialist Food Stores	Outlets selling a selected category of groceries. These include butchers’ shops, bakeries, cake shops, off-licences and greengrocers.
Standardisation	A strategy of directly applying a tried and tested retail strategy to newer markets to ensure customers get the same experience across all stores of a chain.
Stock Keeping Unit (SKU)	The Stock Keeping Unit (SKU) is a unique number assigned to a product by a retail store to identify the price, product options and manufacturer of the merchandise.
Storefront	The total physical exterior of a store. It includes the marquee, entrances, windows, lighting, and construction materials.
Target Market	A segment of consumers that is most likely to purchase the products and services offered by a particular retailer.
Universal Product Code (UPC)	A categorisation where each item is given a ten-digit number, pre-marked on the package by the producer in the form of a bar code over ten corresponding numbers.
Vertical Retailers	Retailers that sell only their own branded merchandise. These goods are not found anywhere except in their own stores or catalogues (also called lifestyle retailer).

Chapter 1

Introduction

1.1 Retail refers to the sale of goods to end users, not for resale, but for use and consumption by the purchaser. The retail transaction is at the end of the supply chain. In India, the retail industry is the second largest employer after agriculture, although it is highly fragmented and predominantly consists of small independent, owner — managed shops. The Indian retail industry is the fifth largest industry in the world.

1.2 Retail industry is one of the fastest growing industries in India. The retail industry comprises of organised and unorganised industries.

Organised retailing refers to trading activities undertaken by licensed retailers, i.e., those who are registered for GST, income tax, etc. These include the corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses.

Unorganised retailing refers to the traditional formats of low-cost retailing, for example, the local Kirana shops, owner managed general stores, hand cart and pavement vendors, etc.

The organised industry represents only 18% share of the retail industry as per data from India Brand Equity Foundation (IBEF a Government Entity) for the year 2021.

1.3 Post liberalisation the retail industry in India is heralded as one of the sunrise industries. Today within the booming service industry, retail is the single biggest contributor in terms of GDP to the national income. Retail has played a major role world over in increasing productivity across a wide range of consumer goods and services.

1.4 The term retailing is a very broad term which can be used to denote a large range of products including durables and consumables. This industry can be categorised into:

(i) Food & Beverage products

(ii) Soft goods — clothing, apparel, and other fabrics.

(iii) Hard goods (“hard line retailers”) - appliances, electronics, furniture, sporting goods, etc.

Further, the retail industry includes the sale/ distribution of the following products:

- Clothing, textiles and fashion accessories
- Jewellery
- Health and Beauty Care Services, Pharmaceuticals
- Consumer Durables, Home Appliances/ Equipment
- Mobile handsets, Accessories and Services
- Food and Grocery
- Books, Music and Gifts, etc.

Objective and Scope of Technical Guide

1.5 This Technical Guide is intended to assist internal auditors in carrying out internal audit of entities operating in the Retail Industry. The Board and Those Charged with Governance in concurrence with the internal auditor, taking into consideration, various pronouncements of ICAI and other regulatory requirements, assessments of control environment and business domain knowledge, primarily decide the scope of the internal audit. This Technical Guide deals with important areas of entities operating in this industry with emphasis on Governance, Risk and Compliance (GRC) of various regulations as applicable to such types of entities.

1.6 This Technical Guide covers the following aspects:

Chapter 1	Introduction
Chapter 2	Overview of Indian Retail Industry
Chapter 3	Risk Management
Chapter 4	Fraud Management
Chapter 5	E-commerce Retailing and Data Analytics
Chapter 6	Technological Trends in Retail Industry.
Chapter 7	Governing Bodies
Chapter 8	Statutory Laws Applicable to Retail Industry

Chapter 9 Internal Audit

Chapter 10 Major Areas of Internal Audit Significance

This Technical Guide does not cover the following aspects:

(a) Internal audit of routine operations in finance and other areas/ functions of business

(b) Internal audit performed by the associated enterprises

(c) Special audits

(d) Forensic Accounting and Fraud Investigations and

(e) Retailing through E-commerce.

Chapter 2

Overview of Indian Retail Industry

2.1 Indian retail industry is one of the fastest growing industries in India, especially, over the last few years. Though initially, retail industry in India was mostly unorganised, and especially with the change of tastes and preferences of the consumers, the industry is getting more significant and organised as well. It is important for an internal auditor to have relevant business knowledge and gain an understanding of the Indian retail industry, its evolution, initiatives from the Government, special features of the industry and the challenges faced by entities operating in this industry, in order to understand the critical areas, nuances and knowledge of the business thereby helping him to frame internal audit procedures to perform efficient and effective internal audits.

Evolution of Retail Industry

2.2 The origin of retail industry in India can be traced back to prior to the emergence of Kirana and mom-and-pop stores, wherein weekly markets, village and rural melas were a source of commercial exchange and has been in existence for ages. Subsequently, these stores developed and started to cater to the local people providing convenience to neighbourhood, a pervasive reach, including facilities of credit with a personal touch. Eventually, the government supported the rural retail. Many indigenous franchise stores came up with the help of Khadi and Village Industries Commission. Public distribution system and co-operatives emerged as a low-cost method of distribution, supported by various Government schemes. The economy began to open up in the 1980s resulting in the change of retailing. The first few companies to come up with retail chains were in textile industry. With the passage of time, new entrants moved on from manufacturing to pure retailing.

2.3 Shopping malls emerged in the urban areas giving a world-class experience to the customers from the mid 1990's. Eventually, hypermarkets and supermarkets emerged in the space. The evolution of the industry includes the continuous improvement in the supply chain management, distribution channels, technology, back- end operations, etc. This would finally lead to consolidation, mergers and acquisitions and huge investments, resulting in development of the organised industry in the Indian Retail Industry.

2.4 One of the major factors leading to the growth of the large retail industry was the introduction of an efficient banking system, especially with the introduction of credit cards into the mainstream buying habits. This led to the growth of the organised industry in the retail industry as small businesses couldn't afford the cost of purchases with credit cards because the turnover and profit margins didn't allow it.

2.5 The next revolution on the horizon in the industry is the e-retailing and on-line purchases. E-retailing was once considered a competitor of little threat because of the initial miscalculation of business focus compounded with outlandish outlays and unrealistic business models. But, e-retailing has refused to die and in fact took a new lease of life with the Covid pandemic. The result is a mounting adversary to the giant chain stores in the shopping malls today. Their tool for success is, ironically, the same tool that help the larger chain stores push the smaller establishment into extinction, i.e., the banking revolution and the advent of credit cards and debit cards, plus of course the convenience of home-based shopping.

In spite of the recent sprout in large format stores, the ratio of organised retail to un-organised retail in India is significantly less in comparison globally.

Composition of Indian retail sector	
Sector	**Share**
Traditional Retail	75%
Organized Retail	18%
E-commerce	7%
*Source IBEF, data for the year 2021	

Key Players in the Industry

2.6 It is important to know the key players in the retail industry. This gives a big picture understanding to the internal auditor. The key players can be seen at global level and at the National Level.

2.7 Key players at National level:

- Reliance retail group:

  Reliance Trends, Reliance Fresh, Reliance Jewels, Jio Mart, Netmeds, Reliance Digital, Urban Ladder, Smart Point, etc.

- Future Group:

  Central, Nilgiris, Brand factory, Heritage Fresh, easyday Club, WHSmith, etc.

- Amazon.in
- Flipkart.com
- Trent & Tata Group:

  Westside, Zudio, Utsa, Star, Landmark, Booker, Croma, etc.

- Aditya Birla Retail group:

  Louis Philippe, Van Heusen, Allen solly, Pantaloons, Reebok, Forever 21, etc.

- Shoppers Stop

2.8 Key players at Global level:

- Walmart Inc
- Amazon.com Inc
- Costco Corp
- The Home Depot Inc.
- JD.com Inc.
- Alibaba Holdings
- Target Corp.

Role of Indian Government

2.9 The Government has been protecting the Indian retail industry from global players ever since liberalisation of the business in India. The government has been supporting the local grocery shops which could be wiped out by global players in the event of a full opening of the retail market for Foreign Direct Investment (FDI), especially, to support the millions of small Kirana shop owners who form the basis of livelihood for millions of people.

2.10 The Government has taken steps to help in growth of e-commerce which eventually acts as the backbone for growth of e-retailing. Besides developing the e-infrastructure in the country through effective telecom policy measures, the Indian Government has created the necessary legal and administrative framework through the enactment of the Information Technology (IT) Act which combines e-commerce transactions and computer misuse and frauds rolled into an Omnibus Act. The Controller of Certifying Authorities (CCA) has been put in place for effective implementation of the IT Act. The Act also enables e-governance applications for electronic delivery of services to citizens.

Open Network for Digital Commerce (ONDC)

2.11 There has always been a complaint by Indian retailers on monopolistic trade practices by some of the e-commerce giants. The long-undermined concerns revived when COVID induced lockdowns the country for months and as a result e-commerce sale skyrocketed. Given the serious concerns of platform-based e-commerce players grabbing lion's share of the retail sales, Government of India, inspired by the Unified Payment Interface (UPI), came out with an open-source platform to democratize e-commerce in India, by providing a fair and equal opportunity to every player involved in retail industry. The open environment is not just for the retailers, but also for the customers, logistics partners, delivery partners, payment gateway providers, etc.

2.12 India has 14 Crore e-commerce customers (next only to China and USA), and the number is growing rapidly. Breaking the long monopoly of India Post Services on rural connectivity, last mile delivery is possible today with start-ups in the logistics space with players like Delhivery and the distribution network setup by the e-commerce players themselves. Even e-retail accounts for only 4.3%, against the countries, like, China where e-retails accounts for 25% of the Gross Merchandise Value (GMV). So, India is still under penetrated in terms of e-retail, with around 1.2 Crore Kirana Stores, that account for 80% of the retails sales in India, while 90% of them being unorganized and lack digital exposure. Given the financial and operational muscles of large e-commerce players, the future of small retailers is under grave threat and their survival and existence is crucial to avoid a monopolistic environment in India retail market. By 2026, digital commerce is estimated to reach INR 15 Lakh Crores, and there is a threat of large number of small retailers remaining out of the e-commerce system, leading to a situation of "Apartheid Growth", where only one section reaps the fruits of all growth.

2.13 Given these conditions, Government of India has set up a not-for-profit (Section 8) company on 30th December 2021, named **Open Network for Digital Commerce (ONDC)** with the below objectives:

(a) Creating an open network, enabling participation of multiple platforms,

(b) Providing basic digital infrastructure with minimal intervention, enabling fair trade.

(c) Opening the e-commerce for large number of players, who otherwise are less likely to adopt digital strategies.

(d) Designing the structure in a way to scale-up with growing participants.

(e) Avoiding unfair trade practices.

(f) Empowering all the participants with the power to choose.

(g) Enhance the digital adoption throughout the retail industry.

(h) Drive the cash lead retail industry towards digital payments environment.

2.14 ONDC is managed by a body of industry veterans lead by Mr. Nandan Nilekani and takes timely instructions from the respective departments of Union Government of India.

2.15 ONDC creates an open network, where multiple platforms can register themselves and the customers can choose them independently, against the platform-based network, where the customer is offered solutions in the form of a bundle (for example, if Mr. A buys product X from the platform C, he has no say in choosing the vendor of his choice, payment gateway of his choice, logistics mode of his choice and delivery medium of his choice. Instead, the platform operator "C" controls the vendor, price, payment gateway, mode of logistics and delivery partner).

2.16 In ONDC, a customer can select a vendor of his choice and a vendor can have his say on the price and the mode of delivery. ONDC network operator is not micromanaging the transactions between the buyer and seller, rather creating a digital environment that enables both the buyer and seller to transact digitally.

2.17 ONDC creates an open network enabling the flow of interactions / command between various participant applications, implying that both the buyer and the seller need not be using the same application for the transaction to take place. Thereby the success of ONDC lies in onboarding as many participants as possible, becoming the universal platform of platforms / applications.

2.18 The following technological components play a vital role in enabling this to happen:

1. Adaptor Interfaces: These are the APIs, which enable the exchange of information and allows the participants of the network to interact with each other.
2. Gateways: Gateway is an application that filters the results based on the request received. Requests are filtered on the basis of location etc.
3. Open Registries: Open registries maintain the list of participants who are joining ONDC.
4. Applications: Applications are of two types. Buyer side and seller side applications. Both the applications carry features that enable the respective functions of buying and selling.

2.19 ONDC will adopt a minimalistic approach of governance in complying with the Information Technology Act, 2000. ONDC will also act as a resolutory of disputes arising amongst the network participants.

Classification of Entities in the Retail Industry

2.20 The Entities in retail industry may be classified on the following basis:

Based on Business Structure

There are different businesses in which an entity operating in the retail industry can be set up. The major ones are elaborated hereunder:

(i) Agency/ Partnership System

It refers to the methods of practicing and using another person's business model. The network partner manages the outlet but does not usually own the goods he is selling. The goods belong to the licensor. The agent signs buy-sell contracts on behalf of the licensor. In return for the sale of goods or services, the agent receives a commission specified in the licensing contract.

(ii) Dealership

Retailers may find the business model of a licensed dealership as a mix of franchise and independent retailer. The licensee has the right (sometimes this is exclusive) to sell a brand of products. Unlike a franchise, the dealer can sell a variety of brands, and generally, no fees is paid to the licensor. Dealerships may or may not be identified as an authorised seller or by the company's trademark.

(iii) Direct Distribution

Offering goods and services directly to consumers, through face-to-face contact, usually at the client's home, workplace or elsewhere outside of retail sales points - form of retail distribution outside of a chain of shops.

(iv) E-store, Internet Store, On-line Store

A sales point involved in e-trading over the internet under a unique world wide web (www) address, with an interactive form that allows the consumer to place an order for a product or service using the information provided (including price and mode of payment).

(v) Franchising System

It refers to the methods of practicing and using another person's business model. The parties signing a franchising agreement remain totally independent of each other. Both the outlet and the goods (which are frequently supplied by the franchisor) belong to the franchisee. The franchisee purchases goods and services on its own behalf and the complete sales revenue belongs to the franchisee, who pays periodic franchise fees to the franchisor.

(vi) Integrator

It is a firm running a franchise or partnership-based retail chain. It may operate on a commission basis or act as supplier if the integrator is a wholesaler.

(vii) Independent Retailer

An independent retailer is one who builds his/ her business from the ground up, i.e., from the business planning stage to opening of the retail store. He/ she may hire consultants, staff, and others to assist in the business.

(viii) Network Marketing

Multi-level marketing (MLM) or network marketing is a business model where the selling of products depends on the people in the network. Not only a product is being sold, but other salespeople are being recruited to sell that product or product line.

Based on Size Operations

2.21 In India, there are different types of retail entities which can be classified in accordance with the size of operations as follows:

(i) Grocery Shop/ Store

A retail outlet offering typical foodstuffs, non-food merchandise (mixed grocery and non-food stores), or groceries only. These refer to the Kirana stores.

(ii) Small-format Shops

There are grocery or mixed grocery and non-food shops under 400 sq. metre in size. They are commonly referred to as mom-and-pop stores.

(iii) Convenience Stores

Small-format chain stores open at least 11 hours a day, with a basic range of groceries, alcohol, cigarettes, and newspapers/ magazines.

(iv) Exclusive Stores

These stores are ranging from a size of 500 sq. ft. to 5,000 sq. ft. and above. These are owned/ managed by the company or through its franchise. These can offer single brand as well as multiple brands.

(v) Speciality Stores

These stores focus on a specific product category. These are medium sized layout in strategic location. Specialty stores provide a large variety base for the consumers to choose from the specific category.

(vi) Large-format Stores

These are grocery and mixed grocery and non-food stores typically above 400 sq. metre in size (retail space). This covers hypermarkets, supermarkets and discount stores.

(vii) Discount Stores, Discounters

These are grocery or mixed grocery and non-food stores around 1,000 sq. mt. in size, offering on an average around 800 - 1,200 products, chiefly foodstuffs, often under the retailer's own private label or produced exclusively for the retailer. Prices are on an average 15-30% lower than the market averages. These are of following two types:

Hard discounters - A type of discounter characterised by a limited product range and a predominantly of low-price private labels.

Soft discounters - A type of discounter characterised by a broader product range, including fresh food and mostly manufacturers' brands.

(viii) E-shopping mall

A website which presents the offers of a number of internet stores.

(ix) Hypermarkets

These are mixed grocery and non-food stores over 2,500 sq. mt. in size, offering on an average 40,000 items, around 50% of which are foodstuffs.

(x) Supermarkets

These are mixed grocery and non-food or grocery stores over 300 - 2,500 sq. mt. in size, offering on average 5,000 -10,000 products, at least 70% of which are foodstuffs.

(xi) Delicatessen Supermarkets

These are supermarkets with an extended premium range, targeting medium and high-income customers.

Special Features of the Retail Industry

2.22 The retail industry is unique in certain aspects as compared to other industries. These can broadly be classified as follows:

(a) Business Process Related

The business of an entity operating in a retail industry has certain unique characteristics, risks and nuances. Some of them are as follows:

(i) Most of big sized retailers have multiple stores across various locations and management of all department stores involves a sophisticated and comprehensive management information system

(MIS). This would require periodic analysis of data on a store wise and department wise basis.

(ii) The industry is labour intensive and requires trusted, young, attractive salespersons to enable sufficient pushing of products to the customers and stores. In the case of small grocery store, the owner directly supervises the entire activity. In large stores, there are sophisticated surveillance systems to supervise the activity to enable prevention and detection of thefts and shoplifting by customers.

(iii) The success of a store is determined on the basis of correctness of the demand forecasting in a location as against the actual number. Hence, correct information is required by the decision makers as regards the demand for a location.

(iv) The business processes and control systems are unique and should be commensurate with size of retail store.

(v) The work timings of these stores would vary taking into consideration the size, location, customers they cater, products and employee availability.

(vi) Branding plays an important role in the Indian retail industry. Branded products as well as branded retails are chosen by informed customers and unbranded products still occupy a significant part of the retail market, especially in the rural areas.

(vii) Corporate strategy might be required to be periodically changed in the light of changing business scenario and trends across markets. Further, there is need of standardisation of practices across locations and stores. This would require quick adaptability by the entire organisation to the dynamic changing environment.

(viii) Competition among products is extremely high with various promotional offers and schemes. Bigger retailers virtually kill the business of many small retailers in the vicinity through their intense marketing strategies and offer to attract customers.

(ix) The demand factors for consumables and durables are significantly different and business intelligence plays an extremely important role for the success of the entity.

(x) The risks for a retail industry are different from any other industry. The areas of risk can vary from business risk to business continuity risk.

(b) Supply Chain Management and Billing

Unlike many other industries, the contract and billing process are unique. There is wide range of practices taking into consideration the depth of penetration of this industry. Some important aspects are as follows:

(i) The dynamics of the Supply Chain Management (SCM) plays the most critical part of the retail industry and involves the efficient management of the distribution processes and delivery processes to achieve success in its operations. This is taking into consideration the complexity of the procurement process from suppliers across geographical locations at varied terms and conditions.

Big entities have warehouses which act as depot for their stores and replenish them on a periodic basis. Further, such replenishments might be from local purchases or from a centralised location.

(ii) Significant economies of scale exist when an entity would buy large number of products by negotiating lower price per unit than its competitors. It gives better competitive advantage over smaller entities.

(iii) Payment might be made in the form of cash, cheque or debit/ credit card, discount coupons/ vouchers, etc. Considering the volume of transactions, the entities might face challenges in ensuring an error free billing of its products.

(iv) Billing process is typically related to format of the store. It is system driven in the case of large stores and fairly simple and unorganised in the case of small stores. Billing needs to be done on a real time basis and there cannot be any delays on this front.

(c) Material Storage and Handling

The success of the store depends on efficiency of management of products and materials, considering the perishable nature of products. Some special features are as follows:

(i) Considering the size and volume of materials, entities find it relatively challenging to maintain sufficient control on the inventory and to perform routine inventory verification. Further, there must be a unique and comprehensive inventory management system to provide for the precise tracking of inventory across locations and distributors to enable the retailers to appropriately deal with them.

(ii) Proper accounting and control for stock returns, freebies and offers apart from gift vouchers.

(iii) Certain products are perishable and in certain products, pilferage too would be a major concern. Proper handling of these materials is an integral part of proper inventory management.

(iv) Inventory requirement at each location would be unique in accordance with the cultural preferences, demography of people and lifestyle of the vicinity. The availability of inventory should be in accordance with all these factors.

(v) In the case of transfer between stores or locations of the same management, there needs to be sufficient tracking of transferred stock and periodic reconciliation to enable proper tracking of inventory.

(vi) Visual Merchandising is an integral part of promotional activities and plays a major role in strategy making in the retail industry.

(d) Economic Conditions

Uncertainty/ instability of economic conditions — both globally and nationally has an adverse impact on the industry. Some important aspects are as follows:

(i) Consumer Confidence Index (CCI) is widely considered an economic indicator of household consumption expenditure. Consumers tend to increase consumption when they feel confident about the current and future economic situation of the country and their own financial situation. Business is directly based on the Consumer Confidence Index of the consumers.

(ii) The impact of global economic changes is extremely significant for retail Industry. This is owing to the high reliance of foreign suppliers for sourcing of certain key products and materials.

(iii) In general, the retail industry involves significant amount of expenditure in foreign currency for the sourcing of various products.

(e) Other Unique Features

There are certain unique features of the Retail Industry apart from those mentioned above, which an internal auditor may consider:

(i) Information technology plays a very significant role in providing the right picture to the managers and decision makers. In the event of a failure in business systems, it would lead to a complete paranoiac situation across business units and standstill of operations.

(ii) Retail Industry faces a lot of "Window Shoppers" where shoppers engage in the activity of browsing shops with no intent to purchase, possibly just to pass the time between other activities, or to plan a later purchase.

(iii) Considering that in certain cases, when the demand is seasonal, there might be requirement for extra work force which could be in the form of an additional temporary employee or extra shift of an existing employee. Proper employee management plays a key role in the overall success of the entity.

It is, therefore, extremely important for an internal auditor to understand these special features of the entity.

Distribution System in Retail Industry

2.23 The industry has a three-tier system for the distribution of its products. The first tier is the manufacturer, the second tier is the intermediary, basically, the distributor or wholesaler and the third tier is the retailer. The manufacturer sells or grants licenses based on different criteria. Each State Government controls what products are brought inside its border.

2.24 The distributor or wholesaler sells and distributes the products to the retailers. An intermediary dealing with one type of product, is called as a distributor, dealer or a franchisee. In such a scenario, the goods/ products would be branded and the retailer intends to make substantial profits by buying directly from supplier/ wholesale agent and selling it to the customers.

Another option available for the intermediary would be dealing with multiple brands of a similar product from various manufacturers to prevent customers moving away to competitors due to lack of availability of desired brand.

2.25 Retailers purchase a product, mark up its cost, and advertise it for sale. The mark-up process is the key to the retailer's business because if the product is marked up too high, consumers will not buy it and if it is marked up too low, there will be no profit and the supply may be quickly get exhausted. In any case, the product value cannot exceed the Maximum Retail Price fixed by the manufacturer.

2.26 India is witnessing change in lifestyles of large section of the population. The need to understand the emerging markets and consumers has become a big challenge for the corporates, especially, in creating and managing a powerful brand. By developing a powerful brand, entities can establish 'brand equity' and the equity assists firms to manage competition and to maintain market share. Branding is one of the most effective competitive tools and it is a challenging task for the marketer to nurture a brand into a strong profitable brand.

2.27 Some new age brands are adopting D2C model of distribution, where they tie-up with a logistics partner and remove the intermediary from the distribution network. Such models are reliant on the internet completely. As soon as a customer orders products from the brand's website or via any other available means, the manufacturer/owner of the brand sends it directly to the customer without depending on an intermediary.

2.28 Indian e-commerce is following primarily two business models:

- Market place model
- Inventory model

Market place model is basically using digital medium as a showcase for the products by various sellers, meanwhile the platform not maintaining any inventory of the same. Platform acts as an intermediary and arranges for payment, logistics and delivery between the merchant and the buyer.

Whereas in inventory models, the platform itself buys the goods from the manufacturers or sellers and stores it in its warehouses and takes care of end delivery.

2.29 Today's brands are more visible than those in the past. They are everywhere-on the TV, hoardings, posters and print media. Brands while proclaiming their positive qualities pull down those of their rivals. Intangible assets such as brands, patents and know-now have become increasingly dominant elements of entity's value.

Trends in Retail Industry

2.30 Urge for digital presence is a major trend to be seen in Indian retail industry, especially amongst the large, organized players. Increasing competition by the e-commerce players is pushing the retail store chains like Reliance and D-Mart to adopt for e-retailing as well. The companies have also found to be taking the leverage of their physical presence in enhancing their digital footprints.

2.31 Subscription model is another emerging trend in the Indian retail industry. It is a business model where the members who pay a certain subscription fee for a certain period of time are entitled to certain special benefits. Such benefits may include free home-delivery, speedy delivery, etc. Such membership programs help the retailers to build a loyal customer base and get lion's share of their member's purchase.

2.32 Indian retail industry is also witnessing strategic partnerships to boost their sales along with supporting their product partner. Such partnerships include selling of certain products (like a particular smartphone) only via a certain platform. Such steps attract the brand loyal customers to the platform that has got exclusive rights to sell that product. Strategic partnerships may also include tying-up with logistical partners to ensure the last mile delivery, speedy delivery, etc.

2.33 A challenge to the Retail Industry in retailer's backward integration, some of the manufacturers are adopting the forward integration strategy as well, i.e., some of the manufacturers, especially FMCG and apparel manufacturers are resorting to building their own D2C brands to reach their customers directly, bypassing the retailers. Thereby, the brand becomes its own seller as well.

2.34 Indian retail is working with its partners more closely than ever. Providing analytical services to its partners is one of the major trends in Indian retailing. Such analysis includes providing valuable customer preference data to the manufacturers. Such information may include geography-wise demand, age group of the customers, preferred mode of payment, re-purchase cycle, etc. Customer behaviour analysis itself is opening a plethora of opportunities in the fields of data mining and analytics. Accurate analysis of consumer behaviour is helping the retailers to approach the right targets.

2.35 Indian retail industry is also reinventing itself in advertising, branding, and positioning itself. Indian retail industry has started to rely on celebrities and social media influencers to attract the crowds. Circulating short feedback clips through social media is a product of experiential marketing practices to quote one such innovative practice.

2.36 Indian retail industry is looking to promote products targeting particular age group, gender and section of the customers as well. This helps the players to position themselves firmly in the market. Such positioning may include practices like selling only Ayurvedic products *via* its platform to attract and hold health-conscious customers, etc.

2.37 Indian retail industry is actively working on backward integration as well. Such backward integration strategies include retailers launching products under their own brand names, buying out stake in major suppliers, acquiring the retail technology companies, having inhouse chatbots to support online purchases, buying out the store space instead of taking it on lease, etc.

2.38 Indian retail is becoming increasingly reliant on the technology. From book-keeping to payment gateways to order management to debtor ageing, technology has become the lifeline of the industry. The software applications are compatible even for small retailers to have access to and adopt them with ease and less hurdles.

2.39 Consolidation is also a major trend being observed in the Indian retail industry. With major giants entering the retail ecosystem, the industry is witnessing consolidation like never before. The industry is witnessing complete and partial takeover of many businesses by large players. Consolidation is also an indication of growing competitive environment in Indian retail industry and consolidation is an indicator of the growth spurt that lies ahead.

Acquirer	**Target**	**Year**
Reliance Retail	Just Dial	July 2021
Amazon	Perpule	March 2021
Flipkart	Scapic	November 2020
Reliance Retail	Urban Ladder	November 2020
Reliance Brands	Zivame	July 2020

Reliance	Hamleys	May 2019
ITC	Mother Sparsh	November 2021
Tata Digital	Big Basket	May 2021
Big Basket	Daily Ninja	March 2020
Walmart	Flipkart	May 2018
Flipkart	Yaantra	January 2022
Spencer's Retail	Nature's Basket	May 2019
Reliance Retail	Shri Kannan Departmental Stores	March 2020

Forces that Affect the Retail Industry

2.40 An analysis of the forces that affect the entity operating in the retail industry is summarised below:

(i) Threat of New Entrants

Over the last decade, there has been a decrease in the number of independent retailers predominantly because of the entry of huge corporates into this industry. Their vertical structure and centralised buying gives chain stores a competitive advantage over independent retailers.

(ii) Power of Suppliers

Historically, retailers have tried to exploit relationships with suppliers. Big retailers have extraordinary influence on the suppliers, and they have the ability to make or break a small supplier. In the retail industry, suppliers tend to have very little bargaining power.

(iii) Power of Buyers

Individually, customers have very little bargaining power with retail stores. If customers demand high-quality products at bargain prices, it keeps retailers within limits and are conscious of the customers.

(iv) Availability of Substitutes

The tendency in retail is not to specialize in one good or service, but to deal in a wide range of products and services. This means that what one store offers you will likely find at another store. Retailers offering products that are unique have a distinct or absolute advantage over their competitors.

(v) Competitive Rivalry

Retailers always face stiff competition. The slow market growth for the retailers means that they must fight each other for market share. More recently, they have tried to reduce the cut-throat pricing competition by offering loyalty points, memberships, and other special services to gain the customer's loyalty.

Factors Leading to the Growth of Retailing in India

2.41 As purchasing power of Indian urban consumer is growing and branded merchandise in categories like apparels, cosmetics, shoes, watches, beverages, food and even jewellery, are slowly becoming lifestyle products. Indian retailers are taking advantage of this growth and aiming to grow, diversify and introduce new formats and are forced to pay more attention to the brand building process.

2.42 The contemporary retail industry in India is reflected in sprawling shopping centres and multiplex malls that offer shopping, entertainment and food under one roof. The concept of shopping has altered in terms of format and consumer buying behaviour, ushering in a revolution in shopping in India.

2.43 The factors that are driving the growth of the retail industry in India are as follows:

(i) Increase in disposable income and customer aspiration

(ii) Low share of organised retail

(iii) Abundance of requisite manpower

(iv) Increase in expenditure for luxury items

(v) Overall growth of economy at a rapid pace

(vi) Increase in pay-scales of young workers in India

(vii) Increase in standard of living of the urban population

Stock Keeping Unit

2.44 It is a unique identifier for each distinct product and service that can be purchased. The usage of Stock Keeping Unit (SKU) is rooted in data management, enabling the company to systematically track its inventory or product availability, such as, in warehouses and retail outlets. They are often assigned and serialised at the merchant level. Each Stock Keeping Unit (SKU) is attached to an item, variant, product line, bundle, service, fee, or attachment. SKUs are often used to refer different versions of the same product.

Chapter 3

Risk Management

Risk

3.1 Risk can be defined as the probability of a threat exploiting vulnerability of business assets or processes or controls by occurrence of an event causing significant impact to the business operations and continuity and which could prevent the organization from achieving its goals and objectives. Areas which can be impacted by risk are broadly classified into strategic, reputation, operational, financial, legal, environmental, etc.

3.2 The ICAI has issued a Standard on Internal Audit (SIA) 130, Risk management. The Internal auditor may refer this Standard in detail to understand the important terms, various responsibilities of Management and Internal auditor and how this standard to be used in the context of mitigating and managing the risk.

Risks Faced by Retail Industry

3.3 The internal auditor may make a risk assessment of the entity under audit. This is extremely important in order to ensure prevention of any non-compliance or concurrence of undesirable event.

The internal auditor may verify whether sufficient controls are available in the entity to detect such risks and prevent its occurrence by suggesting management to take appropriate steps in the light of overall business environment.

3.4 The risks faced by a retail industry can be broadly classified as follows:

(i) Business risk

(ii) Political risk

(iii) Inventory management risk

(iv) Environment risk

(v) Brand/ reputation risk

(vi) Systemic risk

(vii) Technology and data security risk

(viii) Business continuity risk

(ix) Intellectual property risk

(x) Cyber security risk

(xi) Social media risk

Business Risk

Business risk comprises the following:

(i) A change in the product range based on customers changing preference needs.

(ii) A change in the legal environment that imposes new conditions, costs or restrictions upon the manner of providing the services, the means by which the services are delivered to the customer.

(iii) A change in the volume of transactions, either to:

  (a) Increase (requiring additional hiring and perhaps a change in business process) or

  (b) Decrease (resulting in sub-optimization of dedicated resources or re-allocation of resources).

(iv) Risks due to international operations.

(v) Unprecedented increase in the cost of real estate leading to increased cost of operations and strain on the profitability.

(vi) Increase in workers' compensation cost and retention of key employees.

(vii) Change in consumer confidence leading to significant locations in consumption of certain category products.

(viii) Risks on account of non-compliance with statutes.

(ix) Changing importance for locations might have a significant impact taking into consideration the initial investment required to be made at every location and higher rentals that might be paid for them in comparison to the others in the vicinity.

(x) Credit risks related to commercial business consumers.

(xi) Timely availability of information to enable decision making at the right time.

(xii) Increased competition from mass marketers and home improvement retailers.

(xiii) There is mergers and acquisition risk that an enterprise might change owners.

(xiv) Risks due to fraud and theft.

(xv) Risks due to acts of God such as earthquake, flood, windstorms, etc.

Political Risk

Political risk represents the degree to which social and governmental environments may change in the future. This risk may manifest itself in events over which a government has no control, such as, riots or new elections. Other events may be caused by a government, such as, an embargo on imports or exports, increases in tariffs, new prohibitions on transactions with specific countries.

In international outsourcing transactions, political risks need special attention due to the long-term nature of the relationship. There are a number of techniques that can mitigate, but not eliminate, such risks.

Further, the country makes policy for Foreign Direct Investment (FDIs) by a foreign entity in retail industry in India. This is subject to political risks and the policy viable to change which might have a significant impact on the operations and the business established in India. There might also be instances where additional duty is charged on certain products imported in India e.g., antidumping duty. In such cases, the entity might not be able to reap the benefit of cheaper products for its customers. Moreover, the entity is affected by retail policies of the country from which the entity procures products e.g., if there is any quota for exports, it might have an impact on the prices of goods.

Inventory Management Risk

This might have a direct impact on the profitability of business. The entity's procedures with regard to mitigation of risks might be crucial to ensure business competency. The risks with regard to inventory management might include the following factors:

(i) Delay in receipt of products due to poor supply chain management/ supplier management. With the inter-connectedness and flow that has to come to make the chain work properly, the smallest disruptions can throw an organisation off course.

(ii) Inability to source products from the right source and at the right prices.

(iii) Inefficient inventory management system, wherein, the goods are not made available at the right time to the customers leading to poor branding and decline in customer loyalty.

(iv) Rapid obsolescence of inventory.

(v) Technological obsolescence of electronic products.

(vi) Shipping risks due to delicate nature of electronic products.

(vii) Improper handling of goods.

Environment Risks

Environmental risks associated with the retail industry, generally, fall into one of two categories:

(i) Site Acquisition, Development, and Construction

Considering that retailers buy and develop retail property, the retailers should develop an effective due diligence process, and manage environmental risk. The significant cost would be on account of following:

- Clean-up Cost Cap for "capping" the cost of cleaning up known pollution conditions.
- **Pollution Legal Liability** for transferring the risk of cleaning up unknown pre-existing pollution conditions, third party claims, and other related exposures.
- Loss of income due to **delay in opening**/ scheduled completion of the project.

(ii) Store Operations

Environmental risks arising from retail store operations, generally, fall into one of two categories:

a. *Nature of products/ services sold*— Retail operations that store and sell significant volumes of paints, solvents, chemicals, petroleum products, fertilizers, pesticides, automotive batteries, and similar products obviously have a higher degree of environmental risk.

b. *Store maintenance*— The risks associated with store maintenance are summarized in the table below:

Maintenance Activity	**Exposure**
Painting	Volatile organic vapours from paints and thinners & proper disposal of paint and / or thinner-soaked rags and brushed
Floor stripping	Volatile organic vapours from stripping compounds
Renovations	Disturbing / releasing asbestos or lead-based paint in order facilities
Improper roofing	Growth of mold and release of mold spores

Brand/ Reputation Risk

Enterprise viability depends on maintaining the goodwill of the enterprise brand. Damage to reputation might never be recovered or might only be recovered at great expense and distraction. Reputational risk is significant in a retail industry.

Brand risk management techniques include the use of scripts, supervision, random audits, ongoing training and customer feedback. Legal issues in reputational risk can arise where the customer wishes to terminate a service provider, redirect its efforts or adjust the pricing to reflect a loss of goodwill.

Systemic Risk

Regulators and governments focus on the risks to the systems that support local and global economies. A systemic risk affects all participants in an economic sector or industry.

When planning any solution to the sourcing dilemma, executives and managers need to understand the nature of systemic risk and adopt appropriate risk planning strategies.

Technology and Data Security Risk

Technology risk refers to the risk that an entity faces due to change in technology or obsolescence of existing technology. In the event of change in technology, the investment made by the entity becomes futile. Technology could be in the form of purchase/ creation of software or hardware.

Data is subject to numerous and varied threats including:

- **Insider theft** through unauthorized queries and file or report access.
- **Hacks** such as, SQL-injection, cross-site scripting, poisoning, and other OWASP listed attacks.
- **Physical theft** of servers and tapes.

Business Continuity Risk

The major risk which affects the business continuance would include improper supply chain management, damage of brand and significant changes in economic situations. The entity must be prepared to mitigate these risks and ensure successful carrying of business.

Intellectual Property Risk

Brand impersonators, Patent flouters, copyright pirates, trade secret thieves and a major risk to businesses. There are so many products sold in the market by brand impersonators, this will reduce the business for the retailers. Though the IP is registered and there is a legal backing and support for the brand creators, there is no possibility to nullify the impersonated brand sales. Further the patented products are manufactured with minor changes and sold in the market by other brand makers. Following are some of the types of infringements identified in the past:

1. Copyright infringements
2. Trademark infringement
3. Patent infringement
4. Selling Counterfeit Products
5. International importation of products that infringe a copyright
6. Infringement on websites and social media sites
7. Disclosure of trade secrets.

Cyber Security Attacks

Retail companies are vulnerable to cyber-attacks. Some of the retail companies work on the website model. With the e commerce accounting for an ever-increasing number of transactions, retailers are expected to become more vulnerable. Many of the global retail giants like Walmart, Home depot, Target and etc have faced the cyber-attacks in the past decade. This industry is more vulnerable reason being the retail entity will have sensitive information like customer debit and credit card details, customer email-ids, address, etc.

Social Media Risk

Social media may cause a risk to a company's reputation by creating negative publicity. This might bring down the sales of the entity, reduce the share price of the company in stock exchanges, losing out of customers, emotional disconnect of the customers with the brand of the entity, etc.

Risks Mitigation Techniques

3.5 An illustrative list of risks mitigation techniques that the management might opt would include:

(i) In the current environment, the entity should have complete knowledge about those risks and consider all pitfalls, understand the exposures, and develop risk management practices and programs that address this evolving exposure.

(ii) Prioritising the risks, creating a plan to strategically manage the risks, implementing the plan as necessary, and monitoring the plan’s implementation for evaluation and improvement purposes.

(iii) Certain risks, such as, frauds, environmental damage might be reduced through visual inspections, carrying on surprise checks and verification, visual merchandising, just in time approach, etc.

(iv) It might be appropriate for the entity to have a comprehensive insurance policy to cover significant part of risks.

(v) Training of employees in inventory handling, especially in the case of managing open/ broken bags, containers, perishable and sensitive products.

(vi) Proper store maintenance procedure should be implemented.

(vii) A risks identification system would be required to be installed. The Management Information System should provide for certain yardsticks which would enable the management to identify the critical risks and its impact on the entity.

(viii) Indemnity clauses with suppliers and external vendors would ensure that any loss arising due to suppliers and external vendors would be indemnified.

The internal auditor may do a complete assessment of enterprise risks and provide an insight on methods of mitigation of risks. The internal auditor might prepare a questionnaire or a checklist for this purpose.

Risk Assessment

3.6 A risk-based planning exercise shall form the basis of the overall internal audit plan. The Internal Auditor shall undertake an independent risk assessment exercise to prioritise and focus the audit work on high risk areas, with due attention to matters of importance, complexity and sensitivity.

3.7 The internal auditor shall undertake an independent risk assessment of all the Auditable Units identified in the Audit Universe and align this with the risk assessment conducted by the management and the statutory auditor. This is required to prioritise and focus audit work on high-risk areas, with due attention to matters of importance, complexity and sensitivity.

3.8 This exercise may involve site visits and preliminary surveys of the Auditable Unit. Based on this exercise, key risk mitigations (or internal controls) are identified for testing the effectiveness of operation. Absence of any risk mitigations (or missing controls) could point towards process design gaps which shall also be validated and reported.

3.9 The internal auditor may also plan to undertake a dedicated audit of the company's Risk Management Framework and processes, as a separate review or assignment.

Risk Management Framework

3.10 Risk Management Framework is the combination of structure, systems and processes put in place to organise the various risk management activities and to integrate them seamlessly into the organisation. Risk management activities, forming part of the framework, are designed to enhance the organisation's ability to, amongst others:

(i) Provide strategy, leadership and direction on risk management;

(ii) Establish a culture of risk management throughout the organisation;

(iii) Provide an organisation structure for assigning risk management resources and defining their responsibilities;

(iv) Capture and maintain a comprehensive database of all risks;

(v) Ensure expertise and competence in the area of risk management;

(vi) Exercise continuous monitoring and oversight on risk management; and

(vii) Periodic communication of risk management matters and formal reporting of risk status to management and those charged with governance.

Internal Auditor may study SIA 130, Risk Management as issued by ICAI in detail to understand the audit procedures that may be adopted to audit the Risk management framework.

Internal Control

3.11 Standard on Internal Audit (SIA) 120, "Internal Controls" as issued by the ICAI states that Internal Controls are systemic and procedural steps adopted by an organization to mitigate risks, primarily in the areas of financial accounting and reporting, operational processing and compliance with laws and regulations.

3.12 Internal Controls (ICs) are essentially risk mitigation steps taken to strengthen the organization's systems and processes, as well as help to prevent and detect errors and irregularities.

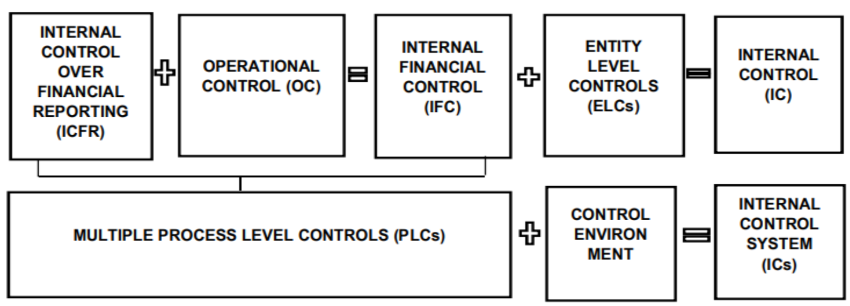
3.13 The actual steps of mitigation (e.g., review, approval, physical count, segregation of duty, etc.) are referred to as "Control Activities". When ICs mitigate the risk of financial exposure, they are also referred to as Internal Financial Controls (IFCs) and when they mitigate operational risks, they are also referred to as Operational Controls (OCs). ICs generally operate with human intervention (Manual Controls), but in an automated environment, computer controls are deployed to secure the systems and called IT General

Controls (e.g., access controls) or check transaction processing at an application level and called Application Controls (e.g., sequential numbering of invoices, etc.).

3.14 The term "Internal Controls System" is an all-encompassing term generally used to refer all types of controls put together, covering ELCs, IFCs and OCs. The Control Environment (ELCs) includes the overall culture, attitude, awareness and actions of Board of Directors and management regarding the internal controls and their importance to the organization. The control environment has an influence on the effectiveness of the overall Internal Control System since it provides the basis for establishing and operating process level controls (such as IFC and OCs) in the organization.

3.15 The internal auditor may obtain an understanding of the significant processes and internal control systems sufficient to plan the internal audit engagement and develop an effective audit approach. The internal auditor should use professional judgment to assess and evaluate the maturity of the entity´s internal control. The auditor should obtain an understanding of the control environment sufficient to assess management´s attitudes, awareness and actions regarding internal controls and their importance in the entity.

3.16 Below is a pictorial depiction of Internal control and Internal control systems:



Chapter 4
Fraud Management

4.1 Frauds significantly affect the revenue of the entity operating in retail industry. On an average around 3% of revenue is lost on account of frauds. Shrinkage or Fraud in retail is a key issue. Shrinkage means "loss in inventory on account of combination of employee theft, shoplifting, vendor fraud and administrative error,"

4.2 Various categories of fraud constitute a major component of the shrinkage. Among the factors responsible for shrinkage losses, employees and vendors are critical factors that need to be managed by retailers. Employees may resort to direct theft, under invoicing in collusion with customers, stealing cash, etc., whereas vendors can under-deliver in terms of number, size or quality of items as against the bill invoice.

4.3 The growing motivation among employees to lead a luxurious life, high reliance on skilled resources, thereby leading to weaker internal controls, and over dependence on existing systems and processes give rise to increased risk of fraud in retail industry.

4.4 Most potentially costly fraud schemes operating in the retail industry happen far from the selling floor, the security cameras and the cash register. This happen when employees behind the scenes circumvent processes and take advantage of insufficient oversight. Retailers face some unique risks that can have a potentially devastating impact on the company's bottom line and reputation. Retail companies should be proactive in identifying fraud risks and implementing anti-fraud programs and controls to minimize the risk of fraud.

Categories of Fraud

4.5 The common categories of fraud that affect the retail industry are as follows:

(i) Financial Reporting Fraud

It can be in many forms and is, generally, committed to make an entity or a subsidiary, branch or operating centre of an entity appear to have performed better than it actually has. One of the most common issues relates to revenue recognition schemes wherein sales are boosted to mislead management, shareholders, or lenders regarding the performance of a particular entity, location, product line, or sales team. While the perpetrator might not realize an immediate benefit from the scheme, such individuals might benefit indirectly by improperly receiving commissions or other incentives such as stock awards based on fraudulent information. Perpetrators of these schemes can be anyone who has an incentive or perhaps is under significant amount of pressure to show positive results and has the opportunity to commit fraud.

There are many types of revenue recognition schemes in this type of fraud. Some of the common issues are as follows:

(a) Bill-and-hold Transactions

It occurs when a sales order is processed, but the inventory is not shipped to the customer. The inventory may be separated in the warehouse, sitting on the loading dock or shipped to a third-party warehouse or staging facility. Sometimes, this may occur because the customer is not ready, willing or able to accept delivery. Decentralized structure and weak controls around inventory make this fraud easier to accomplish. Periodic inventory reviews as well as review of sales, sales returns and accounts receivable aging reports may reveal unusual trends to merit investigation.

(b) Channel Stuffing

It includes shipping substantially more inventory to a reseller than he can reasonably use but agrees to accept it based on unusual or extraordinary terms, like, extended payment terms, deep discounts, or allowing the return of unsold goods for full credit beyond the company's normal returns policy. Operations without formal, enforced procedures for negotiating, approving, and documenting sales agreements are often victims of this type of fraud.

(c) Side Agreements

The normal contract terms are changed or invalidated by an oral or written agreement. Side agreements, usually, accompany channel stuffing as a way to induce resellers to take on more inventory than they can reasonably resell. Lack of written policies regarding agreements are one risk factor that makes this fraud easier to perpetrate another is a commission program based on gross sales where low margins and high returns aren't penalized.

(d) Backdating

It is another way of fraudsters misstating revenue in which sales documents make a transaction appear to have occurred in a prior period. Again, failure to institute or enforce policies about negotiating and executing sales agreements can be a risk factor here.

Certain frauds can be identified by the internal auditor through performance of analytical procedures as described earlier. A few indications of potential fraud might be in the nature of following:

- **Decreasing Gross Margins**

  Increasing sales are increasing could signal a side agreement for a special discount.

- **Unusually High Returns**

  It could be caused by a channel stuffing arrangement or other side agreement permitting reseller returns of unsold goods.

- **Unexplained Differences in Physical Inventory**

  It indicates a bill-and-hold fraud is taking place.

- **Build-up of Aged Accounts Receivable Balances**

  It might be caused by backdating, side agreements, or channel stuffing arrangements.

- **An Unusual Spike in Sales**

  An unusual spike in sales just before the end of the reporting period could indicate any of these schemes.

(ii) Misappropriation of Assets (Theft of Cash or Inventory)

It is a second category of fraud that occurs in retail industry. The various forms of this type of fraud are as follows:

(a) Cash Skimming

It can be conducted through sales transactions and fictitious returns. Customer payments on accounts accompanied by account write- offs are another way to skim cash. A retailer with weak system security or failure to segregate sales, cash receipts and accounting functions is an easy target for cash skimming.

(b) Theft of Inventory

It can be as simple as removal of inventory from the warehouse or along the supply chain. It can include adjustment of books and records to hide the theft. This is more likely to happen in companies with multiple inventory locations or complex supply chains. Failure to properly segregate inventory and record keeping duties makes this kind of theft easy to accomplish.

(c) Marketing Fraud

It is another way of fraudsters misappropriating assets. The entity's personnel collude with customers to share rebates, discounts, or promotional items. Where salespeople maintain long-term client relationships and have significant latitude with terms, this type of fraud can occur.

The fraud indicators include the following:

- Growing accounts receivable balances without sales increases.
- Lower than expected gross margins.
- Higher than expected promotional allowances.
- Unusual number of credit adjustments, customer account write-offs, or customer returns.
- Unexplained variances in inventory¡ larger than expected shrink percentages.

(iii) Unauthorized Receipts and Expenditures

It is a third category of fraud that strikes retailers. The areas of fraud can include the following:

(a) Improper Vendor Allowances

Customers and/or retail employees commit this fraud. This is a risk when vendor allowances are significant and not documented properly, particularly, if policies for negotiating these allowances aren't formal, and procedures for tracking them aren't strict. Retail employees may collude with a vendor's staff or create false documentation to gain allowances, discounts, or rebates. These improper benefits might be used to overstate performance for a location or product line, or pocketed by the fraudster.

This can be identified through analysing and identifying the following:

- Unexpected variances in gross margins which could be due to fluctuations in allowance amounts or timing.
- Decrease in sales while gross margins stay steady.

(b) Bribery or Corruption

When retailers operate in several regions or countries and corporate oversight is less, this type of fraud occurs. Lack of segregation of duties between vendor approval and purchase authorisation, or new customer approval and sales contract authorisation can enable these frauds. They often take the form of kickbacks.

The internal auditor may consider to be alert to factors such as high expenses in a particular location, sole-source contracts and perform his audit procedures accordingly to detect acts that are against the interest of the entity.

Anti-Fraud Programs

4.6 To protect the entity from fraud and misconduct in business processes, vigilant observation of financial indicators and implementation of effective anti-fraud programs and controls help in reducing risk of fraud and protect company from financial and reputation damage. With potential risks and marked instances of fraud and theft, it is imperative for retail companies to take the following steps:

(i) Adopt robust internal controls backed by strong data analytics to mitigate key fraud risks and to raise red flags at early stages.

(ii) Devise a whistle blower policy allowing employees, customers and vendors to report malpractices directly to the management.

(iii) Determine policies pertaining to prevention, detection and investigation of frauds and to have action plans defined for conducting investigation if an incident occurs.

(iv) Set-up dedicated team, internal/ external, to handle stock checks at each of the stores periodically.

(v) Collate an end-to-end study of material movement from source to destination, including counter checks and cross tallying.

4.7 With rising challenges in the industry, the key to success is staying competitive without compromising on the quality of services. Cost effectiveness is necessary to achieve this, and an effective fraud risk management will help companies to identify potential leakage points and opportunities to save.

Fraud Management System

4.8 Fraud management System is an integral part of business with the raise of frauds in the industry. Fraud management system ensures revenue assurance and risk management by monitoring, controlling and managing large quantity of transactional data. It enables retail entities to identify potential fraud and block suspicious activities and protect it from frauds.

The fraud management system may have the following important features:

(a) Business rules engine to allow the setup and maintenance of custom business rules.

(b) Transaction processing Application Programming Interface (APIs) which allow multiple parameters as input, the ability to evaluate these parameters against the defined business rules and as a result provide as output the decision to accept, review or reject the order transaction.

(c) The ability to setup and maintain fraud negative lists.

(d) A risk prediction model or algorithm to provide a risk score based on historical data. It is possible that single software may not be able to provide these capabilities. In such scenarios, real time interfaces to an online risk prediction service (third party ASP model) may be required to determine the risk score which could then be used as an input to the business rules engine.

(e) A workflow engine to model the fraud business process. Another alternative is to build the workflow within the Order Management System (OMS).

(f) Fraud review screens for the order information and the rules tripped. As explained above, the alternative approach could be to build these on the OMS.

(g) The ability to record and store authorisation and settlement data for credit cards. This ability can be used to reconcile chargebacks from the payment providers against the original order transaction.

Order Management System (OMS)

4.9 An Order Management System (OMS) is a system which supports all the stages of sales- from order creation through delivery and even returns. OMS acts as a platform to provide single and centralised system for managing the orders from multiple sales channels. The important activities performed by the Order Management System (OMS) to facilitate the fraud management process are:

(a) As in the case of the online store front, the Order Management System (OMS) must provide the ability to interface with the payment gateway for real time authorisations, AVS checks, card verification codes and payment programs, etc. This is based on the assumption that order and tender modifications are managed in the Order Management System (OMS).

(b) The order related information required as input by the fraud rules engine is supplied by the Order Management System (OMS). This implies that the Order Management System (OMS) must have services to invoke the appropriate fraud APIs and act on the decisions provided by the rules engine.

(c) Based on the directive provided by the rules engine, the Order Management System (OMS) must have the ability to put the order on hold and transition to the fraud business process. It should also have the ability to restart the order fulfilment process based on an accept decision from the rules engine or the fraud analyst.

(d) The Order Management System (OMS) ideally should provide workflow capabilities to model the fraud business process flow. This could also include fraud review screens, ability to generate alerts and manage fraud related queues.

(e) The fraud review process can result in changes to the order including cancellations (for fraudulent orders), changes in payment types (new credit cards/ debit cards provided by customer) etc. If these modifications are managed within the Order Management System (OMS), then it should provide the user interface to make these changes as well as manage the backend processes of deallocating inventory, refunding the customers money etc.

(f) In case the Order Management System (OMS) manages the customer related communications (SMS, emails, etc.,), hence it should also be able to manage the communication associated with payment and fraud related problems.

Enterprise Data Warehousing Systems (EDW) / Analytics

4.10 It is very important to have a data warehousing strategy associated with a fraud management implementation system. The important functions to be performed by such a system are described below:

(a) The EDW needs to pull data from the fraud management system and the Order Management System (OMS).

(b) The extent of the fraud problem faced by an online retailer can only be determined through analysis of order history data. This helps determine the direct and indirect fraud rates.

(c) The validity of the business rules can be verified by using the EDW. They can also be prioritised based on analysis done on the EDW data.

(d) The risk prediction models are only as good as the history data provided. These models must be continuously validated and updated based on data pulled by the EDW system.

(e) The thresholds for the rule's engine can be validated using the EDW.

Fraud Prevention Techniques

4.11 The different types of fraud prevention tools and techniques used by online retailers are as follows:

(i) Online Payment Authorisation of Credit Cards/ Debit Cards

The process ensures that the credit card/ debit card being used is not lost or stolen. It also makes sure that the card has enough credit balance to pay for the purchase. It cannot however make out that the person using the card is actually authorised to do so.

(ii) Address Verification Services (AVS)

An AVS check matches the billing address provided by the customer with the billing address on file for that credit card/ debit card. The customer's address data is submitted together with each payment authorisation request. The system responds with a "score" signifying how well the address data matched. This tool is not very effective as it may not lead to a match in as many as 40% of the transactions and fraudster will have to file address of his credit card, hence nullifying the advantage of such a check.

(iii) Use of Card Verification Codes (CVV)

These codes consist of 3- or 4-digit numbers printed on the front or back of credit cards. These codes are required along with the credit card/ debit card details for authorisations to occur. These codes are not printed on receipts or stored in retailer databases to prevent easy access of the same by fraudster. This process requires that the card be physically present at the time of the transaction thus reducing card not present fraud scenarios.

(iv) Negative Files

These files, typically, define the set of minimum criteria an order transaction must satisfy before proceeding for fulfilment. These consists of lists of known fraudulent data such as email ids, stolen credit card/ debit card numbers and bad shipping addresses, etc. These files are based on past experiences, data mining of fraudulent orders and periodic updates by credit card/ debit card companies.

(v) Risk Prediction Techniques/ Models

Risk prediction model software analyses data from millions of online sales to extract the profile of fraudulent transactions. Based on these large and historical order samples, the software develops an algorithm to identify fraudulent orders. Every order transaction is evaluated by passing its attributes through this algorithm and a risk score is arrived at. Thresholds of this score can be used to identify orders to reject, review or accept.

(vi) Rules Based Detection Techniques

With rule — based detection software, online merchants define a set of criteria that each order transaction must meet. These criteria are a combination of risk scores, order information, tender information, customer demographics, geo locations and order history, etc. The software will automatically screen incoming order by these specific criteria and automate the decision to reject, review, or accept the order.

(vii) Manual Reviews

This involves the manual review of potentially fraudulent orders by fraud analyst. These analysts review orders and get in touch with customers and payment providers to verify that orders are not fraudulent. This technique should be used in conjunction with risk prediction models and rules-based detection. This ensures that the fraud analysts only look at a focused subset of orders having a high likelihood of being fraudulent. While manual review may be viable for smaller merchants with low order volumes, it is not normally a cost — effective or scalable solution for larger merchants with high order volumes or seasonal order peaks.

(viii) Verified by Visa/ MasterCard Secure Code

These programs enable 2 parties (card holder and card issuer) to authenticate each other by exchanging electronic passwords before proceeding with an online transaction. When a previous register password is entered by a card holder and authenticated by the Visa/ Master Card System, the order cannot be charged back due to fraudulent reasons and the merchant is assured of zero liability by the payment providers. Implementation of payer authentication systems can protect merchants from certain charge backs due to fraud, but this protection may only apply if a merchant can maintain low chargeback levels.

All of the tools mentioned above are complementary to one another, as they each inspect different components of a transaction. The best way to combat fraud is to use layers of fraud protection. These layers of fraud protection can be introduced at different stages within the order lifecycle. These stages can be classified into the order capture business process within the online store front and order fulfilment business process within the order execution system.

Chapter 5

E-commerce Retailing and Data Analytics

E-commerce Outlook

5.1 Though a late entrant to the world of E-Commerce, India is catching up to the global trend of E-commerce pretty rapidly. Lowered smartphone prices plus pan Indian network coverage with affordable internet prices have resulted in the sudden spurt of E-commerce in India.

5.2 E-commerce market in India currently stands at approximately $75 billion a year and is expected to reach $ 350 billion by the year 2030. Indian E-commerce is expected to grow at a CAGR of 27% in between 2019-24, a rate much higher than the traditional retail growth rate. Fashion brands, apparel, electronic goods and groceries are seen as the drivers of the Indian E-commerce growth. As an indicator of growing e-commerce, the demand for warehouse space in top eight Indian cities is expected to reach 76.2 million sq. ft. by 2026 from 31.7 million sq. ft. in 2021.

5.3 Special events like festivals and dedicated mega discount sales days by e-commerce players are witnessing huge participation from the buyers and recording billions of worth of trade in such short span.

5.4 Tier 2 & 3 cities of India are recording the highest ever growth for Indian e-commerce and their phase of growth is outmatching the growth in tier 1 cities. Electronic goods and apparels account for 80% of the total goods sold through e-commerce in India. Drive for fashion and brand loyalty are the key factors resulting in massive rush for apparels and electronic goods in India. Online retail was 5% of the total retail in 2019, which is expected to jump to 11% by 2024.

Drivers of India's E-commerce Industry

Internet Penetration

The increasing internet penetration in India has resulted in a surge in e-commerce. Despite that, India's internet penetration still stands at only 42% and therefore, has a huge room for growth. The growing internet penetration is driving the e-commerce activities at an unprecedented phase and looks promising for the years to come.

Smartphones Growth

Smartphone adoption in India has been growing rapidly and India is expected to have 1 billion smartphone users by 2026. The growth in rural India is much higher than in Urban India.

Low-cost Data

The low-cost data in India has enabled the massive growth of smartphones, backed by the internet penetration. The trio of smartphones penetration – internet penetration and the low-cost data are instrumental in driving the e-commerce in India. Incidentally, India is considered to be the place where the mobile internet is the cheapest in the world. One GB of mobile internet data costs around INR 7 in India, which is considerably low.

E-commerce Focused Logistics

India has seen a sharp growth of logistics start-ups, enabling near to last mile delivery in most parts of India. Easy accessibility to the goods purchased through online is a trigger for increasing rural participation in e - commerce.

Brand Loyalty

The strong affiliation towards brands is also making e-commerce dearer to the people. There is a practical limitation to what retail can offer to people under one roof and even if such brick-and-mortar store is available, nationwide expansion of such stores is not economically feasible. The only feasible way of buying a product of particular brand from anywhere in India is to buy them online.

Difference in Price

Indian customer is recognizing the fact that there exists a significant difference between the price of some products sold in online *vs* offline mode. One-time purchases like smart phones, electronic gadgets and home appliances are likely to give a good bargaining power to the buyer, and thus gives e-commerce an edge over the brick-and-mortar stores.

Easy Payment Solutions

Payment was a constraint for rural Indian customer participating in e-commerce. Since “Cash on Delivery” was available only for selected products, this was a crucial factor constraining the growth of e-commerce, mainly in rural markets. The introduction of UPI (Unified Payments Interface), as a convenient instant payment mode through mobile, has changed the payments landscape drastically. The low to no cost transactions, enabled by the hassle-free process have made the UPI, the most successful and preferred payment interface anywhere in the entire world. Indian e-commerce has leveraged the massive spread and success of UPI and penetrated the far-off markets with adoption of UPI. Accordingly, the number of UPI based transactions rose from 0.09 million in July’16 to over 5,862.75 million by June’22.

Social Media Lead Brand Influence

The impact of Social Commerce or S-Commerce is another major factor driving the growth in e-commerce industry. Social media is being effectively used as a major influencer by new age D2C brands, where user experience is communicated in a creative way, with a sharp focus on the target customers. Also, millennials are more likely to go for a brand endorsed by their favourite celebrity actor/actress or sportsperson.

Availability of Civil Services Online

Another major factor driving the e-commerce is that sizeable number of civil services offered by the Government have become online. There was a time, when most of these services were not available online and e-commerce on its own was not able to pull the crowd towards it. With ticket bookings to tax filings to banking turning online, consumers finding e-commerce to be an extension of internet enabled services. Since they see internet as an umbrella under which they can enjoy many services, the tendency to get the maximum out of internet is high and is resulting in the growth of e-commerce.

Private Equity (PE)/ Venture Capital (VC) Lead Aggressive Investments

Despite being widely popular and recording stellar growth, e-commerce in India is struggling to be profitable. Due to insufficient organic cashflows, e-commerce is largely funded by the Private Equity investors and the Venture Capitalists. Data indicates that PE/ VC investors have been pouring money and betting big on Indian e-commerce as they envision exponential growth of these entities in the future.

Young Population

The population of India is young, India is home to world's largest young population and is expected to retain the title for the next few decades to come. Young generation being tech-savvy is more attracted towards the idea of e-commerce than their comparative elder ones.

Ensured Availability of Goods

E-commerce hardly disappoints a buyer, when it comes to the availability of the goods required to be bought. In areas where there are multiple options (such as size of clothes or shoes), the availability of the choice is critical to make a sale. With vast number of choices, where the availability is near to a guarantee, e-commerce has become a reliable source for purchase of goods. When it comes to author specific books and other art specific works, e-commerce is seen as a preferred source of purchase against the traditional retail stores.

Easy Access to Credit

Indian retail industry is closer to the credit facilities than ever before. UPI enabled new-age finance start-ups to grant credit facilities to the retailers based on the cashflow (daily turnover). Such hassle-free, real-time, fool-proof financing is helping the Indian retailer in financing his business.

On the other hand, even the customers are offered credit facilities (majorly by e-commerce players) at zero interest EMIs and other lucrative incentives. Such incentives for purchase of goods on credit was not seen in Indian industry till 2010.

Data Analytics

5.5 Data analytics is the science and process of examining the raw data to draw conclusions about that information. It helps the business to analyse patterns by examining its present and past data which could be structured or unstructured. The retail companies track data at all the stages of buying.

5.6 Some of types of Data analytics in retail industry are as follows:

Descriptive analytics: This is an analysis of past data to understand what has happened and whether there is a progress in the month as compared to past or not.

Diagnostic analytics: This is another type of analysis where the reason of a particular event of trend can be analysed. Basic questions of such as sales are good in a month. Why sales have come down. What is the impact of advertising on the sales, etc. can be answered.

Predictive analytics: This type of analysis helps us to understand the trend and know what could happen in the near future and how much sales can be achieved in this quarter based on the previous quarter trend.

Prescriptive analytics: This type of analysis gives us suggestions on future course of action based on other analysis and trend established in the past and with predictive analysis. This is a structured way of taking informed decision which is data driven.

Data analytics in retail industry is a disruptive technology. By using the Big data, the entity can take decisions on its pricing, supply chain movement and also help to retain the customers. Big data means usage of huge volume of data to help understand the patterns, trends and behavioural trends.

Major Benefits of Data Analytics

5.7 There are various benefits of using the Data Analytics. Some of the major benefits are listed below:

- Forecasting changes in consumer demands:
- Expecting the possible disruptive events:
- Personalisation of the sales experience:
- Revealing an insight on the customer behaviour:

- Pricing the products at optimum level
- Enhancing the loyalty
- Optimising instore operations
- Better inventory management
- Determines location for new outlets.
- Aids strategic decisions.
- Understanding of seasonal products
- Precise customer segmentation
- Buying products at right time at optimum price.

Challenges of Retail Data Analytics

5.8 Though there are many benefits in data analytics, it also has several challenges and the risks arising out of it is also very high. Some of the major challenges of retail data analytics are:

- Complying with the Customer data Protection.
- Customer's privacy
- Identification of customer and understanding their needs
- Difficulty of getting accurate data for analytics
- Budget limitation
- Low quality data.
- Selection of right analytical tool.
- Scaling issues with rapidly increasing data

Chapter 6
Technological Trends in Retail Industry

6.1 The recent phase of growth of Indian retail industry should be credited to the technological advancements. Technology has helped and shaped today's Indian retail industry and has lots of promises in store as well.

Emerging Technologies

6.2 Some of the emerging technology applications which can be seen in the Indian retail industry are as follows:

Use of Artificial Intelligence (AI)

Artificial intelligence (AI) is greatly helpful in predictive analysis, pricing decisions and demand forecasting. AI is useful in analysing customer behaviour like the products they pick up, duration of holding them and returning it back to the shelf. All such details leave a lot of clues on the customer's preferences and helps in placing the products rightly in a store.

Use of Robotics

Robotics are becoming integral part of complex, large warehouse management. Robots are replacing human beings with their efficiency and error free execution.

Store Management Products

There is various technology enabled products like electronic book-keeping software/ applications that are simple, easy and economical to record the day-to-day transactions of even a smallest store. Such products are bringing in much needed financial discipline into the business.

There are debtor ageing software as well which monitor the debt levels of the business and initiate measures to recover the debt after the agreed period, without manual intervention.

There are software to automatically track the inventory levels in the store so that, for no reason, store should be in a fix with demand lying ahead and warehouse lying empty behind. Such smart software's give an alert when goods reach a minimum level and enable the store to initiate re-ordering of the same.

Payment Gateways

Payment gateways are driving the cash led retail towards the cashless path. Debit and Credit cards paved the path for the cashless era, which was cemented and boosted by net banking and UPI, respectively.

Emergence of FinTech

FinTech is also promoting the Indian retail in their own way. From offering financial assistance to the buyers in the form of credit facilities and offering credit facilities to the merchants, they are making money a lesser constraint in shopping. Such assistance may be in the form of dedicated credit cards for shopping, additional incentives for shopping, etc.

Use of QR Codes

QR codes are of very large use in retail industry. They help in solving the complex issue of batching, labelling, and billing. They are also used in payment systems like UPI to facilitate seamless, secure transfer of money.

Use of Voice Recognition Assistants

A significant number of e-commerce users are relying on voice-based search of products; hence e-commerce platforms are adopting the voice recognition assistants to enable voice-based search of products.

Introduction of Drones

Drone technology is evolving day by day with its civilian applications along with the military ones. Introduction of drones in large scale is in discussions, which would radically change the on-door delivery landscape.

Digitized Customer Relationship Management (CRM)

Technology has enabled the retail industry to digitize the crucial CRM function either partially or fully. Bulk mails and SMS services are very much part of customer reach and feedback programs.

Predominant Softwares

6.3 Some examples of the predominant softwares being deployed in the retail industry are listed below:

Point of Sales and Inventory Management Software

A wide range of Point of Sale (POS) applications have been developed on platforms, such as, Windows and UNIX. The availability of local processing power, local data storage, networking, and graphical user interface has made it possible to develop flexible and highly functional POS systems. The most common software are as follows:

(a) ACCESS

(b) Active Retail — Retail Management Software

(c) GAAP Software

(d) Inflow Inventory Management System

(e) Win Till

Retail Management Systems Software

Retail Management Systems Software manages financial reporting, accounting, and operations of retail stores by integrating core business processes such as Point of Sale (POS), Customer Relationship Management (CRM), inventory management, accounting, human resources, marketing, and e-commerce. By implementing a retail management system, organizations can increase sales, decrease costs, and maximise competitive advantage. These applications facilitate the distribution of key data throughout an enterprise and provide the infrastructure for accurate sales reporting and revenue forecasting. The most common retail management software includes the following:

(a) Chain Drive

(b) Epicor Retail

(c) Retail Pro

Apart from the above, there are many Retail Accounting Software which include SAP, Tally ERP 9 and Microsoft Dynamics RMS.

Major Innovations

Over the past few years, there have been many major innovations which include the following:

(a) **Radio Frequency Identification (RFID):** This involves identifying customers by issuing them smart cards embedded with smart chips. These cards would be Radio-frequency Identification (RFID) enabled and would give information regarding the customer like his preferences, shopping behaviour, etc.

(b) **E-Catalogue based Selling:** Limited range of merchandise is available in-store, while the range of a hyper format is made available through self-browse kiosks.

(c) **Mobile Point of Sale (POS):** This would enable the purchase of goods while putting them in a shopping cart. The customer would be spared from the hassle of standing in long queues.

(d) **Buy Online Pick Up In-store (BOPIS):** In this model the customers can select the products and buy them online. Unlike other models where the product gets delivered to the location, here the product will be kept at designated pickup In store and the customer can visit the pickup store and take delivery of goods.

(e) **Digital Signage:** Static signboards have not proved to be beneficial in terms of helping a customer to track a product. Digital signboards integrated with an automated tracking system can make this easier.

(f) **Intelligent Database:** A detailed database of the customer is made available online and helps the retailer to understand a particular customer's buying characteristics.

Chapter 7
Governing Bodies

7.1 This Chapter provides an overview of the various Government Bodies (ministries, departments, etc.) which set the overall legal and regulatory framework applicable to the Retail Industry. A summary of various statutory provisions applicable to the Retail Industry are covered in detail in this Guide.

Ministry of Commerce and Industry, Government of India

7.2 The mandate of the Department of Commerce is formulation, implementation and monitoring of the Foreign Trade Policy (FTP) which provides the basic framework of policy and strategy to be followed for promoting exports and trade. The Trade Policy is periodically reviewed to incorporate changes necessary to take care of emerging economic scenarios both in the domestic and international economy. Besides, the Department is also entrusted with responsibilities relating to multilateral and bilateral commercial relations, Special Economic Zones, state trading, export promotion and trade facilitation, and development and regulation of certain export-oriented industries and commodities.

The Department of Commerce is headed by a Secretary who is assisted by one Officer on Special Duty (OSD), one Special Secretary, one Special Secretary & Financial Advisor, three Additional Secretaries, two Additional Secretary rank officers, thirteen Joint Secretaries and Joint Secretary level Officers and a number of other senior officers.

The Department is functionally organized into the following 10 Divisions:

1. International Trade Policy Divisions
2. Foreign Trade Territorial Division
3. Export Products Division
4. Export Industries Division
5. Export Services Division

6. Economic Division
7. Administration & General Service Division
8. Finance Division
9. Supply Division
10. Logistics Division

Ministry of Finance, Government of India

7.3 Ministry of Finance looks after various financial affairs of India. It is responsible for monitoring various aspects of the Indian economy. The Ministry operates through following departments:

- Department of Economic Affairs
- Department of Expenditure
- Department of Financial Services
- Department of Revenue
- Department of Investment and Public Asset Management
- Department of Public Enterprises

Various statutes, such as, GST Act, 2017, Customs Act, 1962, Income Tax, 1961 as applicable to the retail Industry.

Ministry of Consumer Affairs, Food and Public Distribution, Government of India

7.4 This Ministry operates through two significant departments:

(i) Department of Consumer Affairs

This Department was constituted as a separate Department in June 1997 as it was considered necessary to have a separate Department to give a fillip to the nascent consumer movement in the country.

This Department is responsible for implementation of:

(a) Consumer Protection Act, 2019

(b) Bureau of Indian Standards Act, 2016

(c) Standards of Weights and Measures Act, 1976

(d) The Legal Metrology Act, 2009

(e) The Legal Metrology (Packaged Commodities) Rules, 2011

(f) The Essential Commodities Act, 1955 (10 of 1955) (Supply, Prices and Distribution of Essential Commodities not dealt with specifically by any other Department)

(g) Prevention of Black Marketing and Maintenance of Supply of Essential Commodities Act, 1980 (7 of 1980)

(h) Monitoring of prices and availability of essential commodities

(i) Direct Selling

(j) Training in Legal Metrology

(k) The Emblems and Names (Prevention of Improper Use) Act, 1950

(l) Consumer Cooperatives

(m) Laying down specifications, standards and codes and ensuring quality control of biofuels for end uses

(n) National Test House

(ii) Department of Food and Public Distribution

The primary policy objective of this Department is to ensure food security for the country through timely and efficient procurement and distribution of Food grains. This involves procurement of various food grains, building up and maintenance of food stocks, their storage, movement and delivery to the distributing agencies and monitoring of production, stock and price levels of Food grains.

Ministry of Food Processing Industries, Government of India

7.5 The Ministry of Food Processing Industries is the nodal agency of the Government of India for processed foods and is responsible for developing a strong and vibrant food processing industry. The Ministry aims to:

(a) Enhance farmer's income by better utilization and value addition of agricultural produce

(b) Minimize wastage at all stages in the food processing chain by the development of infrastructure for storage, transportation and processing of Agro-food produce

(c) Introduce modern technology into the food processing industries from both domestic and external sources

(d) Encourage R&D in food processing for product and process development and improved packaging

(e) Provide policy support, and support for creation of Infrastructure, capacity expansion/ upgradation and other supportive measures form the growth of this Industries

(f) Promote export of processed food products.

In the era of economic liberalization, where the private, public and co-operative Industries are to play their rightful role in development of food processing industry, the Ministry acts as a catalyst for attracting greater investment into this industry, guiding and helping the industry in a proper direction, encouraging exports and creating a conducive environment for the healthy growth of the food processing industry.

Important Regulations Applicable to Retail Industry

Foreign Direct Investment Policy

7.6 The Foreign Direct Investment (FDI) Policy is formulated by the Department of Industrial Policy and Promotion under the Ministry of Commerce and Industry. The FDI Policy governs foreign investments in equity of entities established in India. There are different limits allowed for FDI in India for investment in retail industry. The Government has taken steps to protect the smaller retailers and prevented the entry of large global retailers into the Indian markets.

Information Technology Act, 2000

7.7 The main objective of this Act is to provide legal recognition for transactions carried out by means of electronic data interchange and other means of electronic communication, commonly referred to as “electronic commerce (E-commerce)”, which involves the use of alternatives to paperbased methods of communication and storage of information, to facilitate electronic filing of documents with the government agencies. This Act is of significance in the current context since the operations of Retail Industry are significantly carried out through the electronic media.

Other Applicable Indian Acts to the Industry

7.8 Standard on Internal Audit (SIA) 150, "Compliance with Laws and Regulations in an Internal Audit" issued by the ICAI, requires that when planning and performing audit procedures and in evaluating and reporting the results thereof, the internal auditor should recognize that non-compliance by the entity with relation to laws and regulations may materially affect the financial statements. However, the internal auditor is not responsible for non-compliance and cannot be expected to detect non-compliance with all laws and regulations as this is primarily the responsibility of management.

7.9 Thus, in addition to the various Acts, Rules, Bye Laws, Regulations, Circulars, etc., the internal auditor may verify other applicable regulations which include the following:

(a) Governance Laws

- The Companies Act, 2013
- Partnership Act, 1932/ Limited Liability Partnership Act, 2008
- Shops and Establishments Act of respective state
- The Sale of Goods Act, 1930
- The Negotiable Instruments Act, 1881

(b) Economic Laws

- The Income Tax Act, 1961
- The Customs Act, 1962
- The GST Act, 2017
- The Agricultural Produce Cess Act, 1940

(c) Labour Laws

- Employees' Provident Fund Scheme, 1952
- Employee State Insurance Act, 1948

- Payment of Gratuity Act, 1972
- Payment of Bonus Act, 1965
- Professional Tax enacted by the respective states
- The Child Labour (Prohibition and Regulation) Act, 1986
- The Minimum Wages Act, 1948
- The Weekly Holidays Act, 1942

(d) Consumer Protection

- Consumer Protection Act, 2019
- The Essential Commodities Act, 1955
- Prevention of Black Marketing and Maintenance of Supply of Essential Commodities Act, 1980
- Emblems and Names (Prevention of Improper Use) Act, 1950
- The Standards of Weights and Measures Act, 1976/ The Legal Metrology Act, 2009

(e) Intellectual Property Rights

- Trademarks Act, 1999
- The Patents Act, 1970
- The Copyright Act, 1957

(f) Other Laws as applicable to the industry

- The Indian Contract Act, 1872
- Foreign Contribution Regulation Act, 2010
- Securities and Exchange Board of India Act, 1992
- Securities Contracts Regulation Act, 1956
- The Land Acquisition Act, 1894
- The Specific Relief Act, 1963
- Sexual Harassment of Women at Workplace (Prevention, Prohibition, and Redressal) Act, 2013

7.10 Apart from the abovementioned laws, the internal auditor may be aware of the local legislations under which the entity/ undertaking operates e.g., Karnataka Shops and Commercial Establishments Act, 1961, prescribes the daily and weekly working hours, extra wages for overtime work, holidays for all entities established in the State of Karnataka.

The internal auditor is expected to include in the scope of his work the compliance of respective state legislations as part of his internal audit procedures. The internal auditor is also expected to be aware of various circulars issued by the RBI related to foreign currency transactions.

Chapter 8

Statutory Laws Applicable to Retail Industry

8.1 This chapter provides a broad overview of various laws and compliances applicable to entities operating in this industry. The internal auditor may refer to these laws and regulations and study the applicable cases and judgements by competent authorities.

Considering that these laws and regulations undergo frequent amendments/ change, the internal auditor may update himself with the amendments, pronouncements, new regulations from time to time to ensure effective performance of internal audit.

Goods and Services Tax Act, 2017

8.2 Considering that retail industries are involved in the distribution and sale of products in different states the GST Act 2017 (This includes the CGST Act 2017, IGST Act 2017, UTGST Act, 2017 and the SGST Acts of all the respective States) would become applicable on sales made by the entity.

Input Tax Credit

8.3 The State VAT (Value Added Taxes), CST (Central Sales Tax) and Service taxes were creating a cascading effect on taxes which in turn were responsible for higher price of the products as the Entity could not claim the Input tax credit on services availed by them for the sale and furtherance of business. The Entity were also not able to claim the credit of CST and Excise duty to offset the liability arising on the sale of product. The Government introduced the Goods and Service Tax to counter these issues and also to subsume various taxes to reduce the compliance burden on the Entities.

With GST the entities can claim Input tax credit on all the eligible purchases of Goods and Services.

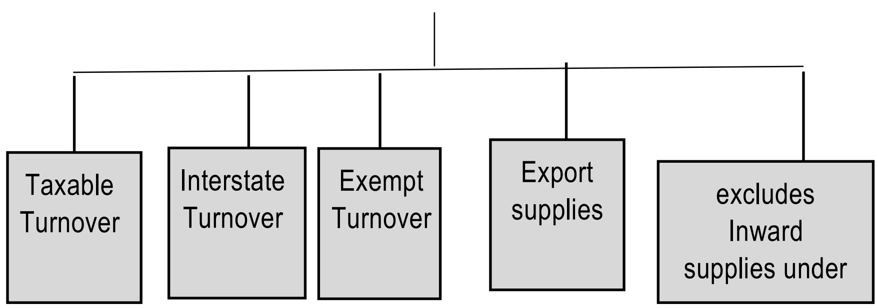
Registrations

8.4 Every supplier of goods is required to obtain registration in the State/UT from where he makes the taxable supply if his aggregate turnover exceeds the threshold limit during a FY. Different threshold limits for supply of goods have been prescribed for various States and Union Territories. The threshold limit prescribed for various States/UTs are as follows:

States with the Threshold Limit of Rs 10 Lakhs	States with the Threshold Limit of Rs 20 lakhs	States with the Threshold Limit of Rs 40 Lakhs
• Manipur • Mizoram • Nagaland • Tripura	• Arunachal Pradesh • Meghalaya • Sikkim • Uttarakhand • Puducherry • Telangana	• Jammu & Kashmir • Assam • Himachal Pradesh • All other States

The Threshold Limit is calculated on the aggregate turnover.

For GST purposes, the Aggregate Turnover includes the following:



Trademark Act, 1999

8.5 Trademark is a type of intellectual property. A trademark is a name, word, or symbol that distinguishes the goods of one business from those of others. Marketing goods or services becomes easier with a trademark because product recognition is assured and made more manageable. The owner has the right to prevent a competitor from using his trademark or sign.

8.6 The objective of the Trademarks Act, 1999 is to register trademarks applied for in the country and to provide for better protection of trademark for goods and services and also to prevent fraudulent use of the mark. The objective of Trademark Act is to provide legal protection to trademark owners/ users and provide legal remedies for the enforcement of trademark rights and for violations/ infringements thereunder.

The term of registration of trademark is ten years, subject to renewal thereafter Registration of trademarks which are imitations of well-known trademarks not permitted.

Shops and Establishment Act, 1948

8.7 The purpose of this Act is to regulate conditions of work and employment in shops, commercial establishments, residential hotels, restaurants, amusement parks, theatres, other places of public entertainment and other establishments. This Act regulates establishments by providing for uniform benefits to the employees, employment of children, young persons and women, maternity leaves, other leaves and payment of wages, health and safety, etc.

The applicability of the Act extends to following:

1. All the Local Areas covered under the Acts of respective State

2. Commercial establishment means a premise where any trade, business, profession or any work is undertaken, which may include society, charitable or other trust, journalistic and printing establishments, contractors and auditors establishments, educational institutes, premises where the business of banking, insurance stocks, and shares, brokerage is undertaken, restaurants and eating houses, residential hotels, clubs, theatres and other places of public amusement or entertainment.

3. Employee means a person wholly or principally employed in or in connection with, any establishment whether working on permanent, periodical, contract or piece-rate wages, or on commission basis, even though he receives no reward for his labour and includes an apprentice, any clerical or other member of the staff of a factory or industrial establishment which falls outside the scope of the Factories Act, 1948.

Considering the fact that this Act is governed and implemented by the r State Governments, the returns, rules, forms, regulations and procedures vary in accordance with the State enactments.

Legal Metrology Act, 2009

8.8 This Act has been enacted to establish and enforce standards of weights and measures to regulate trade and commerce in weights, measures and other goods which are sold or distributed by weight, measure, or number and for matters connected therewith or incidental thereto.

This act applies to whole of India and, basically, provides different guidelines regarding the following:

- Establishment of Standards as related to Weights, Measures or Numerals.
- Physical representation of standard units.
- Standards of weights, measures and numerals.
- Custody and verification of standard equipment.
- Inter-state trade or commerce in weight, measure or other goods.
- Import and export of weights and measures.
- Verification and Stamping of weight or measure.
- Regulation of the Act.
- Penal Provisions.

Competition Act, 2002

8.9 The Monopolies and Restrictive Trade Practices Act (MRTP), 1969 has metamorphosed into the new law, i.e., Competition Act, 2002. The new law has repealed as the extant MRTP Act. The Act was subsequently amended by the Competition (Amendment) Act, 2007

The Competition Commission of India has been established to enforce the law under this Act. The Commission has the following divisions:

a. The Secretariat

b. Antitrust Division

c. Combination Division

d. Advocacy Division

e. Economics Division

f. Legal Division

g. International Cooperation Division

h. Capacity Building Division

i. Corporate Services Division

Some of salient features of the Competition Act applicable to the Retail Industry are discussed below:

The Secretariat

8.10 The Secretariat is the Division within the Commission responsible for handling administrative matters and carrying out the day-to-day affairs of the Commission. The responsibility of communicating with parties in proceedings before the Commission or corresponding with other regulatory bodies, inter alia, is discharged by the Secretariat.

Antitrust Division

8.11 The Antitrust Division (ATD) assists the Commission in the discharge of its enforcement mandates relating to the prohibition of anti-competitive agreements and abuse of dominant position.

(a) Anti-Competitive Agreement

An arrangement, understanding or concerted action entered into between parties which can be anti-competitive Horizontal Agreement or Anti-competitive Vertical Agreement.

(b) Horizontal Agreements are those agreements where enterprises are engaged in identical or similar trade of goods or services. When enterprises collude amongst each other to distort competition in the markets, such agreement is presumed to have an appreciable adverse effect on competition and thus, shall be void. The following falls under the category:

- agreement to fix price.
- agreement to limit production and/or supply.
- agreement to allocate markets.
- bid rigging or collusive bidding.

However, such presumption is rebuttable.

(c) Vertical Agreements are those agreements which are entered into by enterprises at different stages or levels of production, distribution, supply, storage etc. Such vertical restrains includes the following:

- tie-in arrangement.
- exclusive supply/distribution arrangement.
- refusal to deal and
- resale price maintenance.

Imposition of reasonable conditions as may be necessary for protection of intellectual Property Right (IPR) which are listed under Section 3(5) is, generally, not to be treated as violative of the Act.

(d) Abuse of Dominant Position

Dominant Position has been appropriately defined in the Act in terms of the position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to (i) operate independently of competitive forces prevailing in the relevant market¡ or (ii) affect its competitors or consumers or the relevant market, in its favour.

The Act prevents an enterprise from abusing its dominant position.

Dominant position is said to be abused when:

1 Imposing unfair condition or price, including predatory pricing.

2 Limiting production/market or technical or scientific development

3 Denying market access and

4 Making conclusion of contracts subject to conditions, having no nexus with such contracts and

5 Using dominant position in one relevant market to gain advantages in another relevant market.

Combination Division

8.12 The Combination Division facilitates the Commission in its role as an ex-ante regulator of acquisitions, mergers and amalgamations.

Any person or enterprise, which proposes to enter into a combination, is required to give notice to the Commission under Section 6(2) of the Act any time prior to consummation of the same.

Advocacy Division

8.13 Advocacy division is entrusted with the following functions:

- Creating awareness: Creating awareness about the Commission's activities through publication and dissemination of advocacy material.
- Training Programs: Conducting training programs on competition Law.
- Academic Events: Sponsoring Moot court events/seminars/lectures on competition law at premier academic Institutions.
- Conferences: Regularly scheduling roadshows and conferences to engage with stakeholders.

The other divisions also help the Commission to smoothly regulate the provisions of the Competition Act.

Chapter 9

Internal Audit

9.1 Considering the nature of Retail Industry and the pace at which the industry has grown over the past decade, need for ensuring proper controls need not be over emphasized. With increasing number of frauds in the software field and considering the vulnerability of the industry to modification of data, internal audit becomes significant. Internal audit also helps in verifying the controls in place within the entity with regard to sufficiency and effectiveness in the light of overall business. Internal audit also helps in assessing the risks faced by the entity and provide a method for management of the same. Internal controls and risk management are extremely important activities in an entity operating in the Retail Industry.

9.2 Internal Audit provides an effective tool to ease out all complexities, ensures that systems and processes are adequate to support the growth and are adapted to the changes in various regulations, thereby ensuring sustained growth and development.

As defined in Framework Governing Internal Audits, "Internal Audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organizational objectives."

Brief explanation of the key terms used above is as follows:

i) <u>Independence:</u> Internal audit shall be an independent function, achieved through the position, organization structure and reporting of the internal auditor.

   At times, in addition to providing assurance, the internal auditor may adopt an advisory role to help an organization achieve its objectives, provided this does not compromise the independence of the internal auditor.

ii) <u>Internal controls and risk management</u> are integral parts of management function and business operations. An internal auditor is expected to evaluate the design and operating effectiveness of internal controls and risk management processes (including reporting processes) as designed and implemented by the management.

iii) Governance is a set of relationships between the company and its various stakeholders and provides the structure through which the company's objectives are achieved. It includes compliance with internal policies and procedures and laws and regulation.

iv) Organizational objectives incorporate the interests of all stakeholders and include the short- and medium-term goals that an organization seeks to accomplish.

9.3 This definition forms the underlying foundation of all the Standards on Internal Audit (SIA) issued by the Board. Internal audit activities shall be conducted in line with the Definition of Internal Audit.

Basic Principles of Internal Audit

9.4 The Basic Principles as mentioned in Basic Principles of Internal Audit as issued by the Internal Audit Standards Board, ICAI are a set of core principles fundamental to the function and activity of internal audit. The Basic Principles are critical to achieve the desired objectives as set out in the Definition of the Internal Audit, and therefore, apply to all internal audits.

Basic Principles can be summarized as follows:

1. Independence
2. Integrity and Objectivity
3. Due Professional Care
4. Confidentiality
5. Skills and Competence
6. Risk Based Audit
7. System and Process Focus
8. Participation in Decision Making
9. Sensitive to Multiple Stakeholder Interests
10. Quality and Continuous Improvement

Key Concepts

9.5 As per the Framework Governing the Internal Audit as issued by ICAI, there are certain concepts which form an integral part of Internal Audit activity and therefore apply to most internal audit. Key Concepts are in the nature of:

- Internal Controls
- Risk Management
- Governance Processes
- Compliance with Laws and regulations
- Nature of Assurance

Standards on Internal Audit (SIAs)

9.6 Standards on Internal Audit are classified and re-numbered by ICAI in a series format as follows:

(i) 100 Series: Standards on Key Concepts

- SIA 110, Nature of Assurance
- SIA 120, Internal Controls
- SIA 130, Risk Management
- SIA 140, Governance
- SIA 150, Compliance with Laws and Regulations

(ii) 200 Series: Standards on Internal Audit Management

- SIA 210, Managing the Internal Audit Function
- SIA 220, Conducting Overall Internal Audit Planning
- SIA 230, Objectives of Internal Audit
- SIA 240, Using the Work of an Expert
- SIA 250, Communication with Those Charged with Governance

(iii) 300–400 Series: Standards on the Conduct of Audit Assignments

- SIA 310, Planning the Internal Audit Assignment

- SIA 320, Internal Audit Evidence
- SIA 330, Internal Audit Documentation
- SIA 350, Review and Supervision of Audit Assignments
- SIA 360, Communication with Management
- SIA 370, Reporting Results
- SIA 390, Monitoring and Reporting of Prior Audit Issues

(iv) 500 Series: Standards on Specialized Areas

- SIA 520, Internal Auditing in an Information Technology Environment
- SIA 530, Third Party Service Provider

(v) 600 Series: Standard on Quality Control

(vi) 700 Series: Other/ Miscellaneous Matters

(vii) Standards issued up to July 1 2013

- SIA 5, Sampling
- SIA 6, Analytical Procedures
- SIA 7, Quality Assurance in Internal Audit
- SIA 11, Consideration of Fraud in an Internal Audit
- SIA 18, Related Parties

9.7 Standards on Internal Audit (SIAs) are important for carrying out an internal audit of Retail Industry. The internal auditor and the audit team are expected to be updated on the latest pronouncements issued by the Institute in order to conduct an effective internal audit.

Objective of Internal Audit

9.8 The purpose of defining objectives of Internal Audit as mentioned in SIA 230, Objective of Internal Audit, issued by ICAI are to :

(a) Document the formation and functioning of the Internal Audit activity and the terms of the out-sourced internal audit arrangement;

(b) Provide clarity to the Internal Auditor and its stakeholders regarding the nature of the internal audit set-up and its working;

(c) Ensure linkage between what is expected of the Internal Auditor and how those expectation can be met within the Framework governing Internal Audits; and

(d) Promote better understanding on key operational areas, such as, accountability and authority, roles and responsibility, and such other functional matters.

Once the objectives of internal audit are defined, they help to establish the operating parameters within the overall internal audit agenda. These objectives and operating parameters are formally recorded in one of these two documents:

(a) An Internal Audit Charter, primarily designed for the in-house team of internal auditors and its stakeholders; and

(b) An Engagement Letter is a formal agreement signed with the out-sourced internal audit service provider.

Internal Audit Planning

9.9 As per SIA 220, Conducting Overall Internal Audit Planning as issued by ICAI:

"Knowledge of the entity, its business and operating environment shall be undertaken to determine the types of audit assignment which could be conducted. As part of the planning process, a discussion with management and other stakeholders shall be undertaken to understand the intricacies of each auditable unit subject to audit.

The Internal Auditor shall gather all the information required to fully understand the entity's business environment, the risks it faces and its operational challenges.

The extent of information required shall be sufficient to enable the Internal Auditor to identify matters which have a significant effect on the organisation's financials. Hence, there is a need to connect the financial aspects of the business with other business elements, such as industry dynamics, company's business model, operational intricacies, legal and regulatory environment, and the system and processes in place to run its operations.

Audit Planning, Materiality and Sampling

9.10 SIA 220, Conducting Overall Internal Audit Planning, as issued by the ICAI involves the following key elements:

(a) It is undertaken prior to the beginning of the plan period (generally, the financial year).

(b) It is comprehensive in nature covering the entire entity.

(c) It is directional in nature and considers all the Auditable Units (i.e., locations, functions, business units and legal entities including third parties, where relevant), along with the periodicity of the assignments to be undertaken during the plan period.

(d) It is normally prepared by the Chief Internal Auditor (or the Engagement Partner, where an external service provider is appointed to conduct internal audits).

(e) The outcome of this exercise is an "Overall Internal Audit Plan" (or the "Audit Engagement Plan," if outsourced).

9.11 SIA 220 "Conducting Overall Internal Audit Planning" and SIA 310 "Planning the Internal Audit Assignment" as issued by ICAI provides guidance in respect of planning an internal audit for the whole entity and particular part of entity respectively. The Internal Auditor may consider referring these standards before commencement of the Internal Audit

9.12 While designing an audit sample, the internal auditor may consider the specific audit objectives, materiality, population from which the internal auditor wishes to select the sample, area of audit significance and the sample size. Standard on Internal Audit (SIA) 5, "Sampling" provides that when using either statistical or non-statistical sampling methods, the internal auditor may consider designing and select an audit sample, perform audit procedures thereon, and evaluate sample results so as to provide sufficient and appropriate audit evidence to meet the objective of internal audit engagement unless otherwise specified by the client.

Internal Control

9.13 SIA 120 "Internal Controls" states that Internal Controls are systemic and procedural steps adopted by an organization to mitigate risks, primarily in the areas of financial accounting and reporting, operational processing and compliance with laws and regulations.

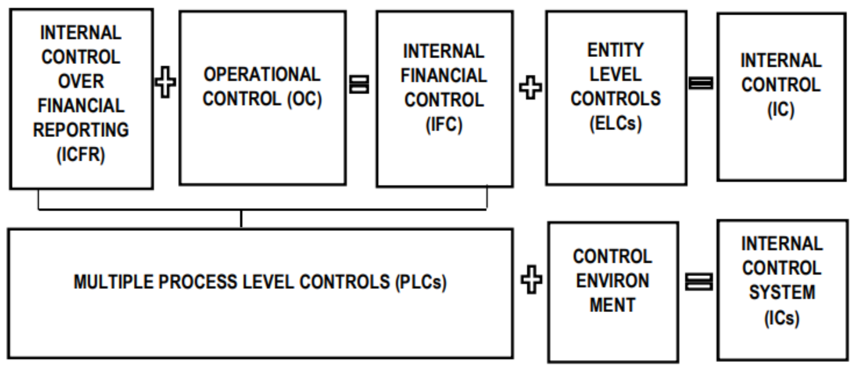
9.14 Internal Controls (ICs) are essentially risk mitigation steps taken to strengthen the organization's systems and processes, as well as help to prevent and detect errors and irregularities.

9.15 The actual steps of mitigation (e.g., review, approval, physical count, segregation of duty, etc.) are referred to as "Control Activities". When ICs mitigate the risk of financial exposure, they are also referred to as Internal Financial Controls (IFCs) and when they mitigate operational risks, they are also referred to as Operational Controls (OCs). ICs generally operate with human intervention (Manual Controls), but in an automated environment, computer controls are deployed to secure the systems and called IT General Controls (e.g., access controls) or check transaction processing at an application level and called Application Controls (e.g., sequential numbering of invoices, etc.).

9.16 The term "Internal Controls System" is an all-encompassing term generally used to refer all types of controls put together, covering ELCs, IFCs and OCs. The Control Environment (ELCs) includes the overall culture, attitude, awareness and actions of Board of Directors and management regarding the internal controls and their importance to the organization. The control environment has an influence on the effectiveness of the overall Internal Control System since it provides the basis for establishing and operating process level controls (such as IFC and OCs) in the organization.

9.17 The internal auditor may obtain an understanding of the significant processes and internal control systems sufficient to plan the internal audit engagement and develop an effective audit approach. The internal auditor should use professional judgment to assess and evaluate the maturity of the entity´s internal control. The auditor should obtain an understanding of the control environment sufficient to assess management´s attitudes, awareness and actions regarding internal controls and their importance in the entity

9.18 Below is a pictorial depiction of Internal control and Internal control systems:



Overview of Compliance

9.19 Compliance means ensuring conformity and adherence to Acts, Rules, Regulations, Directives and Circulars.

9.20 Standard on Internal Audit (SIA) 150 "Compliance with Laws and Regulations" issued by Institute of Chartered Accounts of India requires that internal auditor to provide independent assurance to management and to those charged with governance on the compliance framework. The nature and extent of internal audit procedures to be applied is dependent on the framework in place and maturity of the processes.

9.21 In case the management has implemented the formal compliance framework, the internal auditor shall plan and perform internal audit procedures to evaluate the design, implementation and operating effectiveness of such framework.

9.22 In case there is no formal compliance framework, the internal auditor shall design and conduct the audit procedures with a view to highlight any exposures arising from weak or absent compliance activities and processes, internal auditor shall make recommendations to implement and strengthen those processes and thereby, improve compliance.

9.23 Where the independent assurance requires the issuance of an audit opinion over the design, implementation and operating effectiveness over compliance, this shall be undertaken in line with the requirements of SIA 110, Nature of Assurance.

Overview of Governance

9.24 Governance is an important aspect of internal audit. The definition of Internal audit elaborates on the term Governance by clarifying how this is a critical operation. Governance is a key concept and integral part of internal audit. The definition of 'Internal audit' elaborates on the term Governance by clarifying how this is a critical operation of the company and fulfilling expectations of its various stakeholders.

9.25 Standard on Internal Audit (SIA) 140, Governance as issued by Institute of Chartered Accountants of India with the objective to:

(a) Provide a common terminology on governance to prevent ambiguity or confusion on the subject matter.

(b) Explain the responsibilities of the Board of Directors and Management, Audit Committee with regard to governance, as mandated by law and regulations; and

(c) Specify responsibilities of the Internal Auditor, especially, when providing independent assurance on the governance framework.

9.26 SIA 140 defines Governance as a set of relationships between the company and its various stakeholders (both internal and external) and provides the structure through which the company's objectives are achieved. The relationship and structure help to guide the behaviour of individuals and groups in the right direction. The following are well accepted underpinnings of good governance:

(a) Integrity and Accountability

(b) Trust and Equity

(c) Transparency and Justice

Third Party Service Providers

9.27 Some of the crucial business operations, processes and information of a retail entity could be outsourced to Third Party Service Providers (TPSP) such as supply chain management, delivery operations, getting sales order through web aggregator and etc. Many more operations or processes of the retail entity can be outsourced to TPSP. The TPSP who is doing such operations would collect store and process, transmit, maintain and dispose information concerning the retail entity, it presents unique challenges of risk management.

9.28 ICAI has issued a Standard on Internal Audit (SIA) 530, Third Party Service Providers with primary objective of prescribing the key requirements for providing an independent assurance over business operations at TPSP. The key requirements are in the nature of:

(a) Assessment of risks associated with outsourcing, especially, in securing and protecting its information;

(b) Evaluation of adequacy of controls to address risks of errors and irregularities with respect to financial, operational processing and reporting;

(c) Cost and operational efficiencies in the collection, storage, processing and continuous availability of User Entities' information; and

(d) Ensuring compliance with IT policies and standards, as well as contractual, statutory and regulatory requirements.

9.29 The requirement of Internal Auditor is to study and evaluate the scope of TPSP's services, governance and oversight process in place to outsource and manage risks of deploying TPSPs, especially, risks arising from direct access and control over critical information of the Retail Entity.

9.30 The Internal Auditor shall review both, the Pre-engagement and Post engagement due diligence undertaken by the Retail Entity, including an assessment of the control environment at the TPSP. This review shall include a control assessment (especially an evaluation of controls retained, in-house and outsourced), so that a scope and audit plan can be defined to conduct a comprehensive audit procedure necessary at both, the User Entity and the TPSP.

8.31 The Internal Auditor who is evaluating the retail entity with such TPSP may refer the SIA 530, Third Party Service Provider to complete the other audit procedures as specified in the SIA.

Internal Auditing in an Information Technology Environment

9.32 Most of the retail entities operate in Information Technology Environment (ITE) where information is captured, stored and processed through automated means and is managed through various policies and procedures to support business operations and objectives. The two main components of ITE include:

(a) IT infrastructure (including, but not limited to, hardware, IT architecture, operating systems, communication network storage systems); and

(b) Application software and data (including, but not limited to, Interface, Enterprise Resource Planning, Customer Relationship Management, Dealer and Channel Management System, E-commerce applications, Robotic Process Automation).

9.33 For example, a retail pharmacy store will maintain its inventory in the computer which will have an operating system. Further for billing, the pharmacy will use an accounting software. In this case, the pharmacy is using both the components as specified above. Similarly, most of the retail entities will operate in the ITE. When the entity is operating in an ITE, it will have a new set of risks and issues.

9.34 The ICAI has issues Standard on Internal Audit (SIA) 520, Internal Auditing in an Information Technology Environment with the objective of dealing the risk by defining the essential requirements for auditing in an IT environment so that:

(a) Audits are undertaken after due study and understanding of the Organisation's ITE, which covers the IT strategy, policies, operating procedures, the risks and governance mechanism in place to manage the ITE.

(b) An independent risk assessment, along with an evaluation of the controls required to mitigate those risks, forms the basis of the audit procedures; and

(c) The audit procedures, as designed and executed, are sufficient to allow an independent assurance, especially in the areas of (indicative list):

    (i) Security and reliability of information.

    (ii) Efficiency and effectiveness of information processing.

    (iii) Analysis and reporting of the information.

(iv) Continuous access and availability of the information.

(v) Compliance of the IT related laws and regulations.

9.35 This Standard sets out requirements of internal auditor to gain an understanding of the business operations and the corresponding IT Environment. This information shall assist the auditor to perform an independent IT risk assessment and identify the nature of controls required to mitigate those risks, before commencing any IT audit activities.

9.36 Also, the SIA requires the Internal auditor to have or acquire the requisite qualifications, skill sets and experience to perform IT audits. Specialized skills in the areas of IT governance, Application Controls, Infrastructure reviews, IT Cyber Security and Data Privacy regulation are essential to perform audit.

9.37 The SIA 520 sets the illustrative audit areas to be considered as part of the internal audit scope while conducting an internal audit in an IT environment. Also the SIA sets the illustrative IT controls to be reviewed during an internal audit in an IT environment.

9.38 The Internal auditor doing the audit of retail entity operating in the ITE environment shall study SIA 520, Internal Auditing in an Information Technology Environment in detail and perform other audit procedures and mitigate the risks involved.

Chapter 10

Major Areas of Internal Audit Significance

10.1 Internal audit procedures that apply to any industry also apply to an entity operating in the retail industry. In this Technical Guide, internal auditing procedures pertaining to Retail Industry have been specified. These audit procedures are illustrative in nature which can be performed in addition to the regular internal audit procedures performed by an internal auditor.

Invoicing

10.2 The invoicing process varies significantly and is directly based on the size of the retail store. To elaborate, it varies from a systematic billing process and checking process in the case of large stores to non-systematic cash-based billing in the smaller stores. The billing and invoicing process in the retail industry needs to be simple, systematic, fast, secure and error-free to ensure avoiding unnecessary waiting time for billing and plays a major role in the success of the organization.

10.3 It might be pertinent to note that potential for omitted/ manipulating income is greater in e-retailing, due to the borderless and paperless feature of the organization. With online retail, the reconciliation of shipment costs with both cost of goods sold, and income is another quality audit technique.

10.4 In general, cheques are received from customers whom the management is familiar with or from customers who procure large quantities of products. The management might also offer "on account" payment from such customers.

10.5 A few common types of billing include:

(i) **Cash Pay Outs:** As discussed above, the accounting for cash is a primary focus for the internal auditor. Considering that cash is paid for a significant part of the billing by the entity, maintenance of proper records is a critical part of the overall organization management. It is equally important to ensure that there is sufficient and appropriate fixing of responsibility in the case of management of cash.

(ii) **Z Tapes:** Most simple cash registers contain a "Z" key which can only be operated by the manager, owner, or a key employee. The Z key totals the entire history of activity on the cash register for a period, providing a summary total for (sales) taxable sales, non (sales) taxable sales, credit card sales, credit card tips, cash sales, lottery sales, coupons and discounts, etc. Each day's Z tape is used to record the daily sales in the sale journal. These tapes must be retained by the owner and made available for the examination.

(iii) **Point of Sale (POS):** This is a computerized accounting system that records sales along with related items, such as employee's time and tips received, or reductions to inventory and calculations of profit on each sale. These machines can produce financial statements, periodic statements of profit and loss, profits per item, payroll checks, etc.

10.6 Transfer of property of products can be through the following methods:

(i) **Counter service—**Where goods are out of reach of buyers and must be obtained from the seller. This type of retail is common for small expensive items (like jewellery) and controlled items like medicine and liquor.

(ii) **Delivery (Commerce)—**Where goods are shipped directly to consumer's homes or workplaces. Ordering on telephone is now common, either from a catalogue, newspaper, television advertisement or a local restaurant menu, providing for immediate service.

(iii) **Door-to-Door Sales—**Where the salesperson sometimes travels with the goods for sale.

(iv) **Self-service—**Where goods may be handled and examined prior to purchase.

10.7 Retailers use different methods to collect and account for cash. In some stores, only the owner collects cash from customers. In larger stores, key employees collect and account for cash. In more sophisticated systems, a Point of Sale (POS) cash register may record sales and decrease inventory at the same time.

10.8 Considering the nature of the industry, frequent job rotation would enable the entity to prevent errors and de-motivate the employee to do any fraudulent activity.

10.9 The accounting policy for recognition of revenue too would be an integral part of the internal audit procedures to be performed by the internal auditor.

10.10 If the internal auditor suspects the billing system/ process followed by the management, he can take the help of a systems expert to ensure that there are no manipulations in the system. SIA 240, Using the Work of an Expert as issued by the ICAI provide guidance in this matter.

10.11 The internal auditor may verify all these clauses as a part of performance of internal audit procedures. The internal auditor may perform following analytical procedures:

(a) **Same-store Sales**

Same-store sales is a business term which refers to the differential in revenue generated by a retail chain's existing outlets over a certain period (often a fiscal quarter or a particular shopping season), compared to an identical period in the past, usually in the previous year.

(b) **Initial Mark-up Percentage**

The initial mark-up is the average mark-up required on all products to cover the cost of all items, incidental expenses, and to obtain a reasonable profit. The initial mark-up is expressed as a percentage, and this helps the entity to estimate the cost of the product for determination of the sale price.

(c) **Sales Mix Ratio**

The term "Sales Mix Ratio" refers to the relative proportion in which an entity's products are sold. The concept is to achieve the combination that will yield the greatest number of profits. Most companies have many products, and often these products are not equally profitable. Hence, profits will depend to some extent on the company's sales mix. Profits will be greater if high margin rather than low margin items make up a relatively large proportion of total sales. Hence, the entity must ensure that it pushes the right products through visual merchandising. The internal auditor might comment on the efficiency of the entity in maximizing profits through an effective sales mix.

(d) **Operational Margins Period Wise**

The internal auditor may compute the operational margins such as gross profit margin, periodically and ascertain the variance between the different periods compared with. For e.g., the internal auditor compares the gross margin for the month of February with that of January or February of the preceding year, he might observe huge variances in the margins. The internal auditor may seek explanations from the management for such significant fluctuations and understand the reason for such fluctuation. This might provide an insight on the effectiveness of the management in operations apart from ensuring that there has not been any fraud during the period.

(e) **Significant Fluctuations in Revenue**

Significant fluctuations in gross revenue over a period time needs to be explained in the overall light of the business scenario, taking into consideration seasonal changes and promotional offers. This will provide a deeper insight into the risks faced by the internal auditor and also an insight to the client's business apart from identifying irregularities. The internal auditor might also compare the revenue over a period of time to verify the change in turnover and seek explanations as appropriate.

(f) **Revenue per Square Foot**

One of the methods to evaluate and compare the department wise performance would be to compare the revenue per square foot/ square meter, whereby a common metric is formulated to compare the performance of the department and justify the cost incurred towards the store. Efficiency of usage of space can be understood by the internal auditor by this estimate.

The internal auditor might make a suitable analysis by estimating the revenue per square foot pertaining to that particular department and justify the space provided to the same. This enables proper allocation of office space to enable profit maximization and enhance customer satisfaction.

(g) **Actual Profitability *vs* Budgeted Profit**

In general, every store is given daily, weekly, and monthly turnover targets. These budgets/ targets are determined based on following factors:

(i) Turnover achieved on the same day during the previous period.

(ii) Location of the store.

(iii) Size, availability of products.

(iv) Promotional offers and discount sales.

The effectiveness of the budgets can be estimated based on its comparison with the actual sales. The internal auditor can assess the efficiency of budget making and verify whether the entity's procedures with regards to target setting are realistic. The internal auditor might suggest any changes required to be made to ensure proper function of the existing system.

(h) **Ratio on the Modes of Revenue**

The internal auditor might analyse and compare the ratio of revenue received through following:

(i) Credit Card Payments:

(ii) Cash Billing:

(iii) Credit Billing:

(iv) Passes/ Coupons: and

(v) Discount Vouchers.

This would provide an insight on the collection system. It also enables the auditor to understand the cash flow mechanism and strengthen controls suitably.

(i) **Average Revenue per Bill**

This ratio can be ascertained by estimating the total revenue and total bills raised in a particular period. This ratio is the total amount billed divided by the number of bills raised and analysed store-wise over a period of time. This would provide an insight whether the customer's confidence, requirement of number of billing counters and proper queuing system.

(i) **Percentage of Errors and Rejections**

The internal auditor can verify the quality of billing through measurement of total errors and rejections as against the total volume of billing made. This would help the internal auditor to assess risk of loss of revenue due to incorrect billing, entity's training in billing and efficiency of the billing staff.

(j) **Revenue from Categories of Goods**

The internal auditor may estimate the total revenue received from products sold at discounts and products sold at MRP. It might provide an insight of effectiveness of discount given to a particular product vis-a-vis in increasing the customers flocking to the store and incidentally, the turnover.

10.12 These ratios may be prepared and compared over a period of time. If these ratios are inconsistent over that period, proper explanations need to be obtained, thereby helping the internal auditor in assessing effectiveness, sufficiency, appropriateness of controls and also to highlight the risk environment the business is under. The Internal Auditor may review whether the entity monitors such ratios on a regular basis or not.

Model checklist related to the billing process is given in **Appendix 2**.

Cash Management Policies

10.13 Efficient cash management processes are pre-requisites to execute payments, collect receivables and manage liquidity. Managing the channels of collections, payments and accounting information efficiently becomes imperative with growth in business transaction volumes. This includes enabling greater connectivity to internal corporate systems, expanding the scope of cash management services to include “full-cycle” processes (i.e., from purchase order to reconciliation) via, e-commerce, or cash management services targeted at the needs of specific customer segments. Cost optimization and value-add services are customer demands that necessitate the creation of a mechanism to serve the various customer groups.

10.14 Some of the cash management techniques followed by companies are as follows:

(i) Account Reconciliation Services

Balancing a cheque book for a very large business can be quite a difficult process. Banks have developed a system to overcome this issue. They allow companies to upload a list of all the cheques whereby at the end of the month, the bank statement will show not only the cleared cheques but also uncleared ones.

(ii) Positive Pay

It is an effective anti-fraud measure for cheque disbursements. Using the cheque issuance data, updated regularly with cheque issuance and payment, the bank balances all cheques offered for payment in bank. In the case of any discrepancies, the cheque is reported as an exception and is returned.

(iii) Balance Reporting Services

Balance reporting services help in procuring a company's current banking information from its accounts. With this service, the banks can offer almost all types of transaction- specific details.

(iv) Lockbox

It facilitates the cash improvement where, instead of being delivered to business address, customer payments are delivered to a special post office (PO) box. It is only the customers' payments that are delivered in the PO box and the company's own bank collects the amount and delivers them to the banks of the customers. The bank of the customer processes the payments for direct deposit to the entity's bank account. Lockbox contents are regularly removed and processed.

(v) Cheque Writing

In order to execute the payments faster, banks are providing cheque writing facility to the corporate customers wherein customer can print the cheques locally at their own office with the facility of digital signatures and company logos.

(vi) Bin Management of Post-dated cheque (PDC)

Corporates are outsourcing the activity of Post-Dated Cheque (PDC) management to the banks for further reducing the cost of operations, administration, and data maintenance.

(vii) Liquidity Management

In order to have efficient utilization of excess funds, corporates avail the facility of liquidity management. Liquidity management system prudently manages various assets and liabilities (on- and off-balance sheet) and ensures that cash inflows have an appropriate relationship to the approaching size of cash outflows. The system ensures that necessary funds are available to entertain all cash outflows as they fall due.

Adequate cash management mechanisms ensure efficient collection, systematic disbursements, and ideal deployment of idle funds, tiding over immediate cash needs, and compensating the banks that support these activities of the company. An advanced cash management system enhances the possibilities of earning high net interest income, creates efficient balance sheets, minimizes expenses on resources, and reduces the company's exposures to potential risks related to seasonality of business and debt repayments.

10.15 Cash continues to play a dominating role in the retail industry. Even with the increase of the cashless payments, more than 50% are cash transactions with variations depending on region, industry, and sales format. Small shopping baskets, in particular, are usually paid for in cash. Cash handling is a cost intensive process for retail companies and offers major potential for improving productivity.

10.16 The internal auditor's analytical procedures are divided into the following four steps:

(i) Analysis of Structures and Processes

Analyse the factors such as, customers' payment habits at the point of sale. This gives an exact picture of the status-quo in a company store.

(ii) Development of Solution Proposals

Parallel to this, the retailer's intentions and objectives with regard to cash automation are discussed and specified. Together with the hard facts from the status quo analysis, these aspects form the basis for working on concrete solution scenarios.

(iii) Piloting in the Store

Recommendations involve not only the Point of Sale (POS) hardware but also include re-design and optimization of the entire cash process in a store. These include return on investment calculations, which, due to the current situation analysis, already contain very detailed and realistic pay- back forecasts.

(iv) Decision on the Project

With the experiences gained during piloting, possibly enhanced with a customer survey, the retailer has sufficient data and facts on which to take his investment decision. This is then specified, the project is planned in detail, and the rollout scope and schedule defined.

Retailing being very heterogeneous, various segments, national regulations, different processes and corporate cultures necessitate a tailored solution that fits exactly.

Advantages

(i) Potential for savings through automated end-to-end handling of the cash flow from the point of sale to the cash office and on to the cash-in-transit operator for posting at the bank.

(ii) Considerable reduction in discrepancies (at the point of sale and between the cash centre and store) due to efficient controlling and better monitoring facilities.

(iii) Fewer interfaces thanks to a closed cash cycle.

(iv) Cash flow transparency with end-to-end controlling and reporting to reduce operational risk.

Objective

The objective of cash management systems is to eliminate potential security loopholes by implementing a closed cash cycle.

Procurement of Materials and Consumption

10.17 Procurement is the most important activity in the retail industry. It refers to the products procured for sales. The procurement involves sourcing of products from different vendors across various geographical locations.

Management of procurement of products plays an important role in the success of the entity.

10.18 Sourcing can be done directly from the following vendors:

- Manufacturers
- Intermediaries - wholesalers, distributors, and dealers
- Internet and web-based vendors

10.19 Considering that the total cost of goods consumed accounts for around 75% of the expenditure incurred by the entity and the entity generally operates on very slim net margins, the importance of procurement of products at the right time and the right source plays a significant role in ensuring the profitability and sustainability of the business.

10.20 Evaluation of a vendor is a very complex process due to of the following factors:

- No. of suppliers.
- No. of products.
- Varied geographical location of suppliers.
- Different terms with each supplier with regards to credit period, delivery time, time lag, etc.
- Cost of products.
- Perishable nature of certain key products
- Different handling requirements for different products.
- Size and volume of the products.

10.21 Supplier evaluation needs to be performed by every retailer to ensure that there are no constraints in supply on basis of time, quality of the products, reliability and terms of arrangement. Further, the screening process should ensure that the vendor has the desired integrity and no track record of any unethical activity in the past. The internal auditor may verify whether the entity has evaluated each vendor. The internal auditor also verifies the basis and process of evaluation.

10.22 Some common types of system driven vendor fraud indicators include the following:

- An employee's home address matches with vendor's address.
- An employee's initials match with vendor's name.
- Cheques are written to "cash".
- A vendor's address contains a P.O. box.
- Vendor data missing or found to be illogical.

10.23 The following procedures may be performed by the internal auditor:

(i) Sell-through Rate

The sell-through rate is a calculation, commonly represented as a percentage, comparing the amount of inventory a retailer receives from a manufacturer or supplier against what is actually sold to the consumer. This enables the internal auditor to understand the movement of goods.

(ii) Open to Buy

The goal of good inventory management is to maintain an appropriate level of inventory for the amount of sales. This enables the internal auditor to evaluate the utilization of working capital in the entity.

(iii) Fill Rate

The ratio refers to the percentage of consumer orders satisfied from stock at hand. It is a measure of inventory's ability to meet demand. This enables the internal auditor to estimate whether the entity has been placing order sufficient enough to meet the demand of products from customers and to ensure that there is no loss of sales and customer loyalty.

(iv) Suppliers for a Key Product

It may be better for the entity to have multiple suppliers for a critical product to ensure the availability of products on a timely basis, risk reduction, avoiding over reliance on a particular supplier and ensuring better bargaining power. The internal auditor might provide the management an analysis for such products.

(v) Percentage of Delayed Delivery by Supplier

The internal auditor may estimate the percentage of deliveries received on a delayed basis to total deliveries from a particular supplier. This enables the internal auditor to obtain an insight on the efficiency of the supplier.

(vi) Total Consumption to Total Revenue Product Wise

The internal auditor shall assess whether the entity has a proper control on the consumption to sales ratio (product wise) to verify whether there have been significant fluctuations over a period and have explanations obtained from client for such deviations. The internal auditor can evaluate whether there have been any losses in any of the products and whether the entity is taking steps to ensure that visual merchandising is performed for the right product. In the event of the consumption being excess of revenue, the entity may obtain an understanding that the particular product that gets easily damaged/ perished or stolen and accordingly, would deal with them.

(vii) Inventory Turnover

This Ratio measures the number of times, on average, the inventory is sold during the period. Its purpose is to measure the liquidity of the inventory. This enables the internal auditor to estimate the efficiency of movement of goods and management of inventory by the entity.

A model checklist on procurement of materials and consumption is given in **Appendix 2.**

Supply Chain Management

10.24 Supply Chain Management (SCM) is the management of a network of inter-connected businesses involved in the ultimate provision of product and service packages required by end customers. Supply Chain Management spans all movement and storage of raw materials, work-in-progress and finished goods from point of origin to point of consumption.

10.25 Supply Chain Management ensure that the availability of products is at the right time and at affordable cost. The Supply Chain function involves vendor management, quality assurance and transportation. Vendor management assumes critical importance in retail business where one has to deal with multiple products. Supply Chain Management is viewed in fully vertically integrated firms, where the entire material flow is owned by a single firm and in case, where each channel member operates independently.

10.26 Six Sigma, in Supply Chain Management (SCM), helps in achieving substantial benefits in terms of costs and quality. For effective implementation of Six Sigma in Supply Chain Management, it requires collection of data from multiple organizations spread across multiple geographical locations.

10.27 Supply Chain Management involves two broad categories i.e., strategic and operational, As the term implies, strategic decisions are made typically over a longer time horizon. These are closely linked to the entity's strategy and guide supply chain policies from a design perspective. On the other hand, operational decisions are short term, and focus on activities over a day-to-day basis. The effort in these types of decisions is to effectively and efficiently manage the product flow in the "strategically" planned supply chain.

10.28 The strategic decision in Supply Chain Management needs to include four major decision areas:

- Location,
- Production,
- Inventory, and
- Transportation (distribution),

10.29 Typically, a Supply Chain Management would include the following components:

(i) **Distribution Network Configuration:** Number, location and network missions of suppliers, production facilities, distribution centres, warehouses, cross-docks and customers.

(ii) **Distribution Strategy**: Operating control (e.g., centralized, decentralized or shared) Delivery scheme, (e.g., direct shipment, pool point shipping, cross docking, Direct Store Delivery (DSD), closed loop shipping); Mode of transportation, (e.g., motor carrier, including truckload, parcel, railroad; intermodal transport, including trailer on flatcar (TOFC) and container on flatcar (COFC) Ocean freight, air freight) Replenishment strategy (e.g., pull, push or hybrid) and Transportation control (e.g., owner-operated, private carrier, common carrier, contract carrier, or Third Party Logistics (3PL)).

(iii) **Trade-Offs in Logistical Activities**: The above activities must be well coordinated in order to achieve the lowest total logistics cost. Trade-offs may increase the total cost if one of the activities is optimized. For example, full truckload (FTL) rates are more economical on a cost per pallet basis than less than truckload (LTL) shipments. If, however, a full truckload of a product is ordered to reduce transportation costs, there will be an increase in inventory holding costs which may increase total logistics costs. It is therefore imperative to take a systems approach when planning logistical activities. These trade-offs are key to developing the most efficient and effective Logistics and SCM strategy.

(iv) **Information**: Integration of processes through the supply chain to share valuable information, including demand signals, forecasts, inventory, transportation, potential collaboration, etc.

(v) **Inventory Management**: Considering the volume of inventory, and that certain products are perishable in nature. The entity needs to ensure that the materials are stored to facilitate retrieval based on the expiry date of the particular product. To enable this, the system should be comprehensive enough to track details of all products procured from different suppliers.

(vi) **Cash-Flow**: Arranging the payment terms and methodologies for exchanging funds across entities within the supply chain.

10.30 Operations Research (OR) is a critical tool that enables the entity in framing the ideal supply chain management system.

10.31 Internal audit is an important functions activity as entities work to manage its increasingly complex and pervasive supply chain risk. Supplier disruption can immediately and significantly affect profitability, impair growth opportunities, shatter shareholder value, and compromise reputation through a decreased level of public confidence.

Analytical procedures that might be performed by the internal auditor regarding supply chain management system is given in the **Appendix 2.**

Payroll

10.32 In the retail industry, the cost of payroll in relation to the turnover of the entity might not be very significant. But, the success of the retailer depends on the management of personnel and the availability of right persons. Though each entity may not directly hire large number of employees, but the secondary employment provided by the whole retail industry is very significant across the nation.

Most entities process payroll for the month, based on the records of a different period. For example, when payroll for the month of December is processed, then the leave records, performance record for the period 25th November to 24th December would be considered. The main reason for such processing is to ensure disbursement of payroll by the specified day of the month.

10.33 The internal auditor may consider ensuring that proper, adequate and appropriate cut-off procedures are in place to ensure proper computation and disbursement of salary to the employees. The procedures for computations of amount to be deducted on various heads also may be verified in accordance with organizational policies and procedures. The internal auditor may verify the policies and procedures and compliance of the same on a sample basis.

Computation of incentives is a complex area in any entity operating in a retail industry. The entity, generally, provide incentive based on location, store's turnover, growth in business, innovative approach applied by the Stores Manager, etc. The process becomes complex, especially, when the entity needs to estimate the said information for every store across all geographical locations. For smaller entities, the process is much simple as there is no need for such detailed evaluation.

Compliance with various regulations too is a tedious job, especially, when the entity has presence across different states. In such a scenario, the entity might have to obtain separate registration certifications for different statutes, such as GST, Shops and Establishments Act, Professional Tax, Tax Deduction Account Number (TAN), etc. The entity generally has laid down processes for ensuring compliance with all laws and regulations.

10.34 Certain entities operating in the retail industry provide an opportunity for employees to take ownership in the company through issue of stocks. The schemes may be in the following form:

- Stock Awards
- Employee Stock Option Plan

- Employee Stock Purchase Plan.

These schemes also enable creation of a long-term relationship and trust between the entity and the employee and help in employee retention.

10.35 The internal auditor would consider the following policies of the entity within the audit scope and plan:

(i) Job Rotation

Job rotation is an approach to management development where an individual is moved through a schedule of assignments designed to give the employee exposure to the entire operations. It is also practiced allowing qualified employees to gain more insights into the processes of a company, and to reduce boredom and increase job satisfaction through job variation. Job rotation might be between posting of an employee to different departments within the store to different operations such as maintenance, supervision, billing, reporting, etc.

(ii) Different Shifts

In general, large entities and retail stores build customer loyalty by providing them the convenience of time of shopping through longer opening hours. Most stores work for more than 12 hours a day. Considering the duration of operation, the entity might have to hire employees on a shift basis. The internal auditor may verify the processes in the entity to support such a shift system and enable proper handing over of responsibilities.

10.36 A time sheet is a method for recording the amount of a worker's time spent at work to enable tracking of details related to leave and absence to enable the determination of employee's compensation. In some situations, the recording of time sheet is done through an electronic/ automatic process and is driven by software. In such cases, the internal auditor is required to understand the process in detail and verify it on a sample basis and exceptions, if any, noted on the project may be taken seriously by the internal auditor and adequate explanations may be obtained.

10.37 The internal auditor may also perform additional analytical procedures over a period of time and compare them for ascertaining the following inconsistencies:

(i) No. of Bills Raised/ No. of Hours

This ratio is determined by the number of bills an employee process to the total time taken by him over a period of time. By analysing this ratio, the internal auditor can understand the skill level of employees, steps taken by the management towards maintaining efficiency, importance of training and ability of the management in identifying the right person for the job. This ratio gains significance, especially, because by processing quickly, customer's, satisfaction can be ensured to enable development of brand and loyalty.

(ii) Average Employee Cost per Store

Average cost incurred for an employee (cost includes incentives, gifts, entertainment costs incurred for a store) can be computed by dividing the total cost on employees in a store incurred for a period to average number of employees during the period. The internal auditor may compare this information between different periods or with different stores and ensure that there is no significant unexplainable difference in the average employee cost per store.

(iii) Total Revenue per Store to Number of Employees/ Employee Cost

This ratio can be computed based on the total revenue of the store in a particular period to the number of employees/ employee cost in the same month. This would enable the internal auditor to understand the importance of a firm in terms of its significance.

(iv) Employee Turnover Ratio

Employee turnover ratio helps the internal auditor to verify the attrition rate and assess the entity's effectiveness and steps taken towards prevention of attrition and retention of key employees. In case of employee turnover ratio being higher than the industry, the internal auditor may obtain explanations for such high turnover ratio.

(v) Reconciliation with Respect to Changes in the Number of Employees

The internal auditor can assess the movement in employees for a month in comparison with another by tracing the additions and deletions due to additions, terminations, retirements, etc., in a month based on each grade and obtain an insight on the plans of the management.

A Model checklist related to payroll process is given in the **Appendix 2.**

Fixed Assets

10.38 In general, an entity operating in the retail industry would have the following types of fixed assets:

- Freehold land and leasehold land
- Buildings, warehouses, and leasehold improvements
- Plant and machinery
- Office equipment
- Computer and software
- Furniture and fixtures
- Electrical installations
- Vehicles

10.39 In the event of a comprehensive distribution system being operated by the entity, large investments are required in warehouses and storage locations apart from transportation vehicles. The entity is required to have sufficient control over such assets to ensure that these are being used properly and therefore, periodic physical verification would be of importance.

10.40 The entity might lease certain assets for installation at the stores. The internal auditor may verify whether there is proper control over such leased assets. Further, the internal auditor may ensure that there are sufficient controls within the entity to differentiate between own assets and those assets provided by the vendors/ manufacturers to promote their product. The internal auditor may also perform additional analytical procedures over a period of time and compared them for ascertaining any inconsistency such as following:

(i) Ratio of Assets Installed to Area

The internal auditor may verify the ratio of the total value/ no. of assets put to use per square foot across different stores and in case of any significant difference arising in such a ratio, he may seek explanation thereon.

(ii) Asset Utilization Ratio

Asset utilization ratio is the ratio of total revenue to the total assets. It helps the internal auditor to assess the effectiveness of assets with respect to the revenue made by the entity. The greater the asset utilization ratio, the higher is the operating efficiency of the entity.

(iii) Asset Coverage Ratio

Asset coverage ratio is a measure of company's ability to cover the amount of its existing debts. Essentially, an asset coverage ratio measures the tangible, physical and monetary assets of a company against its outstanding debts and overall liability to derive an understanding of the company's current financial situation. This ratio is a part of a larger liquidity analysis, which takes into consideration factors like, cash on hand, long-term financial obligations, and current liquidity assessments.

If the internal auditor may perform fixed asset verification procedures too as a part of the scope of his work, the auditor can refer to **Guidance note on Audit of Fixed Assets**. Audit techniques which the internal auditor can perform for verification of assets include procedures such as, verification of laptops at the time of logging on to the server/ network monitored through a special software, verification of software licenses and validity, number of licenses against number of computer systems used for specific purpose and so on.

A Model Checklist related to Fixed Asset is given in **Appendix 2.**

Data Security

10.41 Data security is a major risk in the retail industry. Security in a retail industry can be bifurcated into two significant components:

(i) Information Technology Security

The various sources of danger to data can be in the form of following:

(a) Natural Calamity

Fire, flood, earthquake, falling elephants can cause damage to hardware including server, computers and other physical storage devices.

(b) Theft of Data

Data theft is a growing problem primarily perpetrated by office workers with access to technology such as, desktop computers and hand-held devices capable of storing digital information such as, flash drives, iPods and even digital cameras. Since employees often spend a considerable amount of time developing contacts and confidential and copyrighted information for the company they work for, they often feel they have some right to the information and are inclined to copy and/or delete part of it when they leave the company or misuse it while they are still in employment.

While most organizations have implemented firewalls and intrusion-detection systems very few consider the threat from the average employee who copies proprietary data for personal gain or use by another company. A common scenario is where a salesperson makes a copy of the contact database for use in their next job. Typically, this could be a violation of terms of employment.

(c) System Crash

A system crash is a condition where a program (either an application or part of the operating system) stops performing its expected function and stops responding to other parts of the system. Often the offending program may simply appear to freeze. If this program is a critical part of the operating system kernel the entire computer may crash.

(d) Computer Fraud

Computer fraud covers a variety of activity that is harmful to people. Computer fraud is using the computer in some way to commit dishonesty by obtaining an advantage or causing loss of something of value. This could take form in a number of ways, including program fraud, hacking, e-mail hoaxes, auction and retail sales schemes, investment schemes and people claiming to be experts on subject areas.

(e) System Bugs

A bug is the common term used to describe an error, flaw, mistake, failure, or fault in a computer program or system that produces an incorrect or unexpected result or causes it to behave in unintended ways. Most bugs arise from mistakes and errors made by people in either a program's source code or its design, and a few are caused by compilers producing incorrect code.

(f) Power Failure, Accidental Deletion/ Modification

Power failure and accidental deletion/ modification of files is a common type of problem faced by many small entities due lack of sufficient infrastructure and also training to the employees.

(g) Hacking

Hacking could be in the form of:

- Passwords required to enter or change the PC's BIOS
- Passwords required to enter a network
- Passwords required to start the operating system
- Passwords required to enter major software packages (e.g., payroll)
- Encrypted (encoded) data files

(h) Telecommunication Failure

Sometimes, the telecommunication network might fail, which might result in freezing of flow of data from and to the computing system. During such time, the entity might not be able to perform its operations.

(i) Virus Problem

A computer virus is a computer program that can copy itself and infect a computer. A computer virus has two major classifications. They have the ability to replicate itself, and the ability to attach itself to another computer file. Every file or program that becomes infected can also act as a virus itself, allowing it to spread to other files and computers.

(j) Unknown Risks

There might be threat to data due to other reasons not included above. The internal auditor needs to keep an eye on these too to ensure complete data security.

10.42 The data of both the customer and the retail entity needs protection. There might be severe penalties imposed by the customer on account of fraudulent activities by the retail entity. The work area would not be reasonably accessible by an outsider without proper security check and prior authorization to ensure safety of data and to prevent theft thereto. Conditions such as inhibition of use of mobile phones, personal laptops, cameras, and pen drives are enforced.

The internal auditor may verify the sufficiency of control of data. He may also obtain explanations for any loss/ damage of data, if any during the reporting period apart from steps taken to prevent them in the future. He may also verify whether the policies and procedures are put in place. The internal auditor may refer to SIA 520, "Internal Auditing in an Information Technology Environment" and SIA 240, "Using the Work of an Expert".

A model checklist related to internal audit under the computer environment is given in **Appendix 2.**

(ii) Physical Security

The entity should safeguard its property, staff and customers. Entity also uses physical security as a deterrent to prevent shoplifting and crime. Further, to ensure enhanced security, entities are looking technology and automated systems to prevent shoplifting and crime. The tools include video surveillance and integrated systems.

Ensuring the security of retail organization would mean protecting customers, staff and assets, while benefitting from complete visibility of sales floor, point-of-sale (POS), receiving doors, distribution centres and parking facilities. It would involve security of the following areas/ activities:

(a) In-Store

- Ensure integrated surveillance of POS and cash-handling areas.
- Manage access to restricted areas and locked displays.
- Protect customers and employees.

- Verify fire, intrusion, and electronic article surveillance (EAS) event alarms using video.

(b) Back Office and Warehouse

- Protect employees and prevent theft.
- Safeguard assets and equipment.
- Monitor productivity and safety.
- Track time and attendance through access control.

(c) Parking and Outdoor Premises

- Identify suspicious vehicles.
- Ensure entry and exit point security.
- Protect assets and buildings.
- Monitor merchandise delivery.

Further, International organizations have also established standards and guidelines for physical security as part of an overall security management program that also includes information security and meets governmental requirements and consumer expectations.

Certain examples of internationally recognized standards and guidelines that are used to implement security management systems to effectively manage physical security pertaining to the retail industry would include following:

a. BS 25999-1:2006: Business Continuity Management Code of Practice (management system for disaster recovery and business continuity)

b. BS 7799-3:2006: Guidelines for Information Security Risk Management (management system approach for the assessment and treatment of risk)

c. ISO/PAS 28000:2005: Specification for Security Management Systems for the Supply Chain (management system specification for physical security)

d. ISO 22000:2005: Food Safety Management Systems - Requirements for Any Organization in the Food Chain (management system for preventing the introduction of food safety hazards)

e. OHSAS 18001: Occupational Health and Safety Management (specification for health and safety management systems)

The internal auditor may extend his scope of internal audit to verify the importance given by management to physical security system. Further, he may be able to understand and correlate the relationship between reduction of costs related to theft/ shrinkage and incurred for enhanced physical security.

A Model checklist of procedures that an internal auditor may perform relating to physical security is given in **Appendix 2.**

Operating Costs

10.43 Significant operating costs for any entity operating in a retail industry include the following:

(i) Lease Expenses

Lease expenses could be of the nature of leasing of office building for workspace or leasing of assets for official purpose or accommodation provided to the employees. This would be a significant part of the expenses considering that the entity needs to own the location or lease the location for its display. The success of the entity is based on location of store and, incidentally, to have a store at the right location would mean incurring higher cost.

(ii) Advertisement and Marketing Expenses

Advertisement expenses are incurred predominantly for the purpose of creation and development of a strong brand name. Branding is one of the most important aspects of any business, large or small, retail or Business to Business (B2B). An effective brand strategy gives major edge in increasingly competitive markets. A brand is something that tells the customers (existing and prospective) what they can expect from the entity's products, and also differentiates offering from competitors.

The various strategies that the entity might use for marketing are as follows:

(a) Loyalty Program

A retail establishment or a retail group may issue a loyalty card to a consumer who can use it as a form of identification when dealing with that retailer. By presenting the card, the purchaser is typically entitled to either a discount on the current purchase, or an allotment of points that can be used for future purchases.

The loyalty program may be monitored by program managers who are typically agencies with specialist skills in loyalty consulting, creative and communication, data analytics, loyalty software, and back-end operations.

(b) Multi-channel Marketing

Multi-channel marketing is using different marketing channels to reach a customer. A channel might be a retail store, a web site, a mail order catalogue, or direct personal communications by letter, e-mail or text message. The objective of the company doing the marketing is to make it easy for a consumer to buy from them in most appropriate manner.

To be effective, multi-channel marketing needs to be supported by good supply chain management (SCM) systems, so that the details and prices of goods on offer are consistent across the different channels. It might also be supported by detailed analysis of the return on investment from channel, measured in terms of customer response and conversion of sales. Multi-channel marketing allows the retail merchant to reach its prospective or current customer through a channel of his/ her liking.

(c) Penetration Analysis

Penetration analysis deals with the analysis of the extent of reach of a particular commodity. The analysis helps the management in identifying the requirement of stock at a particular location and methods to promote the same.

(iii) Store Maintenance Expenses

Maintenance of a store is inevitable to provide customer satisfaction and to ensure that goods are not perished earlier than they are supposed to. Hence, the entity has to incur significant maintenance expenses. In general, the entity might enter into an Annual Maintenance Contract (AMC) with agencies to enable such maintenance on a regular and professional basis.

(iv) Finance Charges

Finance charges are incurred for the purpose of working capital and capital expenditure of a retail industry. The entity needs to ensure cost efficiency in borrowing of funds. The entity may also opt for an external commercial borrowing for the purpose of incurring expenditure in foreign currency.

Measuring Operational Efficiency

10.44 The internal auditor can measure the operational efficiency by following methods:

- Operations research - based method.
- Data Envelopment Analysis (DEA).

A retail store is deemed to be efficient (efficiency = 1) if its output is optimal (maximum possible) for given inputs in comparison with the outputs and inputs of all comparable stores. The efficient frontier is a series of points or a line connecting the most efficient stores which are determined after comparing outputs and inputs of all retail stores. Therefore, Data Envelopment Analysis (DEA) produces relative efficiency boundaries of the retail stores under study, which are called envelopes.

In this study, efficiency is the ratio of the weighted sum of outputs to the weighted sum of inputs. The weights are estimated separately for each retail store such that its efficiency is the maximum possible or is equal to 1. Weights are automatically calculated for all the stores while calculating their relative efficiencies. Therefore, weights change each time a store's efficiency is calculated using this model and are measured relative to the remaining stores.

10.45 The internal auditor may verify the procedures and controls for capturing of specific expenses with regards to its sufficiency, appropriateness and efficiency. Moreover, the internal auditor may consider to ensure that common expenses are allocated across these undertakings in a justifiable basis. The internal auditor may also perform additional analytical procedures over a period of time and compare them for ascertaining any inconsistency such as following:

(i) Total Fixed Cost

Significant increases in the total fixed cost signals expansion activity. In such cases, the internal auditor may verify the sufficiency of controls with respect to the growing entity.

(ii) Operating Cost to Revenue (Undertaking-wise)

An entity operates in varied legal environment and different challenges are faced by the entity operating in each such environment. The internal auditor can estimate the operating cost (i.e., cost including labour, communication, lease and all other variable expense to the particular undertaking) to the revenue generated by it. This would provide a basis for evaluating the cost effectiveness of operating in each of the undertakings.

(iii) Variable Cost per Man Hour per Undertaking

Variable cost per man hour can be computed by dividing the total cost incurred in an undertaking divided by man hours for the same period. This can be compared with different periods to verify whether there has been a significant increase/ decrease in the expense and identify reasons for the same.

(iv) Interest Cost to Loans

Interest cost to loans provides a basis for the estimation of the average cost of borrowed funds in the entity. The internal auditor can estimate the average cost of borrowing and compare them with the existing rate to verify whether the interest paid is significantly high.

Other Significant Areas of Internal Audit

10.46 Other areas of internal audit significance are as follows:

(i) Visual Merchandising

Visual merchandising starts with the store itself. The management decides the store design to reflect that the store is going to sell the product and how to create a warm, friendly, and approachable atmosphere for its potential customers.

Many elements can be used by visual merchandisers in creating displays including colour, lighting, space, product information, sensory inputs such as, smell, touch and sound, etc. as well as technologies such as, digital displays and interactive installations.

10.47 Retail professionals display the product to make the shopping more comfortable, convenient and customer friendly in the following manner:

- Making it easier for the customer to locate the desired category and merchandise.
- Making it easier for the customer to self-select.
- Making it possible for the customer to co-ordinate and accessorize.

- Informing them about the latest fashion trends.

10.48 The benefits of visual merchandising are as follows:

- Educating the customers about the product/ service in an effective and creative way.
- Establishing a creative medium to present merchandise in 3D environment, thereby enabling long lasting impact and recall value.
- Setting the company apart in an exclusive position.
- Establishing linkage between fashion, product design and marketing by keeping the product in prime focus.
- Combining the creative, technical and operational aspects of a product and the business.
- Drawing the attention of the customer to enable him to take purchase decision within shortest possible time, and thus augmenting the selling process.

10.49 Following are the techniques of enhancing visual merchandising:

(a) Planogram

A planogram allows planning the arrangement of merchandise on a given fixture configuration to support sales through proper placement of merchandise by style, option, size, price points, etc. It also enables a chain of stores to have the same merchandise displayed in a coherent and similar manner across the chain.

The main purpose is to support ease of applicability to the merchandiser while increasing selection and enhancing the merchandise display in a neat and organized manner.

(b) Window Displays

A retailer's window is the most controllable element in relation to image and must match the merchandise's target demographic. Display windows may communicate style, content and price. They can be seductive, exciting or based on emotional stimulus through stimulation, or evocation of all five senses. Another direction taken by retailers who rely on volume sold is price-based selling. These clearly emphasize value for money with easy and obvious ticketing.

(c) Food Merchandising

Restaurants, Grocery Stores, and C-stores are using visual merchandising as a tool to differentiate themselves in a saturated market. With Whole Foods leading the way, many are recognizing the impact that good food merchandising can have on sales. If a food merchandising strategy considers the five senses, it will keep customers lingering in the store, and help them with the buying decision process. Texture can be utilized to entice customers to touch, and samples are the best form of food advertising. Especially for large quantity items, the ability to experience the product before committing to the purchase is critical. Food merchandising should educate customers, entice them to buy, and create loyalty to the store.

The internal auditor may analyse visual merchandising considering the importance of visual merchandising in the success of a store. It may include matters, such as, periodic improvements that can be made or realignment/ shuffling of inventory.

Surprise Verification

10.50 If physical verification or examination is done without prior information to the management, it is called as Surprise Check. An element of surprise is experienced by management or the employee in such cases. Surprise check is used in physical verification of cash, security items, inventory, etc.

The internal auditor may use surprise checks as an effective tool for finding effectiveness and continuity of internal controls.

(ii) Managing Shrinkages

Retail shrinkage is the difference in the value of stocks as per books and the value of actual physical stock at the store on any given point of time.

Shrinkages at the stores could be on account of any one or combination of the following:

(a) Process Lapse

There could be a number of lapses that lead to shrinkages at the stores. Some of the main ones could be as follows:

- Lesser Receipts at the stores against what is transferred out of the Distribution Centre. Where receipts are not verified 100 per cent on receipt, this cannot be ruled out.

- Under statement/ accounting of damages at the stores. Stores may have a tendency to understate the damages including handling damages that are destroyed at the stores itself. This will result in shrinkages for those SKUs which were not removed from the books as damaged stocks.
- Under statement/ accounting of dump of fruits and vegetables. Understatement of dump is quite common as it reflects the operational efficiency of the store¡ such under accounted products get reported as shrinkages when stocks are verified.
- Not updating manual bills into POS.
- Delayed or non-accounting of returns made to the DC/ Vendors from the stores.
- Not updating the consumer promotions in the system leading to manual intervention at the POS.
- Other cases which warrant manual intervention at the POS as manual intervention may result in wrong billing too.

(b) System Lapses

- Poor quality of scanners or stickers and duplicate SKU code would force manual intervention at the POS. Manual intervention may also amount to errors and contribute to shrinkages.
- Other system lapses due to which book stocks are reported wrongly.

(c) Vendor Fraud

Short supply by the vendor as against the quantity in the Goods Received Note (GRN) would certainly amount to shrinkages at the warehouse/ DC itself. Moreover, any such malpractice adapted by DSPs (direct supplies to stores) would also amount to shrinkages.

(d) Employee Fraud

This is one of the common means of fraud causing shrinkages. The following could be a few types of malpractices:

- Improper Invoicing — billing lesser quantity/ non billing of certain products/ billing products with lower prices as against actual selling price of products sold.

- Theft by employees.
- Frauds in the case of products exchanged by customers.
- Fraudulent practice in handling home deliveries.

(e) Customer Shop Lifting

This is another common problem causing shrinkages. Generally, specific products including beauty products, skin care products, razors, etc. are more prone to such shop lifting by customers. It is also extremely difficult in controlling the customer theft though some measures are being taken by a few retailers based on their experience and learning.

10.51 Corrective steps taken at the right point of time would certainly help the retailers mitigate the risk to a greater extent and reduce the losses on account of shrinkage. The following could be some areas where best practices need to be deployed:

a. Having clear SOPs for operations at stores.

b. Ensure adherence to the SOPs.

c. Avoid or minimize manual intervention at the POS.

d. Ensure proper training to the staff.

e. Educate the staff on the importance of reduction of shrinkages.

f. Proper physical verification of stocks.

g. Deployment and monitoring of CCTV at the stores.

h. Employees frisking.

i. Background check on staff.

10.52 The following measures would certainly help in reducing the shrinkages:

- Setting up a dedicated internal/ external team to handle stock checks at each of the stores periodically. Initially each store is covered at least once a month.
- Creation of stock check squad that would visit each store every day and verify a few SKUs on a random basis.

- The scope of services to be provided by an internal auditor might also include surprise checks on a random basis.
- Surprise verification of receipts at the stores. Monthly/ quarterly audit of the entire operations of the stores to assess adherence to the laid down processes.
- Closely monitoring stores with huge shrinkages.
- Closely monitoring and analysing category of products that contribute to huge shrinkages.

10.53 The internal auditor may consider shrinkage as an essential part of his audit procedures. The areas that may be reviewed by the internal auditor are as follows:

- Methodology designed by management to precisely manage shrinkage.
- Control measures taken by the management.
- Sufficiency of procedures controlling shrinkage.
- Effectiveness of the steps taken by the management.
- Detecting weaknesses in the system.
- Major Areas of Internal Audit Significance

(iii) Handling of Products and Disposal of Damages and Expiries/ Products nearing Expiry/ Obsolescence

(a) Handling of Products

Handling of products would be an important part in the activities carried by a retail industry. It involves activities such as, pushing, pulling, lifting, carrying and holding.

The internal auditor may perform assessment of each manual task and the following factors may be considered in framing his internal audit procedures:

- Nature of the objects being handled.
- Actions and movements involved in the task.
- Range of weights handled.

- Availability of lifting and moving equipment
- Force to be applied.
- Duration and frequency of the task
- Time and distance over which the object is handled.
- Working posture imposed by the task.
- Training and experience of the employee
- Age of the employee doing the task
- Work environment
- Workplace layout and housekeeping
- Analysis of relevant injury statistics
- Protective clothing and equipment required to do the task and
- Any other factor considered relevant by the employer, employees or employee representatives.

(b) Disposal of Damages and Expiries

The internal auditor would assess the following in case of disposal of damages and expiries/ products meaning expiry/ obsolescence:

- Storage systems and manuals of the entity
- Periodicity of verification of stock
- Methodology used in identification of damages for each class of products.
- Methods to prevent damages and its sufficiency.
- Identification of the types and classes of products which are subject to damages.
- Treatment of identified damages and its disposal.
- Controls on disposal of such goods
- Verification procedures at the time of receipt of goods from the supplier/ distributor/ manufacturer¡
- Agreement with vendors in the event of such damages/ loss

- Sufficiency of controls for accounting for such damages and disposals
- Analysis of cost of damages and nature of goods damaged; and
- Comprehensiveness of stock taking procedures.

Financial Accounting and Reporting

10.54 The internal auditor may verify the sufficiency of controls related to maintenance of books of accounts by the entity. The internal auditor may also verify the controls for allocation of costs between different departments in every store and verify whether it is adequate and reliable in the light of overall business operations.

An entity in retail industry might have various stores. Accordingly, accounting operations might be performed centralized, decentralized or may be a combination of both manners. The entity might find it best suited if the accounting system is comprehensive enough to provide a Management Information System (MIS) sufficient information for decision making and enable the entity to understand complexities of business, status of implementation of new ideas and the status of operations of the entity.

10.55 The reporting system should be comprehensive enough and should be able to provide the following information.

(i) Sales and Collection

- Daily statement of sales through cash, credit card, coupons, credit sales, debit card across individual stores.
- Reconciliation between sales and collection status with outstanding debtors.
- Trends of sales in a particular location.
- Department-wise sales.
- Consumption vs Sales Analysis.
- Benefits of advertisement through additional revenues and customer loyalty.
- Repetition of customers to estimate customer loyalty through customer loyalty programs.

- Highlight the growing demand of a particular product to capitalize on its sales and vice-versa.
- Impact of visual merchandising on different products.
- Benefit of promotional schemes as against normal sales.

(ii) Inventory Management

- Loss of inventory on account of theft, spoilage/ perishing of goods.
- Inventory at each store, warehouses and storage centres.
- Inventory ageing system.

(iii) Supplier Analysis

- Matrix of orders placed for each product across departments.
- Status of all pending orders.
- Orders that have exceed the expected due date pending receipt.
- Tracking of credit period for each distributor.

(iv) Others

- Gross Profitability Ratio across different products.
- Customer feedback review analysis.
- Sensitivity analysis for price and discounts, non-availability of key products.

A model checklist related to financial accounting and reporting is given in **Appendix 2.**

Mystery Audit

10.56 Mystery shopping is an objective view of a business through the eyes of a customer. A mystery shopper visits a business anonymously, posing as a regular customer, to experience and evaluate the level of customer service provided by the business. Mystery shopping provides management with a detailed assessment of employee performance and the variables that affect a customer's experience and satisfaction with the business.

It is a tool used by mystery shopping providers and market research companies to measure quality of retail service or gather specific information about products and services. Mystery shoppers posing as normal customers perform specific tasks such as, purchasing a product, asking questions, registering complaints or behaving in a certain way and then provide detailed reports or feedback about their experiences.

Tools used for mystery shopping assessments range from simple questionnaires to complete audio and video recordings. Mystery shopping can be used in any industry, with the most common venues being retail stores, hotels, movie theatres, restaurants, fast food chains, banks, gas stations, car dealerships, apartments, health clubs and health care facilities.

Methodology of Mystery Shopping

10.57 When a client company hires a company providing mystery shopping services, a survey model will be drawn up and agreed to which defines what information and improvement factors the client company wishes to measure. These are then drawn up into survey instruments and assignments that are allocated to shoppers registered with the mystery shopping company.

The details and information points, shoppers take note of typically include the following:

- Number of employees in the store on entering.
- How long it takes before the mystery shopper is greeted.
- Name of the employees.
- Greeting is friendly, ideally according to objective measures.
- Questions asked by the shopper to find a suitable product.
- Types of products shown.
- Sales arguments used by the employee.
- How the employee attempted to close the sale.
- Employee suggested any add-on sales.
- Employee invited the shopper to come back to the store.
- Cleanliness of store and store associates.
- Speed of service.

- Compliance with company standards relating to service, store appearance, and grooming/ presentation.

Shoppers are often given instructions or procedures to make the transaction, a typical to make the test of the knowledge and service skills of the employees more stringent or specific to a particular service issue (known as scenarios). For instance, mystery shoppers at a restaurant may pretend they are lactose-intolerant, or a clothing store mystery shopper could inquire about gift-wrapping services. Not all mystery shopping scenarios include a purchase.

While gathering information, shoppers usually blend in to the store being evaluated as regular shoppers. They may sometimes be required to take photographs or measurements, return purchases, or count the number of products, seats, people during the visit. A timer or a stopwatch may be required.

After the visit the shopper submits the data collected to the mystery shopping company, which reviews and analyses the information, completing quantitative or qualitative statistical [analysis] reports on the data for the client company. This enables measurement against the previously defined criteria.

The internal auditor may take the following into consideration for the performance of mystery audit:

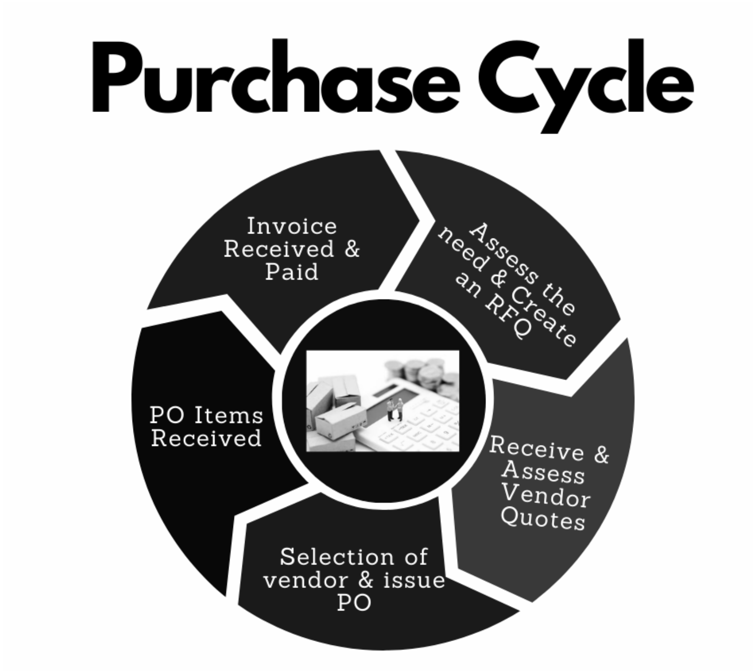
(i) The mystery audit program which details the periodicity, selection criteria, methodology of testing.

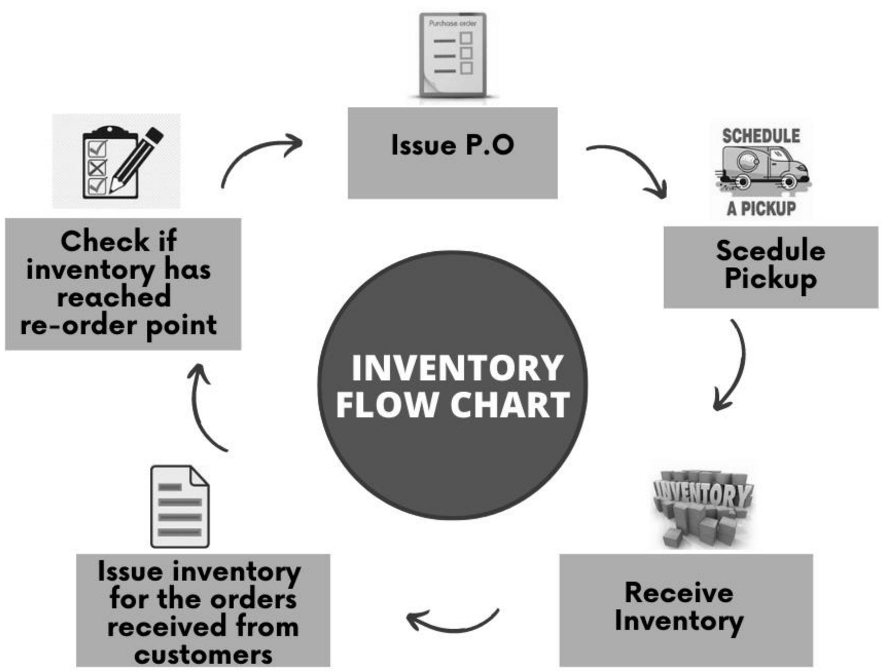
(ii) The scope of verification (such as, testing of management's efficiency of controls, implementation of entity's policies, behaviour and sensitivity of employees and their customer relations, control over inventory, and so on)

(iii) The reporting requirements by the internal auditor

Appendix 1

Model Processes in Retail Industry


Purchase Cycle
Invoice Received & Paid
Assess the need & Create an RFQ
Receive & Assess Vendor Quotes
Selection of vendor & issue PO
PO Items Received


Issue P.O
SCHEDULE A PICKUP
Scedule Pickup
Receive Inventory
Issue inventory for the orders received from customers
Check if inventory has reached re-order point
INVENTORY FLOW CHART

Appendix 2

Model Internal Audit Checklists

Sl. No.	PARTICULARS	Yes	No	N/A
I	**Verification of Billing Mechanism**			
1.1	Whether there is a proper billing system commensurate with the size of business.			
1.2	Whether the controls have been verified to ensure fixing of appropriate responsibility to the person. Whether there are sufficient systems to ensure periodic job rotation preventing mis- appropriation of funds.			
1.3	Whether there is any log maintained by the entity as regarding errors and mistakes in billing.			
1.4	Whether correct GST rate is charged for the sales made.			
1.5	Whether there is any variation between sale price and approved sales price.			
1.6	Whether proper approvals are taken for giving credit period to the customers.			
1.7	Whether proper approvals are received for giving discount to customers.			
1.8	Whether valid reasons were captured on the handbills raised.			
1.9	Whether hand bills were found not updated in the accounting ERP.			
1.10	Whether there is a routine checking of collections (cash, coupons, vouchers, credit card receivables, etc.) made at the time of change in billing personnel.			

1.11	Where is cash kept in case of cash sales, whether the cash is deposited on everyday basis to bank or submitted to Head office.			
1.12	Whether the settlement is done for card receipts every day.			
1.13	Whether the processes are sufficient to ensure appropriate banking of cash and sending of coupons to the head office.			
1.14	Whether there is sufficient monitoring by the entity to ensure prevention and detection of losses on account of shoplifting and theft.			
1.15	Check whether any of the sales fields can be edited manually like, sale date, Item code, description, quantity, Discount or amount.			
1.16	Whether the agreement with payment gateway partner is reviewed.			
1.17	Whether verification of settlement is done by payment gateway partner.			
1.18	Whether reconciliation of collection is as per books & payment gateway.			
1.19	In case the Retail entity has different ERP for Sales and Bookkeeping, whether the sales and sales return as per the Sales ERP is matching with the Bookkeeping ERP.			
1.20	Whether proof of delivery to customer are verified.			
1.21	Whether there is a sales return policy in the retail industry and the sales returns of items are against the Company's policy.			
1.22	Whether all the sales returns are properly authorized.			
1.23	Whether stock inward is entered in the ERP, in case of a sales return.			

1.24	Whether sales Returns are being accepted without Original Invoices.			
1.25	In case of sales returns, whether refund is accounted in right account.			
1.26	Whether exchanges were done against discounted merchandise.			
1.27	Whether Gift voucher is used for sales. If yes, whether the Gift voucher is verified with the gift voucher issue list and found, correct.			
II	**Procurement of Materials and Consumption**			
2.1	Whether the entity have a written policy for the procurement process.			
2.2	Whether written policy is sufficient and complete in all aspects, and it is upgraded on a frequent basis.			
2.3	Whether there is a proper requisition note with approval from the appropriate level of authority sent from the concerned department.			
2.4	Whether the entity raises an approved Request for Quotation (RFQ) within reasonable time across various suppliers.			
2.5	On receipt of various quotations, whether there are sufficient processes to ensure that the right quotation is approved as regards quality, reliability, price amongst other factors.			
2.6	Whether the contract between suppliers is complete with all terms and conditions and have the risks appropriately specified.			
2.7	Whether the entity have a process of evaluation of all the vendors. Whether the level of approval has been specified for each vendor.			

2.8	On selection of the supplier, whether an approved Purchase Order (PO) has been placed with the supplier within reasonable time.			
2.9	Whether the Actual PO quantity are ERP PO quantity are matching.			
2.10	Whether there are any contracts entered by the entity with suppliers for critical materials to ensure adequate supply at a reasonable price.			
2.11	Whether there are sufficient procedures to inspect materials as regards to specification and quantity, received by the entity at the site before unloading and signing of the delivery note.			
2.12	Whether there are sufficient documentary controls such as Gate Pass for entry of goods.			
2.13	Whether purchases are supported by transportation evidence and expenses, like E-Way Bill, consignment note from transporter, etc.			
2.14	Whether a sample check for compliance of procedures has performed.			
2.15	Whether the receipt of material is properly accounted.			
2.16	Whether the material receiving department is maintaining sufficient records of receipt and inspection of material.			
2.17	Whether the delivery note has been approved by the appropriate level of authority before making the entry.			
2.18	In cases where materials are supplied by customer, whether appropriate accounting of such material is done.			

2.19	Whether the entity have proper control for materials received from the client. Whether they are separately identified and demarcated.			
2.20	Whether the entity have proper Controls Regarding Payment To Vendor.			
2.21	In case of critical materials or slow-moving materials, Whether the entity transfer the materials from one site to another rather than from purchasing them from external sources.			
2.22	Whether Transfer of goods within units are accounted in the books of accounts.			
2.23	In the event the entity is sourcing from foreign suppliers, whether the entity has entered into a contract / legal agreement for such supplies.			
2.24	Whether the entity has made an analysis of the suppliers that may cause critical operational problems if there was any default.			
2.25	Assess financial impact of a critical operational issue/ disruption to the operations.			
2.26	Whether there are any double invoice booking & double payments.			
2.27	Whether variation in rates considered for same inventory by same vendor.			
2.28	Whether there is variance in per unit Cost Price as per GRN and per unit Cost Price as per PO.			
2.29	Whether purchases returns are rightly recorded.			
2.30	Verification of purchase returns - excess/short/damaged			
2.31	Whether the credit notes or debit notes are verified and reason thereof.			

III	**Analysing the Supply Chain Management System**			
3.1	Whether the entity has made a comprehensive study on the supply chain.			
3.2	Whether the supply chain management system is commensurate with the size of business.			
3.3	Whether the entity has taken steps to evaluate the cost-benefit of having an in-house system to an external service provider.			
3.4	Whether the terms of contract with the external service provider are appropriate in the overall business scenario.			
3.5	Whether there are sufficient indemnification clauses available in the agreement to enable management of risk to an appropriate level.			
3.6	Whether there are established risk tolerances by type of risk, supplier, commodity, etc.			
3.7	Whether there is a clear understanding of the true cost (direct plus indirect) of supply chain risk events.			
3.8	Whether cost estimate are made and reviewed at frequent intervals.			
3.9	Whether there are any pre-defined management responses corresponding to increased levels of supplier risk.			
3.10	Whether there is system of Risk-based pricing and performance analysis to support improved risk response development.			
3.11	Whether the entity has focussed on early intervention and identification of any default than a crisis management.			

3.12	Whether there is a contingency plan for recovery in the event the distributor/ distribution system fails for any reason,			
	Distribution Network Configuration			
3.13	Whether the entity has analysed the benefit of an external distributor as against an internal system.			
3.14	Considering the importance of the distribution network, Whether the entity have a prescribed network and organised system of movement of products.			
3.15	Whether the entity have a written policy for its distribution network and mobilisation of goods.			
3.16	Whether the entity have all its major suppliers at strategic locations.			
3.17	Whether there are sufficient controls within the entity for procuring same or similar products from various suppliers/ distributors.			
3.18	Whether the distribution centres are located at strategic locations to enable quick movement and timely availability of products.			
3.19	Whether there are sufficient controls in the entity to ensure that the decisions are made by the appropriate personal and every movement is authorised by the appropriate level of authority.			
3.20	Whether the entity have a process of identifying frequent delays/ errors/ losses and rectifying the same.			
	Distribution Strategy			
3.21	Whether the entity have a strategy for efficient handling and managing inventory movement.			

3.22	Whether the strategy clearly cover all areas of decision making.			
3.23	Whether the strategy is renewed at a frequent basis.			
3.24	Whether there are instances wherein the entity has procured goods/ transported goods at a price which is more than its alternative.			
3.25	In such cases, whether there are sufficient approvals obtained to incur higher costs for the procurement of goods.			
3.26	Whether there are sufficient control systems installed to enable capture of exceptions and appropriately highlight such variances.			
3.27	Whether the entity has estimated the cost of various strategies and its benefits accepting the final strategy.			
	Trade-offs in Logistical Activities			
3.28	Whether the entity has made an evaluation of the cost of alternatives possible.			
3.29	Whether the entity have a scientific basis of evaluation the overall cost of transportation.			
3.30	Whether the method of evaluation of cost of transport between options has been made in a comprehensive manner.			
3.31	Whether a comprehensive agreement has been made between them to ensure that the Logistics Company would bear the risks related to transportation of goods.			
3.32	If the entity has an in-house logistics division, Whether there are sufficient controls within the entity to ensure that there is no excess cost involved in transportation.			

	Information and Data			
3.33	Whether the entity have a comprehensive system to track all the cost incurred for logistics operations and distribution system management.			
3.34	Whether the entity makes a risk analysis based on such information.			
3.35	Whether the entity has a comprehensive system to study the transportation time, transportation cost per product, lead time, and inventory level of all products.			
3.36	Whether the entity contacts customers to establish future demand / requirements. Make a forecast of future demand based on past data.			
3.37	Whether the entity use the Data Analysis techniques to predict the future sales trend.			
	Inventory Management			
3.38	Whether the entity have sufficient control on the individual product stock available at different locations.			
3.39	Whether there is an automated/ semi-automated system of routing of inventory from different locations to enable the availability of products.			
3.40	Whether frequent physical verification is performed at all locations at a simultaneous basis and reconciled with the books on a periodic basis.			
3.41	If there is a difference between the actual stock counted and stock as per books, whether the difference is double checked and investigated in detail.			

3.42	Whether the procedures to conduct physical verification of inventory is sufficient.			
3.43	Supplier performance			
3.44	Whether suppliers are chosen based on the value additions rather than the lowest pricing			
3.45	Whether the management has benchmarked the supply chain performance with other supply chain with similar characters.			
3.46	Whether the supplier performance KPI's is used as part of supplier performance evaluation.			
3.47	Whether suppliers are missing to achieve any KPI's. If yes, are the reasons recorded for the same.			
	Additional checks			
3.48	Whether PR Vs POs is compared on a sample basis in areas like rate, quantity, and amount.			
3.49	Verify controls on receipt of invoice, mapping & accounting of the same with necessary statutory compliance.			
3.50	Verification of all the documents maintained relating to procurement and comparison of the same.			
3.51	Verification of all the documents maintained relating to procurement and comparison of the same.			
3.52	Verify the process relating to supply chain (distribution process) of inventory and its related cost.			
3.53	Comparison of budget/estimates vs actuals.			

IV	**Specific areas of Payroll Processing**			
4.1	Whether the entity have a payroll process as approved by the appropriate level of authority.			
4.2	Whether the payroll process is complete in all aspects, as applicable to the entity.			
4.3	Whether the entity maintains a checklist of statutory remittances to be made on account of PF, ESI, Labour Welfare Fund, etc..			
4.4	If the entity opts for bank transfer, whether there is sufficient level of authority to issue to a bank transfer instruction to the bank.			
4.5	Whether the payroll processing is cross checked before payment is made.			
4.6	Whether there are sufficient manual records maintained by the entity with regards to their recruitment, offer letter, appraisals and increments and all other correspondences with the employee.			
4.7	Whether the incentive schemes have been verified on a test basis.			
4.8	Whether controls are in place to ensure that incentives are computed in accordance with the schemes.			
4.9	Whether these controls have been tested for effectiveness.			
4.10	Whether sample testing of incentive have been made and paid to the employee to ensure adherence to the Incentive system.			
4.11	Whether the attrition rate is exceedingly high. Whether justifications for such a high rate, if any, is obtained?			

4.12	Whether the entity maintain separately all complaints, and redressals received from the employees.			
4.13	Whether the reasons and explanations for any failures and control weakness is observed.			
4.14	Whether the entity comply with the accounting requirements for ESOP, ESPP schemes and have a proper record of the shares opted by the employees.			
4.15	Whether the entity have sufficient controls and records for cases where disbursements are made to employees working from home.			
4.16	Whether there is a mismatch of names as per attendance register and as per pay register.			
4.17	Whether pay heads as considered in appointment letter are in line with company's compensation policy.			
4.18	Compare resigned & newly Joined employee list as provided by HR with Pay register & employee master data and note discrepancies.			
4.19	Compare date of joining & leaving as per appointment letter vs pay register vs employee master data vs relieving letter.			
4.20	Reconciliation of salary expenses as per Books & as per pay registers & bank statement.			
4.21	Verify attendance sheet and bio metric reports and check how number of paid days are arrived at for payroll processing (Also, check the no. of leave taken by an employee).			
4.22	Check cases of Resignation / Retirement / Termination and the formalities to be performed for the same and verify the exit checklist and full & final settlement.			

4.23	Compare salary payable as per pay register and paid as per NEFT sheet / cheque / cash.			
4.24	Verify how many leaves can be carried forward to next year, how many leaves will lapse and how many leaves can be encashed.			
V	**Internal Audit of Fixed Assets**			
5.1	If there are laptops issued to employees, whether the information system division have sufficient control over the laptops. Whether these laptops are verified on a frequent basis.			
5.2	Whether entity have sufficient protection for its Servers from both internal and external damage.			
5.3	Whether competitive quotations are obtained before raising Purchase Order.			
5.4	Check whether asset tagging is done & verify the tracker for the same.			
5.5	Whether the fixed asset verification is done by the management on a frequent interval.			
5.6	Whether any process in place to check if any indication of impairment of assets as on reporting date is existing.			
5.7	Whether there are sufficient control and processes to ensure capitalisation of assets on the appropriate date.			
5.8	Verify the documentation, internal controls, methodology followed in capitalisation of intangibles in line with AS 26.			
5.9	Whether the entity has taken assets on lease and is there sufficient control on such assets.			
5.10	In case, assets are held at mobile/ temporary stores, whether the entity have sufficient			

	control over them and does it make a periodic physical verification.			
5.11	In the event, the entity is dealing with distribution/ sale of products which are of the nature of fixed assets, whether there are sufficient controls and procedures to ensure appropriate classification.			
5.12	Whether Invoice, PO & GRN are cross verified before passing entries in books (Three-way mapping).			
5.13	Understand the process of accounting and reconciliation with books of accounts.			
5.14	Reconcile the carrying values of fixed assets as per Books & FAR.			
5.15	Whether FAR contains details as enumerated in CARO.			
5.16	Check whether the depreciation and amortization of fixed assets are in line with AS 10, Property Plant and equipment.			
VI	**Information Technology Security**			
6.1	Whether robust password policies are implemented and maintained in the organisation.			
6.2	Whether multifactor authentications are enabled for various logins.			
6.3	Whether endpoint protection systems and firewalls are in place in all the systems of the organisation.			
6.4	Whether Operating systems, endpoint protection systems and firewalls are kept up to date.			
6.5	Whether Identity and access management policies are in place in the organisation.			

6.6	Assess whether each user has the access rights they need to work and no more.			
6.7	Whether proper data backup is taken on regular time intervals to prevent the loss of crucial business information.			
6.8	Whether email security software in in place to get a better oversight on business emails behaviour and risks.			
6.9	Review all the access granted to your important systems.			
6.10	Review cyber security awareness and training measures and improve periodically.			
6.11	Whether the staff is trained well enough to detect threats like phishing emails, downloading malware-ridden files, etc.			
6.12	Whether the computers in the office are restricted to access only the trusted websites.			
6.13	Whether the Wi-Fi of the organisation has strong passwords.			
6.14	Whether the management has ensured that the Wi-Fi of the organisation is not made available to outsiders and employees of the organisation.			
6.15	Whether the cyber security assessments are done annually or biannually to identify the vulnerabilities and establishing an action plan to eliminate them.			
VII	**Physical Security**			
7.1	Whether the entity provide sufficient importance to physical security and security measures.			

7.2	Whether the security arrangements made reviewed by the management on a periodic basis to ensure that there is sufficiency of security measures at each store/ location.			
7.3	Whether the management ensure a continuous shifting of security personnel from each department/ location.			
7.4	How does the management treat theft and shoplifting cases in the event the fraudster has been traced.			
7.5	Whether the inventory physical verification done by the management to identify any thefts.			
7.6	In case of clothing retailer, whether the electronic article surveillance gadgets or security tags are used for all the clothing merchandise to detect and prevent the thefts.			
7.7	Whether the staff is trained on the shoplifting prevention programs.			
7.8	Whether the bag check policy is implemented at the store exits.			
7.9	Whether high value merchandise is placed in the locked display cabinets.			
7.10	Whether the shoplifting prevention signs are placed in prominent areas of the store.			
7.11	Whether the management believe in periodic modification of security procedures and systems to ensure that there is limited possibility for external people and employees in ascertaining failures in internal security.			
7.12	Whether the management make an estimate to verify as to what would be the maximum possible loss in the event of failure of security measures and systems.			

7.13	Whether the security/gate inward register is maintained by each store.			
7.14	Whether sufficient CCTV cameras is installed in the stores to ensure its security.			
VIII	**Financial Accounting and Reporting**			
8.1	Whether the entity have proper accounting system commensurate with the regulatory requirements.			
8.2	Whether the entity have specific books of accounts for each store located across states to enable proper declaration of turnover for statutory purposes such as GST Returns.			
8.3	Whether the control systems are in place for estimating the revenue generated location-wise sufficient to ensure that proper books are maintained for the location.			
8.4	Whether the entity have location-wise employee details to ensure proper allocation of payroll cost to the location			
8.5	Whether the books of accounts and the inventory systems are integrated. If not, whether manual cross checking is done in periodic intervals.			
8.6	Whether the budgets and actuals are compared on period intervals to identify the deviations.			
8.7	Whether the manual invoices raised if any accounted in the books of accounts.			
8.8	Whether the management has identified the customers who haven't paid by the due date, and send out reminders.			
8.9	Whether various accounts are reconciled on a periodic intervals and differences are identified.			

8.10	Whether the books of accounts are closing every month.			
8.11	Whether the time period for the closure of the books of accounts on a monthly basis is reasonable with regards to the operations of the entity.			
8.12	Whether the controls for re-opening of books proper to ensure prevention of manipulation.			
8.13	Whether the books are maintained in a manner to provide information to the management for decision making.			
8.14	Check whether there is a maker checker policy and ensure its compliance with books of accounts.			
8.15	Check whether the books of accounts are locked after the year.			
8.16	Whether the books of accounts are complete and accurate.			

Appendix 3

List of Organizations, Online Resources and Other Sources

1	ONDC | Open Network for Digital Commerce	https://ondc.org/
2	National Retail Federation	http://www.nrf.com/
3	Retail Industry Leaders Association	https://www.rila.org/
4	National Association of Chain Drug Stores	http://www.nacds.org
5	Association for convenience and petrol retailing	https://www.convenience.org
6	National Grocers Association	http://www.nationalgrocers.org