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Even Trusted Staff Can Become Dishonest Bookkeepers

DISHONEST bookkeepers continue to prey on trusting companies. The modus operandi varies, but usually involves manipulating the employer's bank account. In the past, the first scapegoat was usually the company's bank, but 1990 amendments to the Commercial Code and recent case law have diluted the potential for recovery against banks and shifted the loss back to the employer who hired the bookkeeper. This makes it imperative that businesses put their own house in order by examining their internal accounting policies and adopting safer practices.

Dishonest bookkeepers employ one or more of the following schemes:

- A bookkeeper with signature authority issues checks to himself or herself or an interested third party, disguising the payment as a legitimate business expense.
- The bookkeeper obtains authentic signatures for checks made payable to a nonexistent employee, fictitious recipient or a real person not entitled to money.
- The business owner signs blank checks and gives them to the bookkeeper who uses them to embezzle funds.
- A bookkeeper purloins a check and forges the drawer's signature.

ENTREPRENEUR'S NOTEBOOK

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- A bookkeeper alters the payee line after obtaining a signature to the bookkeeper or a colleague.
- The bookkeeper issues a check for a vendor's invoice and increases the amount of the payment after obtaining a signature. Proceeds are split between vendor and bookkeeper.
- A bookkeeper purloins an incoming check, or an already issued one, and forges the endorsement, depositing the check into the bookkeeper's account.

Not just bookkeepers, but anyone with access to checks can use these schemes and escape detection for years.

Preventing embezzlement

A business owner who protects company funds not only loses less money, but also sends a clear message that financial irregularities will not be tolerated. In the event of a lawsuit, an employer who has taken protective measures has a much better case than one who has been negligent. Here are some ground rules.

Remember that it can happen to you. Employers who trust their long-time bookkeeper sometimes discover that they have been a poor judge of character. Even trusted employees who may be close friends get into financial trouble. They usually plan to pay their "loan" back, but it never works out that way. Another necessary precaution, no matter how tight your schedule, is to read your bank statements before an employee has a chance to remove fraudulent items. It will help you detect a forged signature or altered check. Finally, screen all new employees. A simple background check may show a history of previous problems or criminal convictions.

Employers often don't follow their instincts when it comes to suspicious behavior. For example, beware of a bookkeeper who is living beyond his or her means, or one in financial distress. Even an employee who is too reliable could be cause for concern. Some embezzlers will resist taking vacations or sick leave for fear that someone else may go through their desk and discover their schemes. Follow up on creditor's claims of funds owed which show as paid in your files, and on debtor claims that a bill has been paid which is still outstanding according to your records.

Finally, fidelity bonds for critical employees should be considered, especially if the employee handles large volumes of checks or cash.

Smart accounting practices

To prevent forgery losses, there are at least eight critical functions that must be adequately segregated and controlled: Approval of check requisitions; cutting checks; signing checks; receiving and entering customer payments and endorsing checks; making deposits; updating accounts receivable records; ensuring that listed receipts match bank deposits and accounts receivable credits; and examining monthly bank account statements and checks.

In small to medium-sized companies with one- or two-person accounting departments, the same person commonly requisitions checks and cuts them, makes deposits and even reviews account statements. This practice invites disaster. In such circumstances, the owner must perform one or more of the critical functions and provide oversight.

In a single bookkeeper arrangement, the owner should approve all check requisitions with supporting documentation, sign checks and maintain physical control over unused checks and check signing machines. He or she should also open mail, list the checks and ensure that the amounts received are deposited, follow up on customer complaints, directly receive and examine monthly bank statements and checks, and authorize the opening and check signing authority over all company bank accounts.

The owner should also prepare monthly bank reconciliations or have them prepared by an outside CPA. One or more of these functions can be delegated to an employee other than the bookkeeper, but the owner should ensure, at least quarterly, that required functions are being adequately performed.

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Entrepreneur's Notebook is a regular column contributed by EC2, The Annenberg Incubator Project, a center for multimedia and electronic communications at the University of Southern California. Contact James Klein at (213) 743-1759 with feedback and topic suggestions.