



Why traceability assurance is a powerful tool for internal audit



A track and trace system that does not deliver damages trust. Internal audit is well equipped to provide assurance across all aspects of such a system in addition to using the concept of traceability to deliver valuable assurance in a variety of contexts.

In 2020, traceability hit the headlines when 'track and trace' became one of the Covid-19 mitigation measures. While understanding the interactions of millions of people is a complex technological and societal challenge, traceability is also a straightforward and powerful tool for all internal auditors regardless of sector, size of organisation or scope of internal audit activity.

- What does traceability mean to you?
- Is important to your organisation?

Audit leaders are frequently under pressure to innovate and maintain relevance. Traceability is not a new concept but looking at it through a new lens may reveal opportunities to enhance compliance assurance, improve transparency and think differently about a broad spectrum of risks.

What is traceability?

The National Institute for Standards and Technology (NIST) uses the words “documented unbroken chain” to describe traceability. This cradle to grave approach is one which sits neatly within the remit of independent assurance.

All internal auditors will be familiar with the necessity to follow financial flows, verify transactions and produce an opinion. A general ledger transaction that includes an identification code for a journal entry enables financial traceability.

In many sectors, traceability is central to an organisation’s activities with a plethora of regulations, legislation and industry standards that mandate it. It is a critical element of the assurance provided by internal audit: pharmaceuticals, agriculture, food, healthcare, retail, manufacturing, utilities and financial services to name a few.

This thought leadership piece is not about supply chain traceability; there are a raft of specialist quality auditors and software providers of services that support in-house activities. One such provider is the Optel Group, their website includes a wide variety of **case studies** which may be of interest for audit leaders wanting to understand more about the topic; sectors include pharmaceuticals, cosmetics, food, agriculture, medical devices and mining.



All of these examples have a common thread. Traceability is about following a transaction, being able to locate evidence and validate facts; all the fundamentals of internal auditing as part of a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, internal control and governance processes.

Provenance is everything in today’s world.

Think for a moment about traceability and its role in the assurance you provide. Does it feature in your standard methodology? Is it part of your audit language? Do you think it has a place?

Consider it in relation to two key aspects of internal audit: compliance and transparency.

Is traceability different to compliance?

In short - yes. Compliance in a broad sense ensures that a defined set of rules, a process, a set of criteria have been applied and followed. An example of this is ISO9001 a commonly used quality management standard in which section 7.5.3 deals with identification and traceability, where the former is mandatory and

traceability is optional.

Imagine a situation where an organisation promotes its ethical values only to find that all the office desks were purchased from a company that advertised stock as sustainable but in reality, sourced cheap materials from unscrupulous merchants. Widespread consequences such as reputational damage, loss of trust, potential loss of talent or good will from employees, misinformation in sustainability reports...the list goes on.

- How complete is your compliance assurance?
- Do you ask how traceability risk is managed by the organisation?
- What might you find if you look below the surface?

Despite the fancy audit titles, some of the assurance provided over strategy, culture and governance is essentially compliance; establishing the process and evidencing that the steps are followed in a timely and appropriate manner. Yet is this sufficient, does it really make a difference?

Could these audits be enhanced by applying traceability to decision-making?

In the digital age, data traceability is readily accessible, yet in the case of board decision-making, data is often extracted and manipulated into reports with the inherent risk of error leading to misinformation.

Transparency and traceability

Transparency is when the facts that are captured through traceability, the evidence associated with criteria such as time, quantity, quality, accuracy, ownership, price, place etc., are translated into visible information for stakeholders.

Transparency enables trust, a key component of reputation and a learning culture.

Audit leaders that take every opportunity to promote transparency increase the value of their assurance.

Over the last decade, there has been and continues to be growing consumer demand for corporate transparency and ethical trading which traceability makes possible. The bean-to-cup **Digital Traceability** initiative launched by Starbucks is an example of this, putting the capability in the hands of the consumer to see the unique story of their purchased bag of coffee beans.

As a consumer, do you expect an organisation to provide a rapid response to questions?

In the food sector, for example, reaction time is important when a contamination is identified and products need to be recalled; being able to respond quickly to an investor question or a journalist is equally as important as being able to demonstrate that traceability is embedded in operations...not simply invoked to recover from an incident.

Following an independent review of UK consumer product recalls in 2016 in which all parties, retailers, regulators and consumers, agreed that processes were inadequate, the government set up an official public **website** for information on recalls. It is a communication tool.

Does it provide transparency and meet consumer needs?

Elevate this concept to the boardroom, visualise a website that provided transparency of issues with the inputs or outputs of decision-making – corporate, government, local authority, charity. Fanciful? Not necessarily, local government audit and risk committee minutes are already published. How do you, or

would you, as audit leader, provide assurance that the records are a transparent, true reflection of proceedings?

As audit leaders, is your focus on the facts that evidence governance, internal control and risk management or do you also consider the transparency of information and knowledge?

Internal and external reporting must be transparent. For example, organisations that are siloed may find that supply chain traceability data is not joined up. Others may be reluctant to share data with external stakeholders fearing loss of competitive advantage over the benefits of enhanced reputation. Not only can this limit the value of reporting but also reduce learning and the opportunity for improvement.

Internal audit and traceability adoption

Traceability is predominantly a quality process enhancing compliance practices; a first- and second-line activity. For more information on the three lines model click [here](#). Internal audit's role as the third line, is to provide independent and objective assurance and advice on the adequacy and effectiveness of governance, internal control and risk management.

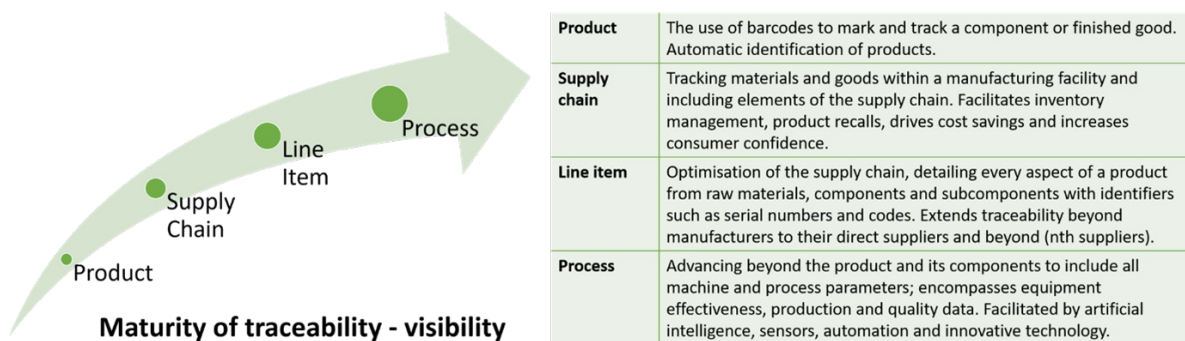
Consider for a moment your organisations risk appetite with respect to reputation, customer service, and sustainability. Is there alignment with the traceability capabilities for data, reporting and decision making in these areas?

- Who provides traceability information/assurance to the board?
- Does internal audit?

The board of any organisation, particularly one that makes or sells something, may find itself overwhelmed with data, reports and assurance. Creating an assurance map is a way to structure oversight information in order to clarify purpose, eliminate duplications and resolve gaps.

- What does this look like for your board?
- Could audits of first- and second-line assurance be improved by thinking about traceability?

A generic model of how traceability matures in supply chain management can also explain how internal audit can adopt different levels of traceability assurance proportionate to the needs of the organisation and resource available.



Product | Basic

At a basic level, the evidence internal audit gathers should have some form of identification to validate its

authenticity; it may be a time/date stamp for a system generated report or a signature on a contract. Like the barcode, this is a collection of facts used for a specific purpose.

- What quality processes ensure evidence is authentic?
- How is anecdotal input managed?

Supply chain | Hindsight

Traceability sits well with the internal audit mindset and methodology - essentially an audit trail of evidence to determine a product as being fit for purpose, a project satisfying requirements, or a decision based on appropriate information. It is the means to undertake root cause analysis, exploring the five why's, following a trail back to its origins, understanding the real cause behind the symptom(s).

- Where can existing processes be utilised for better root cause analysis?
- Which operational tools can be exploited to introduce continuous monitoring?

Line item | Insight

Supply chain auditing has extended to **nth suppliers**, likewise internal auditors can extend their assurance to the formula that creates a report, the source data of inputs, the calculations behind reported numbers etc. It is also an opportunity to look for unconscious bias within algorithms or processes such as recruitment.

Project methodologies, software engineering and change management programmes routinely include a traceability matrix to track that requirements are met and validate the existence of each element. Is this something internal audit could adapt when auditing strategy?

- What is the extent of automation for decision-making information?
- How does the organisation's culture support/hinder the traceability of performance data?

Process | Foresight

Digitalisation is continually evolving the technology available to enable traceability, particularly the Internet of Things, artificial intelligence and blockchain. All technology that is in use today.

Data analytics is a prerequisite for internal audit activities in the 2020's, analysing patterns, learning from events and handling complexity.

Audit leaders must be confident providing foresight, talking about future risk to be a proactive governance partner in any organisation.

Robust data management is essential for traceability to be effective: security, accuracy, completeness, validity, relevance, reliability. A core assurance capability for internal audit.

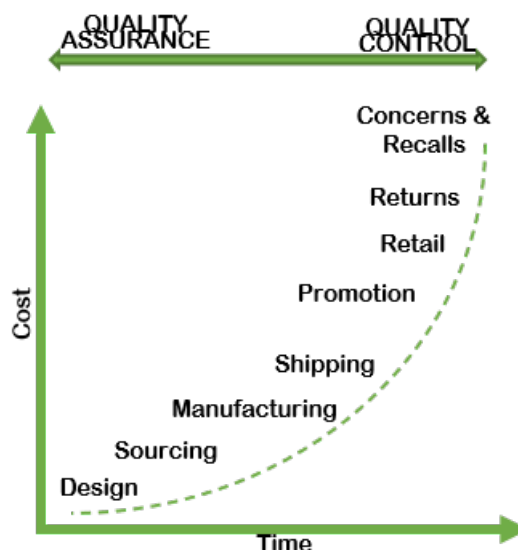
- Do you have access to the skills to provide assurance in this space?
- Is your audit plan relevant to the risks facing the organisation?

Benefits of supply chain traceability systems

It is useful for audit leaders to be familiar with the operational advantages of using tools that enable traceability, as internal audit can also use them, to leverage assurance opportunities and build commercial acumen. Many of these points are also common to the other traceability scenarios that have been discussed.

Benefits include:

- Supports transparency, accuracy and honesty in reporting
- Enhance capacity to manage reputational risk
- Brand protection
- Provide evidence of sustainability claims
- Increased stakeholder trust/confidence
- Quality data inputs to insurance premium negotiations
- Added value on safety and quality information/metrics
- Efficient and effective product recall
- Fraud prevention
- Protection against counterfeit materials/purchases
- Supports risk impact assessments
- Supports continuous improvement of processes
- Improved visibility, resilience and security of the supply chain
- Augmented supplier management
- Cost efficiency through tighter inventory control
- Reduction in early stage issues
- Easier root cause analyses and resolution of issues



Risk considerations

Traceability is a practical concept and one which internal auditors should consider in a very broad sense not simply in relation to its most obvious supply chain associations.

To help with this, the following tables provides examples of how traceability can be linked directly and conceptually to all of the risks highlighted in **Risk in Focus 2021**, an annual survey of CAEs published by the Chartered Institute of Internal Auditors.

Risk in Focus 2021	Examples of relevance to traceability
Cybersecurity and Data Security	<p>Reliance on and associated exposures to digital data</p> <p>Data sharing by multiple organisations often across different geographic regions and associated protocols</p>
Regulatory change and compliance	<p>Enhanced transaction data and management improves compliance with policy, process and certifications</p> <p>Accuracy and quality of reporting, particularly to regulators</p>
Corporate governance and reporting	<p>Increased stewardship by organisations</p> <p>Decision-making inputs</p> <p>Demand for transparency throughout supply chain (nth suppliers)</p>

Financial, capital and liquidity risks	Tighter inventory management Increased productivity
Bribery, fraud and other financial crime	Blockchain reduces opportunity for fraud Transparency discourages bribery and corruption
Supply chains, outsourcing and 'nth' party risk	The area most associated with traceability. Intrinsic to enhanced management of supply chain and associated risks including supplier validation, control weaknesses, bottlenecks and pressure points.
Digitalisation, new technology and AI	Effective management of big data Enables both predictive and reactive activities Requirements for new system developments and change programmes
Disasters and crisis response	Accessibility to validated information for crisis management Ability to react and adapt swiftly
Communications, management and reputation	Builds trust through transparency Enhances quality of supply chain communications Strengthens reputational risk management
Human capital and talent management	Identify opportunities for automation Accurately measure performance and output
Corporate culture	Supports a healthy culture with shared values and purpose
Health and safety	Embedded people, equipment and vehicle safety in relation to capacity and activity planning
Mergers and acquisitions	Can simplify integration of established processes
Climate change and environmental sustainability	Reduces errors, wastage and damages Capture carbon usage, validate recycling, classify geographics Use data to target sustainability improvements
Macroeconomic and geopolitical uncertainty	Improves understanding of exposure risk such as the exposures to new trade barriers, increased tariffs, civil war and the interests of social activists

Closing thoughts

Take time to consider the questions that have been raised. Internal audit must be relevant in the years ahead or risk obsolescence. Whether traceability does or does not offer something new to an audit methodology remains open for discussion. What is important is that audit leaders have open minds to all possibilities to be innovative, adapt and maintain relevance in an uncertain and challenging environment.

"The only way you can trust your source is to make sure they know their source."

OECD