Cooked books

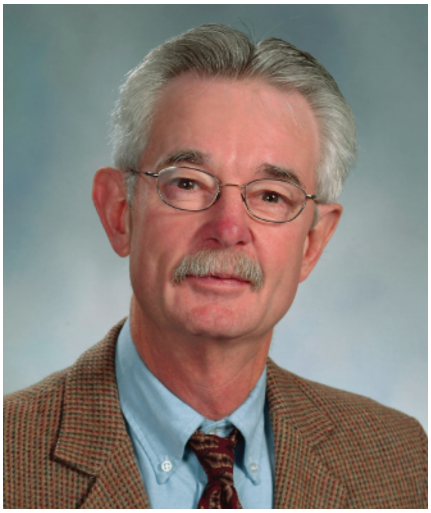
How to safeguard against internal theft **Interviewed by Elizabeth Grace Saunders**

Forget alarm systems. The most potentially dangerous intruders already know the codes. When employee dishonesty penetrates a company, the consequences can be incredibly damaging.

"Financial losses from employee dishonesty do happen," says Ralph Cummings, fidelity underwriter at Westfield Insurance. "We see them every day.

"The results can be devastating not only financially but also psychologically. The guilty employee often is a trusted, longtime member of the business. The hurt that comes from the breach of trust adds to the loss."

Smart Business spoke with Cummings about the issue of employee dishonesty and how to prevent it.



Ralph Cummings
Fidelity underwriter
Westfield Insurance

How do dishonest employees steal from their companies?

Small-scale theft happens with the loss of relatively low-cost materials and supplies. Large-scale theft usually results from taking expensive property or accessing the company's bank account.

At one truck dealership, an individual in the parts department took expensive truck parts with him over a long period of time. He would make excuses, such as he was taking the items for a delivery, when in fact he was taking them for his own profit. Another unfortunate loss happened with a contractor whose bookkeeper took money from the company over a period of seven years. The loss exceeded $1 million and cost the owner his business and his relationship with his sister, who was the bookkeeper.

The business community often isn't aware of these dangers and situations because the affected companies don't want to publicize the loss. But the truth is that employee theft does happen, particularly when employees are trying to support expensive bad habits, and businesses need to guard against it.

How does employee dishonesty affect businesses' insurance expenses?

Insurance is a mechanism for spreading losses among policyholders. Protection against a large, uncertain loss (an embezzlement) is traded for a small, certain loss (the premium). As a company's losses grow in size and amount, the premiums to pay for them will increase.

How can companies create a culture of honesty and integrity?

Every company should closely examine the way it deals with its customers and employees. Does the company deal fairly with others, or does it often take advantage of them? If employees are encouraged or permitted to deal dishonestly with customers, how can they be expected to deal with integrity with their employer? A culture of honesty and fair dealing must start with upper management.

Treating employees fairly and respectfully is also very important. Showing an interest in each employee, and making each feel that his job is important can foster employee satisfaction. But beyond that, an employer must demonstrate that cheating, dishonesty and unfair business practices will not be tolerated.

What controls can help prevent employee dishonesty?

Over the years, I have seen many employee dishonesty losses. There is one method that seems to recur most often and seems to result in very large losses.

Every insured company has a bank account. At least one employee is responsible for reconciling the monthly bank statements against the employer's records. That person is the most likely to detect any discrepancy between the two. Very large losses happen when this person is also permitted to handle bank deposits or to have access to blank checks.

For example, if an employee is given a deposit to take to the bank but decides to keep it for himself, the bank statement will show no deposits for that particular day. An impartial bookkeeper would catch this discrepancy in the records. However, if the person reconciling the bank statement is also the person who should have made the deposit, he will obviously not let management know about his theft. With no unusual records and no checks on the behavior, the employee is free to continue this activity indefinitely.

Likewise, if the person who reconciles the bank statements also has access to unissued checks, he could use the employer's checks to pay his personal bills, make purchases, or simply make checks payable to himself. Even if this individual does not have check-signing authority, he could forge a signature. Banks generally just pay the checks and rely on the customer to let them know of any discrepancies. It is not uncommon for losses of this type to continue for years and reach very high amounts.

One of the biggest keys to preventing employee dishonesty is to have the bank accounts reconciled by someone who does not handle the bank deposits and who does not have access to unissued checks.

RALPH CUMMINGS is a fidelity underwriter. Reach him at (330) 887-0544 or ralphcummings@westfieldgrp.com. In business for more than 157 years, Westfield Insurance provides commercial and personal insurance services to customers in 17 states. Represented by leading independent insurance agencies, the product we offer is peace of mind and our promise of protection is supported by a commitment to service excellence. For more information, visit www.westfieldinsurance.com.