Audit of Fraud
Fraud Detection Techniques & Forensic Audit

Misappropriation of Stores
- A Case Study

Indian Audit & Accounts Department
Regional Training Institute

E-mail address: rtiaadnr_ngp@sancharnet.in
Phone: (0712) - 2545420, 2545816, 2545829
Fax: 0712-2562577
Appropriation of Stores' has been prepared based on Part II of the report of Comptroller & Audit General of India (civil) Government of Kerala.

I extend my sincere thanks to Shri S. Nagalakshmi, Chief Accountant, who made us available all the relevant documents. I am also thankful to him for arranging the case study on the lines directed from time to time.

I hope that the readers would benefit from this. Their suggestions drawn in the case study are most appreciated.

RTI, Nagpur,

## CONTENTS

<table>
<thead>
<tr>
<th>Sr.No.</th>
<th>Topic</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Background</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Fraud Environment</td>
<td>1</td>
</tr>
<tr>
<td>3</td>
<td>Opportunity to prevent fraud</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>Act of Fraud</td>
<td>2</td>
</tr>
<tr>
<td>5</td>
<td>Opportunity to detect and proving fraud</td>
<td>2</td>
</tr>
<tr>
<td>6</td>
<td>Lessons learnt</td>
<td>3</td>
</tr>
<tr>
<td>7</td>
<td>Enclosures for reference</td>
<td>3</td>
</tr>
<tr>
<td>8</td>
<td>Flowchart</td>
<td>4</td>
</tr>
</tbody>
</table>
## LIST OF KEY DOCUMENTS

<table>
<thead>
<tr>
<th>Appendix No.</th>
<th>Details</th>
<th>Page No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appendix 1</td>
<td>Para appeared in the Audit Report of Comptroller and Auditor General of India for the year ending March 31, 2003 (civil), Government of Kerala.</td>
<td>5</td>
</tr>
<tr>
<td>Appendix 2</td>
<td>A copy of letter from Kerala Water Authority based on petition from Secretary CITU Trivandrum.</td>
<td>8</td>
</tr>
<tr>
<td>Appendix 3</td>
<td>A report of verification of Public Health Division, Trivandrum.</td>
<td>32</td>
</tr>
<tr>
<td>Appendix 4</td>
<td>A copy of Enquiry Report on unauthorized issue of material.</td>
<td>58</td>
</tr>
</tbody>
</table>
Misappropriation of Stores

1 Background:

Despite persistent comments of Audit since 1997-98 about inadequate frequency of physical verification of stores by Stock Verification Units and Executive Engineers of the Divisions as prescribed in Accounts Manual of Kerala Water Authority, no heed was given by the divisions, which led to shortage of stores costing Rs. 1.17 crore by way of pilferage/unauthorized issue of stores/lifting stores on bogus indents/gate passes and by manipulation of issues in Bin cards over the period 1997 and January 2000. The Public Health Divisions involved were:

1) Public Health Division, Alappuzha.
2) Public Health Division, Thiruvalla.
3) Public Health Division, Thodupuzha.
4) Public Health Division, Thiruvananthapuram.

2 Fraud Environment:

As per the provisions of Accounts Manual of Kerala Water Authority, periodical physical verification of stores by Stock Verification Units and by Executive Engineers of the concerned divisions to cover all transactions in a financial year is mandatory. Such verification aims to ensure correctness of posting of receipt/issue of stores in Bin Cards and Priced Stores Ledgers with actual quantities found in physical verification. It is also essential on the part of division to reconcile the quantities of balances in Bin cards with the balances in Priced Stores Ledger and record certificate in PSL. The fraudsters took the advantage of non observance of provisions of Accounts Manual.

3 Opportunity to prevent fraud:

The following preventive controls could have avoided the occurrence of this fraud.

a) The proper scrutiny of indents for requisition of issue of stores by competent authority viz Sub-Divisional engineer/Executive Engineer.

b) The careful scrutiny of monthly store account at sub-division and division level.

c) At the time of posting indents in Ledger in division.

d) A regular reconciliation of quantities in Bin Cards with that of balances in Priced Stores Ledger.
e) Reconciliation of indents for issue of material with gate pass could have detected bogus gate pass/bogus indent.

f) The manipulation in Bin cards could have been detected in a periodical review of bin cards/completed bin card.

g) The Executive Engineer should ensure physical verification of stock every year to ascertain correctness of actual balances in order to effect accounting adjustments after investigating the reasons for excess/shortage in quantity of material.

h) The Stock Verification Unit also failed to carry out the verification of stock periodically as stipulated in rules. (Refer flowchart on p-4)

4 Act of Fraud:-

The scrutiny of records (January-March 2003) in respect of nine divisional officers revealed that the concerned Executive Engineers did not conduct physical verification of stores under their control.

It was also found that the Stock Verification Units verified stores only thrice in one division, twice in seventeen divisions and once in nine divisions during six years from 1996-02.

Physical verification of stock necessitated following complaint lodged by one of the trade unions about unauthorized lifting of galvanized iron pipes worth Rs.1.20 lakh, from the Divisional stores, Thiruvananthapuram (August 2001) revealed shortage of 661 items of stores costing Rs.87.78 lakh towards lifting of stores under the cover of bogus/false indents/gate passes, manipulation of entries in the bin cards, non reconciliation of figures in the Priced Stores ledgers which was supervisory lapses on the part of divisional officers.

Physical verification of stock between March 1998 and December 2000 by Stock Verification Units revealed shortage of stock costing Rs.28.83 lakh in four divisions.

Thus, lapse on the part of Kerala Water Authority to ensure periodical physical verification of stores at divisional and Stock Verification Units led to misappropriation of stores of Rs.1.17 crore.

5 Opportunity to detect and proving fraud:-

5.1 Red flag indicators

Audit had been commenting since 1997-98 regarding inadequate periodicity of physical verification of stores of divisions by Stock Verification Units and by Executive Engineers of divisions by making internal arrangement as stipulated in Accounts Manual of Kerala which