## Black Market Sales

### The Scenario

The auditor was analyzing inventory losses at overseas retail locations and noted the following trends:

- One overseas store reported a five percent inventory count variance at the end of the year. The organization's inventory tolerance rate is one percent.[1]

- The same store reported shrinkage of $10,000 for alcohol and cigarettes during one quarter of the previous fiscal year.[2]

The auditor visited the retail location and interviewed the store manager regarding the reported losses of cigarettes and alcohol. The store manager was aware of the situation and stated that they thought one of the employees, who owned a liquor store outside of the military base, was stealing the merchandise and selling it for profit in their store. Additionally, one employee was recently fired when the store manager caught them taking home a case of liquor at the end of their shift. The manager found out that the fired employee was selling liquor on the local black market because the profits were high and American made liquor was very popular with local residents.

The auditor continued their review of receiving records for alcohol and cigarettes and noted that merchandise losses were consistently reported during each month of the past year. The auditor completed a physical inventory of liquor but was not able to locate fifty cases of Liquor X, which was recorded as received the previous day. During their review of sales transactions, the auditor noted a $5,000 cash sale for fifty cases of Liquor X at the same time the shipment was received by store personnel. The auditor concluded that an employee or group of employees purchased the merchandise and paid the retail value of the liquor to prevent a variance with the retail book inventory. Because black market profits were high, the merchandise would yield a profit of at least $8,000 for the $5,000 purchase.

**General Comments / Lessons Learned**. At many overseas locations, American made liquor, cigarettes, and electronics are popular items on local black markets. As a result, it is important that auditors remain alert to high inventory shrinkage reports and inventory count variances for these commodities. Because the black market profit margin for these items is very high, it is not uncommon for store employees to pay the retail price for the goods and then resell them for a large profit, as illustrated in this scenario.

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[1] Inventory count variances between actual stock and the system stock amounts are generally subject to tolerance limits.

[2] Inventory shrinkage is the difference between the book inventory that an organization should have because of its sales, purchasing and manufacturing processes and the actual inventory it has on hand. Main causes of shrinkage include theft by employees or customers, inventory counting errors, accounting mistakes, fraud, and lost or damaged goods. (http://12manage.com/description_inventory_shrinkage.html)

**FRAUD INDICATORS**

- **Inventory count variances exceed the established tolerable level.**
- **Excessive shrinkage reported for popular black market commodities.**
- **Employees fired for stealing items such as alcohol, cigarettes, or electronics for resale on the local underground market.**
- **American made goods, popular with local residents, cannot be accounted for during physical inventories.**
- **Large quantities of popular black market commodities are recorded as sold when merchandise is received; sales are generally cash transactions.**
- **Unusually large cash transactions.**