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## QuickBooks® for Contractors Newsletter

### Embezzlement, It CAN Happen To You.

As a busy business owner it is quite easy to fall into the bad habit of simply turning over your business's accounting to someone else; because your time is best spent in the field and not in the office doing paperwork. Not only is this a bad habit, it can also become a dangerous situation.

In the course of my bookkeeping career, now over 25 years, I've seen many instances of employee theft – from the simple act of people taking home office supplies in the fall for their children, employees giving themselves unauthorized raises, bookkeepers embezzling money from the business, accountants "cooking the books", and even family members "making a mess of things".

Whether it's theft of money, supplies, inventory, equipment, or intellectual property, nearly every small business will experience some type of employee theft or embezzlement at one time or another.

Small businesses are particularly vulnerable to theft simply because they don't have the resources or security controls in place to stop them.

Employee theft is extremely common; unfortunately, we hear about it or read about it in the newspapers all of the time.

While it is fair to say, *most people don't steal*, embezzlement does happen; so it only makes good business sense for you to consider what you can do to minimize your employees' opportunities to steal.

Here are some simple ideas you can use to reduce your chances of becoming a victim.

### Protecting Your Business from Embezzlement

Fortunately, there are easy ways to minimize the opportunity for embezzlement at your company. Here are some steps you can take to protect your business's assets:

- **Do a background check before hiring someone to be an employee.** A person with a criminal background of theft or a problematic financial past might be tempted to take resources from your business. It's a good idea to be informed about the person you're hiring *before* you hire them.
- **Keep track of your company's checks.** Purchase and use pre-numbered checks and periodically check for missing check numbers by using the QuickBooks *Missing Checks* report; available by going to the Reports menu -> Banking -> Missing Checks.

Have a written "voided check" procedure that requires all voided checks to be coded to an Expense Account called "*Voided Checks*" and use the memo field to record the reason the check was voided; for example, printer jam. Periodically generate a *Quick Report* for this account to see what checks have been voided and why; create a *Quick Report* by going to the Lists menu -> Chart of Accounts -> scroll down to the Voided Checks account, click to select it -> click the Reports button -> choose Quick Report.

Our best advice is to Never, NEVER sign a blank check.

- **Sign and verify all checks, especially payroll checks.** It's a good idea to sign all checks-even small ones-yourself. This can be a lot of work (as a corporate controller, I used to sign about \$100,000 of checks every week), but you can have an employee prepare the checks for your review and signature.

Not reviewing and verifying checks before you sign them is like signing your bank account over to anybody who wants the money (and that could be everybody).

The benefit of signing all your checks is that your signature will be a requirement for money to leave the business. No cash will be deducted from the business bank account without your knowing about it.

For payroll checks, review the hours worked, pay rates, taxes deducted, and who the check is made out to. You should always know who works for you and how much they get paid.

If you'll be on vacation for, say, a couple of weeks, the business will probably need to pay some bills while you're away. You can deal with this in a couple of ways.

- You can decide to trust an employee enough to leave behind a signed check or two; the employee can then use these signed checks to pay for things such as an unexpected C.O.D. shipment.
- You can decide to simply require vendors to wait.
- Pay upcoming bills before your leave.

If you leave signed checks, be sure to leave specific instructions as to what these checks should be used for, and review the checks when they come back from the bank to be sure that your instructions were followed.

- **Make bank deposits nightly.** As the business owner, you should make the nightly bank deposits. This is especially true for cash because it is so tempting and easy to steal. Your funds are much safer in the bank than in your desk drawer or the cash register.
- **Understand your books.** Embezzlement is easy to miss and difficult to prove if your bookkeeping is sloppy or unsupervised. You need to be educated in how to review financial statements and know what to look for. Your accountant can show you how to do this, or you can take an accounting or bookkeeping course.

Use and review the QuickBooks *Voided/Deleted Transactions Detail Report*, found by going to the Reports menu -> Accountant & Taxes -> Voided/Deleted Transactions Detail. This report will show you who voided, deleted, or changed a transaction and when it was done.

Another report that you should review periodically is the *Audit Trail Report*; this report is accessed from the Reports menu -> Accountant & Taxes -> Audit Trail. This report can be very overwhelming, so it is our advice that you consult your CPA or QuickBooks ProAdvisor for help on what to look for in this report.

Employee embezzlement and theft costs U.S. businesses millions of dollars each year. Small businesses are especially vulnerable because the ramifications of theft can cripple a small firm and even force it to close.

- **Reconcile the bank and credit card statements yourself.** Make it your company policy that you are the one who is responsible for reconciling the monthly bank and credit card accounts. This way, you can make sure that no one is forging your signature and writing a check or two for non-business reasons.

This might seem unlikely, but if your business writes a hundred checks a month totaling tens or hundreds of thousands of dollars, would you really notice an extra check or two if the amounts were "only" a few hundred dollars?

- **Separate Mailroom Duty from Bank Deposit Duty.** One of the most common ways to embezzle money from an employer is called lapping. To lap, an embezzler skims a little bit of the cash that comes in each month and then adjusts the books to hide the skimming.

As long as the person skimming the cash also maintains the checkbook, it's easy for the theft to go unnoticed. The embezzler simply ignores or hides the fact that, for example, the \$500 Customer A owes you has been paid.

You can minimize the opportunities for lapping if you have one employee open the mail and make notes on an Accounts Receivable report of incoming cash and another employee enter the bank deposit information into the computer.

For this approach to work, you simply compare the Accounts Receivable Report of incoming cash maintained by the mailroom person with the bank deposit information shown in the computer, and you contact customers about past-due payments. This way, you can discover, for example, that Customer A actually paid the \$500 owed and that the check has cleared the bank.

- **Protect Other Valuable Assets.** From an embezzler's perspective, cash is the most convenient item to steal. It's portable, easy to store, and easy to convert to other things an embezzler might want.

Because cash is usually watched so closely, however, embezzlers often steal other items of value, such as office equipment, inventory, and supplies.

You can follow a couple of general rules to minimize losses such as these. You can keep a record of the things that your business owns and periodically compare what your records show you have with what you actually hold.

If you buy and sell inventory, for example, keep a record of what you buy and sell. Then, once a month or once a year, compare what your records show with what you have in your warehouse or storeroom.

You can also restrict access to any valuable assets that the business owns. Warehouses and storerooms should be locked. Access should be limited to people who really need what is being kept behind lock and key. If you have items of high value in a storeroom, for example, and several employees have access, it's also a good idea to make it a rule that people go into the storeroom only in pairs. (A dishonest employee is less likely to steal if someone else is present who may see and report the theft.)

- **Require Vacations.** There's a final embezzlement prevention tool that many big businesses use and that you should probably consider: Require regular vacations of a week or two. (Banks almost always do this.)

Here's the rationale: Some embezzlement schemes are so clever that they're almost impossible to catch. The one typical weakness of these super-clever schemes, however, is that they usually require ongoing maintenance on the part of the embezzling employee. By making the employee take a vacation, you can see what happens if the employee's not around.

## General QuickBooks controls and procedures.

We've discussed some specific practices that you can implement to insure that your business isn't being ripped off; in this next section we'll talk about some general internal procedures that many business owners can implement quite easily.

- **Who should be the QuickBooks Administrator?** As the business owner, you should create the QuickBooks Admin account and password and be the Administrator for your own QuickBooks company data file. All too often we have seen or heard from many business owners that their CPA or QuickBooks ProAdvisor is the Administrator of their QuickBooks file and that they don't even know what the Admin password to their own data file is; quite frankly we do not agree with this practice. Your books are YOUR books, just like your business is your business. You should not give that kind of control to anyone.

We have heard of instances where the business owner and the CPA/ProAdvisor has had a "falling out" and the business owner cannot perform even the simplest of Administrator functions because they do not know the Administrator password and the former CPA/ProAdvisor will not tell them what that password is. This results in the business owner having to pay for password retrieval.

- **Who should know the Administrator password?** Your CPA/ProAdvisor or in-house bookkeeper should know what the Administrator password is; otherwise you could be pulled off the jobsite to perform menial tasks.
- **The Administrator Account should NOT be used when entering daily transactions.** The Administrator account is a special purpose user account and should be treated as such.
- **Each QuickBooks user should have their own QuickBooks user login account.** As the QuickBooks Administrator you should create a user account for each person who will have access to your company data file, this includes a user account for yourself which you will use when entering transactions. When you create user accounts you are the one who controls who can access what information.

A word of caution for Enterprise users, the permission setting in the Enterprise version are much tighter than in Pro or Premier and you do need to be careful when setting up user permissions or you can effectively prevent an employee from performing the tasks that you do want them to be responsible for.

- **When should the Administrator Account be used?** We recommend that you use the Administrator login account when reconciling the monthly checking and credit card accounts; and then on an "as needed" basis, as there are times when it is required that you, your CPA, or bookkeeper must be logged into QuickBooks in single-user mode as the QuickBooks administrator

- such as changing companywide preferences in QuickBooks or granting permission for a third-party application to access your QuickBooks company data file.

- **Set closing dates and use the *Closing Date Exception Report*.** On a monthly or quarterly basis, after you have reconciled the bank and credit card statements **or** after the quarterly payroll tax reports have been completed; set a closing date with a password; closing dates are found from the Edit menu -> Preferences -> Accounting -> Company Preferences tab. This will prevent accidental or unauthorized changes to previously reconciled transactions, because only those people who know the password will be allowed to make changes, and get them into the habit of using the memo field to indicate why a cleared transaction was changed. You can then run a *Closing Date Exception Report*, found from the Reports menu -> Accountant & Taxes -> Closing Date Exception Report.
- **Monitor Accounts Receivable Reports.** Implement a procedure that by a specified time on Friday that you receive an *Open Invoice Report*, found from the Reports menu -> Customers & Receivables -> Open Invoices. You should review this report and then leave it for your mailroom clerk for Monday morning, so that she can make notes of payments received during the week and return it to you after mail time on Friday. You can then compare the previous week's report to the current weeks report for any discrepancies. For example, the mail clerk indicates that payment for Invoice number 1001 was received on Tuesday, but the current Open Invoice Report shows that it is still outstanding.
- **Monitor your Accounts Payable Reports.** Don't leave it up to someone else to decide which bills get paid and which ones will be delayed....you could be in for an unpleasant surprise!

How often does your company pay its bills - weekly, bi-weekly, monthly? Implement a procedure in which **you** receive an *Unpaid Bills Detail Report*, found from the Reports menu -> Vendors & Payables -> Unpaid Bills Detail by a specified time on a certain day of the week with the current bank balance indicated.

Review the report and **YOU** decide who gets paid and who doesn't; maybe even make a few phone calls if cash flow is tight. The day before it's time to pay the bills, ask for the current bank balance and make any necessary adjustments. Leave this marked up report for your Accounts Payable clerk for the morning that they are to cut the checks. Keep in mind that taking advantage of early payment discounts could help pay for other upcoming bills.

The suggestions contained in this article are not designed to turn you, the business owner, into an untrusting boss but rather are suggestions to help you maintain control of your business and its financial affairs.



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