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Retailer's guide to financial:

How to
**Comply &
Thrive**



retailpro



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Executive summary

The retail business is essentially a numbers game: volumes, size, style, colour, quantity, percentage, price and so on. To get to the numbers that really matter, retailers have to make sure they have the right financial metrics to track performance. These numbers are desired not only by the companies themselves, but also by auditors and investors. That is why the finance function in retail, or its back office, cannot afford to neglect the significance of the right financials.

Especially in today's increasingly restrictive regulatory environment, retailers risk losing their profits as well as credibility, whether they have global or purely domestic operations. Financials reported by retailers must be a true reflection of the state of their business. However, mistakes during the process may arise, causing pains for many companies:

- Inventory counts are often inaccurate
- A sizable portion of merchandise/revenue is lost due to employee theft
- Staff may enter wrong information on an order that could mean thousands or even millions of dollars saved or lost
- Ambiguity in determining payment terms and account balances between retailers and manufacturers/vendors, particularly regarding returned merchandise
- The POS and back office systems are not linked to each other, which can result in out-of-date information on reports and data discrepancies

There are five areas of concern that retailers need to address in order to comply and thrive:

- Auditing and verifying inventory values
- Employee security
- Data checks and procedures
- Tracking vendor payment terms and received/returned merchandise
- Integrated POS/Back Office

Technology plays a great role in alleviating these problems. Back when retail technology simply meant a POS system, its benefits were demonstrated in a study by BC Ferries in 1996. Compared with those without POS technology, businesses that implemented it reported a 29% increase in sales and a 34% increase in gross profit.

The study was conducted a while ago and it can be reasonably assumed that over the years, with much functionality added to retail management systems, the benefits for retailers are even greater.



Auditing and verifying inventory values

To certify the accuracy of financial reports, retail staff must calculate net income. For many businesses, the biggest difficulty in computing net income is properly measuring inventory and cost of goods sold.

Measuring inventory value is complicated for two reasons:

- Counting inventory at a given point in time is like measuring the water in a sink with the drain open and the tap on. Inventory is in a state of constant change as items are continuously being sold, purchased, returned and transferred
- Inventory values tend to distort over time. There are several sources for these distortions, but most are the result of vouchers not being updated with the final cost and quantity totals that are listed on the vendor's invoice

Auditing inventory ensures that the record of goods purchased (on the vendor's invoice) matches the record of the cost of goods received (on the receiving vouchers), thus eliminating the primary source of inventory valuation problems.

Discrepancies in inventory valuation have four common sources:

- **Items being sold before they are received** – In the rush to get merchandise onto the floor, items are sometimes sold before they are actually received into the system. This can cause the inventory quantity to be temporarily negative and can skew the calculations used to determine inventory cost. In such cases, inventory must be reprocessed to ensure receiving vouchers impact inventory valuations before sales transactions
- **Incorrect cost information** – Vendor invoices showing the actual cost of items are often received days or weeks after the merchandise is physically received. This can cause misstatements of cost of goods sold and margin. When a discrepancy exists, the receiving voucher must be corrected later to match the true cost as listed on the vendor's invoice. Then inventory must be reprocessed to correct transactional costs, margins and inventory valuations
- **Data input errors** – Accurate information depends on accurate data input. If an employee unintentionally enters \$140.00 for a \$14.00 item, then inventory valuations will be wrong
- **Documents processed out of sequence** – The sequence in which transactions are processed can have an effect on inventory costs and sales margins. During normal operation, transactions are processed as they are received (by polling) at the main station but not necessarily in the correct order for valuation purposes. A stock audit ensures documents are handled in the correct sequence

Each time one of these events happens, it creates a temporary inaccurate statement of costs that can affect inventory valuations and sales margins for the period, until the vouchers are finally updated with correct cost information. Since inventory values are entered on financial reports as a lump sum, even minor discrepancies on individual items can greatly skew the total inventory value when those items are added together.

A physical inventory at the end of the period can provide an accurate picture of quantities at that time, but it does not always guarantee that the cost values are accurate, as a stock audit does. Also, many companies are required to submit quarterly or even monthly financial reports. Thus, performing a physical inventory at such frequencies may be expensive and time-consuming.

Employee security

In the 2004 National Retail Security Survey by the University of Florida, retail shrink accounted for **1.54%** of annual retail sales for large retailers—and for up to three times as much for small- and medium-sized retailers. A study from AMR Research of the same year indicated employee theft as the biggest cause of loss in retail operations, accounting for **50%** of losses. (see table)

Areas Most Prone to Loss Within A Retail Operation

Employee Theft	50%
External Shoplifting	30%
Administration Errors	15%

Source: AMR Research, January 2004

Another study by the American Business Research in 2006 found that **35 billion** dollars in U.S. retail sales were lost due to inventory shrinkage (theft) and additional billions lost due to human errors by employees.

Shoplifting was conservatively estimated to account for **30%-40%** of total retail loss. One in every 28.2 employees was apprehended for theft by their employers. Only **4.6%** of total retail theft losses resulted in a recovery. This means for every **\$1.00** recovered by companies, \$20.76 was lost to retail theft.

Undoubtedly, employee security has been a headache for retailers around the world. To comply with the law regarding financial reports and protect profits, businesses need to implement safeguards against employee fraud, including theft and transaction fraud.

First and foremost, retailers need to make employees aware of the consequences of dishonest behaviour. In other words, a loss prevention programme stipulating guidelines and punishment should be in place before technology can come in to assist in better implementing it.

An effective retail management system enables retailers to control access to specific features and data in the system and related programmes. For example, only the specified users will be able to edit quantity or cost information for inventory items. Businesses can also:

- Control the granting of discounts
- Control the types of tender that can be accepted
- Control the creating/editing of records

A strong password and rights allocation policy is also needed to ensure a fully auditable environment.

On a per-person basis, dishonest employees stole approximately **4.8 times** the amount stolen by shoplifters



Amount stolen by employees:
\$661.37

Amount stolen by shoplifters:
\$137.76





Data checks and procedures

Human errors are the source of many inventory valuation issues, making it more troublesome for retail officers to certify financial results with confidence. A study by AMR Research in 2004 showed that 15% of retail loss was due to administration errors.

Human errors can never be totally eliminated, but a powerful retail solution contains many features that reduce the likelihood and impact of data entry errors:

- Price and cost information is entered into documents automatically, based on predefined values
- The creation and editing of documents that impact inventory is controlled by employee security, as is the editing of item information. This ensures that only employees deemed trustworthy have the ability to adjust inventory values
- Any unusual cost or quantity changes, such as those resulting from data entry errors, are identified so retailers can take steps to correct the mistakes

Tracking vendor payment terms and received/returned merchandise

Returned items and their values are another source of inventory valuation problems. A retailer and vendor may sharply disagree about whether or not items can be returned and the value to assign those items. Thus, to gain a clear picture of inventory values, retailers must reconcile any such disagreements. The best way to do this is to agree with the vendor ahead of time about what to do if items are damaged or defective. These terms should be captured in the retail management system used by businesses.

Invoice matching is another important procedure. Retailers need to make sure what is ordered matches what is received. This process can be improved by using a system that captures all the data needed to verify the PO against the shipment. For the ultimate level of security, a retail management system should allow more than one level of approval before inventory is updated.

Integrated POS/Back Office

During the process of capturing data for financial reports, it is essential to have access to various areas of the retail business on the fly. Hence, there are real benefits to having integrated POS and back office systems:

- Discrepancies are impossible as data is exchanged between systems
- Each store's inventory is updated on the spot as sales and returns take place
- Nightly polling communicates data from each store to the corporate station, so that any financial reports run the next day will have up-to-date data

Compared with those without **POS technology**, businesses that **implemented it** reported a



29%

increase in **sales** & a



34%

increase in **gross profit**.

(Source: BC Ferries, 1996)

Comply and thrive with Retail Pro

Retail Pro—a leading retail management solution—contains features that address the five areas of concern above and give company officers the confidence they need to certify financial reports, allowing you to:

- Track inventory from the moment it arrives until it leaves the store, resulting in precise inventory counts, and facilitated record adjustments when necessary
- Control employee access to specific features and functions, reducing employee theft and transaction fraud
- Reduce data entry errors at point of sale through error checking and automation of the transaction process
- Track payment terms for vendors and provide a means to reconcile differences between the invoice sent by the vendor and the Retail Pro receiving vouchers
- Have a completely integrated POS and back office system to ensure data is up-to-date and eliminate discrepancies

Controlling changes to quantity and cost

Retail Pro controls changes to inventory quantity and cost through transactional documents.

There are four transactional documents that can affect quantity and cost:

- Receipts
- Vouchers
- Slips
- Memos

These transactional documents provide an audit trail for the retailer via the **Stock Ledger**, helping retailers:

- Track inventory more efficiently
- Pinpoint the cause of unexpected changes to quantity or cost
- Resolve discrepancies, such as when the cost of an item in one style differs from the cost of an item in the same style

Transactional documents also provide information for reporting and analysis and enable cost and quantity information to be captured and sent to the accounting system.

Stock audit and physical inventory

The **Audit** area enables retailers to perform periodic audits of each subsidiary's merchandise. An audit determines the value of the subsidiary's inventory (the cost paid), and has the following benefits:

- Helps ensure that financial documents and tax statements are prepared in a timely and accurate manner
- Gives managers proof of the integrity of their data so that they can confidently make purchasing and other decisions
- Makes it possible to maintain accurate margins and judge profitability

Retail Pro 9 contains a built-in physical inventory module that enables retailers to perform physical inventories and update inventory. Retailers can enter item counts via a variety of methods, including using a scanner or importing a text file.

Since **inventory values** are entered on financial reports as a **lump sum**, even **minor** discrepancies on **individual** items can **greatly** skew the **total inventory value** when those items are added together.



How employee security works

Security is handled by defining users and user groups and assigning security rights for each group.

Security rights give all members of a group access to the same features of an area. Individual users can be added to or deleted from groups, as required.

Security Administrator also contains advanced password security features, including:

- Ensures strong password and account lockout processes
- Has passwords expire and require change after a specified time, and prevents previous passwords from being reused for a given period of time
- Locks the user account after a pre-specified number of login attempts

Monitoring PO progress

Before orders are shipped, retailers can enter payment terms and related notes/conditions in Retail Pro and on individual vouchers to prevent disagreement should the goods received be defective.

As merchandise is received, Retail Pro generates a voucher that clearly displays all the information needed to verify the shipment against the PO and packing slip. Returns to the vendor can be generated on the spot or later.

This procedure maintains a current record of merchandise in transit—including when it left, by whom it was consigned, and by what means of transport. Any discrepancy between quantities sent and received is automatically brought to the attention of the retailer.

Integrated POS and back office system

Retail Pro provides retailers the access to both POS and back office features, so multiple remote stores can query data from the system simultaneously, even while the main office and remote sites are busy making sales, POs, reports and so on. Some features of Retail Pro polling are:

- Never stops other activities to carry out polling
- Polls many stores in a very small amount of time
- Ensures polling reliability

The main system easily controls the setup of remote sites and handles changes at remote sites (passwords, price levels, etc.) as part of routine polling. It also:

- Gets new or existing stores set up fast with minimum effort
- Provides tight control over multiple remote sites
- Reduces errors at remote sites

Polling is initiated at will by the remote site. Data can be uploaded or downloaded at any time of day or night. Retail Pro polling:

- Makes 100% of polling results routinely attainable
- Requires little or no attention at the remote site



About Retail Pro

Retail Pro was developed in the mid-1980s and is now a leading international point of sale software provider. **Retail Pro** solutions manage **billions of transactions** annually in more than **45,000 store locations** worldwide, in **75 countries**, and **18 different languages**.

About TRG International

TRG International is an independent provider of business and performance solutions and supports **thousands of users** in **70 countries**. Clients range from small domestic companies to large multinational companies in both the private and public sectors.

Our activities focus on enabling businesses and people to perform better.

- Business applications solutions for accounting, strategizing, planning, budgeting, retail, hospitality, ERP, business intelligence, golf and virtualisation
- People solutions for the selection of the right people for the job and development of their full potential

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