Quantum Services

Profit & Performance IMPACT

INSIGHT!

Audit Frequency – Finding The Perfect Mix

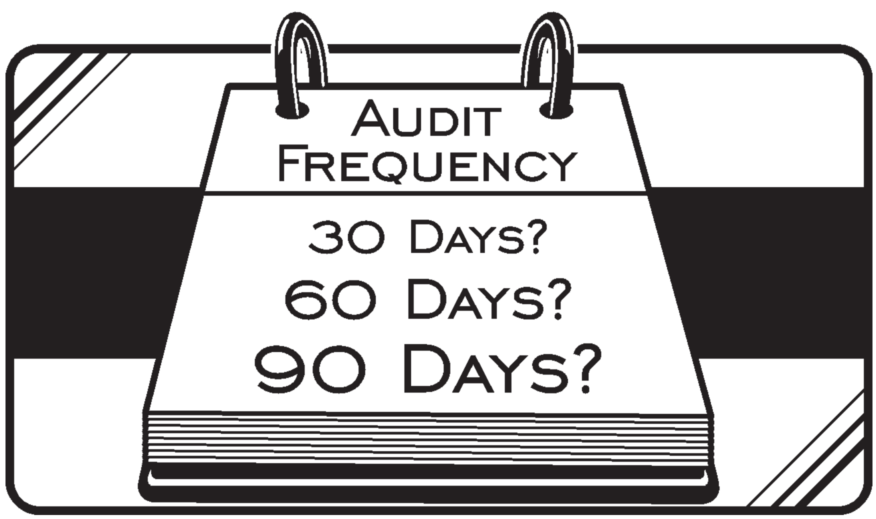
$10.00

Every week? Every month? Every 60 days? Quarterly? *Inventory audit frequencies jump back and forth a lot these days – usually as ongoing experiments in expense control. Some C-stores are even trying to find out if using computer-modeled formulas can predict which stores will experience higher shrink, and thus need more frequent audits.*

Here are two schools of thought –

- Some people in the industry believe shrink is an uncontrollable cost. They contend that shrink is a cost of doing business, so more frequent audits are probably meaningless.

- Supporters of more frequent inventory audits, on the other hand, say if you get a dishonest employee, and if you don't audit every 30 days, your losses in the 30-60 day period will be huge.



AICS, Inc.
4284 North High Street
Columbus, Ohio 43214
614.261.1190 (OHIO)
800.888.9414
614.261.8166 fax
www.quantum-services.com

Quantum Services

Quantum Services, headquartered in Columbus, Ohio, has performed more than 1,500,000 c-store audits since the firm was founded -- and serves the c-store industry *exclusively*. Quantum's audits and inventories are backed by in-depth knowledge about store level operations to help operators and store managers rapidly improve profits and performance.

Audit Frequency – Finding The Perfect Mix

INSIGHT!

Trends

In Quantum Services' experience, more and more stores are returning to monthly audits. The key to optimizing your audit frequency is having a strong management team and highly skilled supervisors. Why? Because skilled supervisors are people who can evaluate risk factors (such as what are the cash shortages and the tenure of the employees?). If you have a strong supervisory team, they should be able to make the call. They are accountable, so why shouldn't they have the inventory audit tool at their disposal to use whenever they feel it is necessary?

Another alternative some operators have experimented with is to audit stores based on results.

For example, if a store has:

0-1 percent shrink	➠	*audits performed every 90 days*
From 1-2 percent	➠	*audits scheduled for every other month*
Shrink over 2 percent	➠	*audits are monthly*

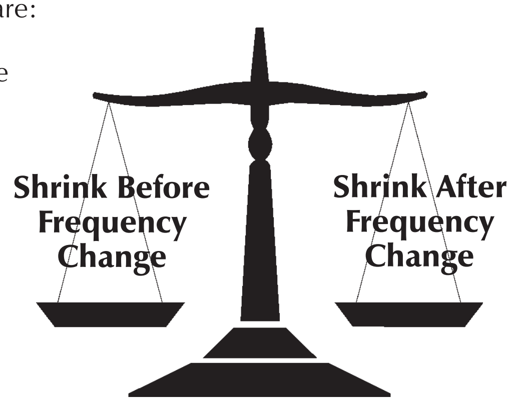
The major flaw with this approach is that the exposure to increased shrink, for stores on a 90 day cycle, is significant. However, if you are watching for "triggers" (see inside), you may be able to reduce exposure.

Test Your Actions/Track Your Results

While Quantum Services does not take a position on how frequently audits should occur, Quantum's Bill Sjoblom recommends that C-stores evaluate inventory audit programs in the same way people and companies buy insurance. For example, if audit frequency is reduced from every 30 days to every 90 days, you are buying less insurance.

But more importantly, he adds, TEST THE RESULTS when you make a change. A simple method is to compare:

- Shrink in the period of time before the frequency change
- The money saved in audit costs
- Shrink in the period of time the new frequency program was in place
- The change in shrink



AICS, Inc.
4284 North High Street
Columbus, Ohio 43214
614.261.1190 (OHIO)
800.888.9414
614.261.8166 fax
www.quantum-services.com

“If your shrink increased by more than your audit cost savings, you probably made a bad decision,” Sjoblom says.

Triggers for Finding an Optimum Frequency

There are numerous triggers for determining audit frequency. All of the triggers mentioned below are in use at C-stores today. Which make sense for your business?

<u>A bad audit result</u> – One of the most common triggers is when a bad audit result occurs, and the manager does not have confidence in the count. This triggers a recount. **Point to ponder: How often does this happen and why is there no confidence in the audit crew?**

<u>Changes in store management</u> – An audit at this point can assign clear accountability to the new manager. It provides an inventory for the outgoing manager and a starting point for the new manager. **Point to ponder: Even if you change store managers but keep the same store staff, shouldn't the new manager still be accountable?**

<u>Following a store break-in</u> – Audits are quite common here. Cash and high priced, easily-fenced items such as cigarettes usually are targeted during break-ins. These events are much less frequent these days since most C-stores are now open 24 hours. **Point to ponder: If only cigarettes and cash are taken, why audit the entire store?**

<u>Triggers</u> — A couple of the largest chains examine as many as 100 factors, all of which are statistically weighted and placed in a conceptual model to predict shrink. **Point to ponder: Is an estimation based on statistical models a good substitute for regular shrink control measurements?**

What Do You Think?

Does Increased Frequency Reduce Opportunity?

The belief used to be that if you count a store, people will know they are being watched and won’t steal. This may be applicable for dishonest employees who are inexperienced thieves. The more experienced, dishonest employees typically figure out your system after a few months. Thus, the opportunity to steal never goes away. The key is to spot symptoms and trends, and to take action.

Quantum Services

Profit & Performance IMPACT

INSIGHT!

Audit Frequency – Finding The Perfect Mix

Does Reducing Frequency Save Money? Does Increasing Frequency Save Money?

Operators with monthly audits often feel they don't need "insurance" and can save money by reducing frequency. Based on research conducted by Quantum Services in the industry, even a one-tenth increase in the percentage of shrink can wipe out the savings gained from simply going from monthly to bi-monthly audits.

Are You Missing the Connection Between Cost of Increased Shrink and Audit Frequency?

C-store operators historically have gone with monthly audits from a gut assumption. But risk goes down the more often you audit, right? Based on that assumption, then, why not go every two weeks instead of monthly? As a practical matter, auditing every two weeks does not give you enough time to take action, and therefore is a waste.

Quantum's Recommendations

1. If you are going to tinker with frequency, analyze your audit costs vs. your shrink cost for a set period of time. Look at it for the prior period of time, also. Experiment with a few stores before rolling out a company-wide change.

2. Put control of audit frequency decisions in the hands of people who have direct line supervision of stores. If there is a need to make over all cuts, ask your auditors to help you implement reductions and put the available funds in the hands of supervisors – a group that is perhaps the best resource for knowing which stores should have more frequent audits, and which can go for an extra month or two.

3. Treat the audit like insurance. Take a hard look at the true cost of shrink to your organization when you go "without coverage" for a longer period of time. Make sure shrink isn't eating into the money you thought you would save when you reduce frequency.

AICS, Inc.
4284 North High Street
Columbus, Ohio 43214
614.261.1190 (OHIO)
800.888.9414
614.261.8166 fax
www.quantum-services.com

Quantum Services

Quantum develops industry **ALERTS!, INSIGHTS!, REPORTS!, TIP SHEETS!** and **TRAINING** materials with the goal of helping operators increase their profits and performance.

Quantum is the largest company of its type in the world providing audit/inventory services *exclusively* for convenience and petroleum stores.

Please do not photocopy these materials. They are intended for individual use.
Call Quantum Services at 1-800-777-9414 for your personal copy or multiple copies.

Thank you.

© 2006 by Quantum Services, Inc. All rights reserved.