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Accountant *Versus* Embezzler

By E. A. St. John

Every day, every hour, in all parts of the United States is fought a silent but active warfare, in which hundreds of accountants seek to detect some tell-tale discrepancy revealing a defalcation, and in which hundreds—yes, hundreds—of embezzlers strive to conceal their thefts by an endless and highly interesting variety of bookkeeping tricks.

In this country alone, embezzlers steal more than $100,000,000 every year; and, but for the vigilance and efficiency of accountants, would make away with an inestimably larger sum.

The fifty fidelity insurance companies of the nation paid $9,235,836 in embezzlement claims in 1922 and their payments during the previous decade increased steadily as follows:

Year	*Embezzlement*
1910	$1,396,081
1913	2,030,201
1918	3,060,348
1919	4,633,604
1920	5,623,819
1921	8,270,000

Naturally, therefore, we surety folk watch the constant, nation-wide accountant-versus-embezzler struggle with a very practical interest.

A careless accountant who overlooks small irregularities in a set of books or a weak-spirited accountant who permits himself to be persuaded to take an easy-going attitude about small irregularities may cost the surety companies very heavy losses.

Since the fee of the accountant is not paid by the surety company but by the surety company's obligee, the accountant feels no obligation to protect the surety company.

But accountants have obligations to the public as well as to the business people who employ them; and so, in reporting a small embezzlement, should warn the employer against leniency or concealment, for many embezzlers whose first offense has been forgiven have subsequently embezzled very large amounts, and,

whenever even the smallest irregularity is not reported to the surety company, *the fidelity bond becomes void from that time.*

Some years ago a state bank examiner discovered some small irregularities in the accounts of the popular and magnetic manager of a suburban bank. He complained to the bank's directors, who were local tradesmen inexperienced in banking, and they persuaded him to ignore the irregularities because the manager was a "good business getter" and a "valuable employee." Several years later the bank examiner, in his periodic visit, discovered that those first small irregularities had grown to a $300,000 shortage, which closed two banks, ruined a community and caused at least one despairing depositor to commit suicide.

Accountants, when on a job, must avoid all personal entanglements.

An accountant down south was employed periodically to examine the books of a small bank. He found the bank manager very attractive and obliging. Whenever he got ready to compare the totals of the individual accounts with the totals of the general ledger, the manager always offered to help by reading off the totals while the accountant himself operated the adding machine. This went on for many years until the accountant had a temporary illness and another accountant came in his place. The bank manager took one look at the new accountant's firm jaw and impersonal face, and then got his hat, excused himself and disappeared, never to return. By reading false totals to the first unsuspicious accountant, he had been enabled to conceal a series of embezzlements totalling $60,000.

An accountant's good name is his chief capital. A good name, once compromised, is almost impossible to get back. Four $1,000 bills were once placed on the desk of the assistant cashier of a small town bank. The bank occupied an old-fashioned building with cracked wainscoted walls. At the end of the day, the four $1,000 bills had disappeared and could be found nowhere. The assistant cashier was discharged under suspicion and no other concern would employ him in a position involving any trust. He had no money; nor had he friends in other towns so that he could start again elsewhere. For years he could get only the most menial positions. Then the bank was remodelled and the four $1,000 bills were found to have slipped behind one of the cracked walls. The discredited assistant cashier sued the bank for his lost name and got a jury verdict. But the money damages

did not compensate for his wrecked business career and years of business ostracism.

Causes of the great increase of embezzlement in the United States during the last decade are largely due to increase of opportunities which, in turn, are due to the increased complexity and elaborateness of business. Close supervision of trusted employees is very difficult, if not impossible nowadays; and little or nothing is known regarding the antecedents, private lives, temptations, etc., of trusted employees. References of trusted employees are often not investigated; if investigated they are usually done so only by letter or telephone. My company has actually found criminals with prison records employed in financial institutions, discovery of these records being made only when we were asked to issue fidelity bonds.

It is next to impossible for even the ablest accountant to discover an embezzlement if the embezzler's tricky technique is flawless and if the embezzlement does not become too large. But here are some typical recent embezzlement cases with the suggestions of my associate, Herman J. Lofgren, as to how an efficient accountant might have detected them.

Example No. 1

A cashier received cash deposits made by customers in payment for stocks for margin deposits which he appropriated to his own use to the amount of $12,900. He kept this shortage covered by substituting cheques received from clients for the cash and increasing his bank balance over night to cover up the deficit until he received further deposits the next day to make good.

In order to misappropriate the $12,900 it is evident the cashier resorted to the time honored method of "lapping" and raising bank balances by making entries for receipts not deposited in their entirety.

To manipulate the accounts successfully, all entries on the cash blotters would be made by the cashier. The postings therefrom to the customers' accounts would be made by the bookkeeper, and entries on the margin cards would be made by the margin clerk.

Monthly statements to customers would be mailed as is customary and apparently everything would be in proper order.

In order to detect or circumvent such schemes, the accountant should check all cash credits to customers' accounts against cash

blotters, foot cheque books and reconcile bank balances for all months during the period of his audit, and where necessary obtain original deposit slips from banks.

MODUS OPERANDI

Currency received				
John Brown	(1)	$1,500		
James Smith		1,000		
F. Jones	(3)	750		
C. Chandler	(4)	1,750		
T. Bryant	(2)	650		
V. S. Beatty	(2)	1,250		
H. H. Lovett	(3)	1,500		
J. L. Gray	(5)	8,400–500	Appropriated	
Jas. F. Ballinger	(6)	700		
L. L. Wilson	(7)	1,250		
M. R. Cox	(8)	1,150		
W. J. Muir	(9)	1,000		
W. J. Turpin	(10)	500		
M. C. Miner	(11)	500		
			$14,000	
Cheques received:				
Geo. I. Brandon	(1)	$2,500		
R. Alexander	(2)	1,900	Substituted for items 1 to 4	
C. W. Wright	(3)	2,250		
R. L. Holland	(4)	1,750		
			$ 8,400	

LEDGER ACCOUNTS

BANK ACCOUNT BLANK TRUST CO.

1923		*Debit*	*Credit*
January 1st	Balance	$25,000	
January 31st	Deposits, items 1 to 4	8,400	
	Actual balance	33,400	
	Amount raised by fictitious entries on cheque book stub	14,000	
		$47,400	
Capital and sundry liabilities:			
January 1st, 1923,	Balances		$25,000
Sundry customers' accounts:			
January 31st,	Credits		$22,400

EXAMPLE NO. 2

A bookkeeper, trading in three different accounts kept in his wife's name, lost money in the trades and to make the accounts good transferred credits from interest and commission and partners' accounts to make good his margins to the extent of $29,000.

To cover up the losses sustained in trades the bookkeeper would manipulate his books in the following manner:

Total debit to customers for interest charges as per interest book	$30,000 (1)
(Footings on interest book would then be changed to read, viz.: $25,000)	

Interest credit to earnings....................		(1)	$25,000
Concealed or direct ledger credit posted as a cash receipt to wife's account....................		(1)	5,000
Concealed or direct ledger debit to partners' account....................................	20,000	(2)	
Concealed or direct ledger credit to wife's account		(2)	20,000
Charged to customers for commissions.........	50,000		
Credit to earnings..........................			46,000
Concealed or direct ledger credit to wife's account			4,000
Carried forward.........................	$100,000		$100,000

The accountant should prove the footings of the interest book and check the total credited to earnings. Likewise the commissions on purchases and sales of stocks as shown by the blotters should be proved and checked against the amount credited to earnings. If this is done for all months to be covered by the audit irregularities as described will be quickly revealed.

Example No. 3

Assured's bookkeeper and order clerk acting in collusion traded, buying and selling stocks which were paid for by the firm in the belief that the trades were genuine, they using the name of several customers who had had accounts but whose accounts had been closed. They made fictitious entries in the books, did not carry margin cards and when the books were audited borrowed balances from accounts which had credits to offset the debit balances existing in the accounts being used.

The detection of manipulations of this character depends to a great extent upon the nature and scope of the accountant's examination.

According to the language of the problem, customers' accounts with full credit balances were used to clear the debit balances in the amounts being used for trades.

This illustrates very forcibly how imperative it is for the accountant to mail confirmations to all customers, whether their accounts are closed or not. Such confirmations should state the amount of the debit or credit balance, and the long or short position. If there is neither a balance nor stock position, the statement should so read. When the statements were incorrect complaints would quickly follow and the irregularities would thus be disclosed.

Example No. 4

A customer's man using the name of a relative, trading without the knowledge or consent of the firm, ran into a loss which the

margin clerk failed to report to the firm on the statement of the other employee that the customer was good for the loss and would make it up. The market continued to go against the traders. The margin clerk, to conceal the losses, took the margin card out of the box and when the firm discovered the condition of things there was a loss of about $130,000.

Strictly speaking, this is not an accounting problem, but is a case of dereliction on the part of the margin clerk. Nevertheless, an alert bookkeeper would see almost at a glance that the account was under-margined or without equity, and unless he was in collusion with the customer's man and margin clerk, he would report the matter to the office manager or a member of the firm.

If the books were being audited, the condition of the account would be disclosed the moment the accountant made up his equity statement.

Example No. 5

Two employees of a stock brokerage house created a loss of approximately $25,000. These two men, one a bookkeeper and the other a margin clerk, were acting together in buying and selling stocks in four accounts. Three of the accounts were opened in good faith and were closed by the original owners. After they had ceased operating, however, these men continued to buy and sell, using these accounts, and they opened another account which was entirely fictitious. They were able to cover these transactions by switching debit balances to other accounts and when the auditors came in at the end of the year they took out the loose leaves from the ledgers and substituted loose-leaf pages from other accounts showing the necessary balances to make the individual accounts balance with the general ledger.

In this instance, the switching of debit balances to other accounts has a tendency to make the accounts so debited under-margined or without equity. Manipulations of this character present little or no difficulty to the experienced Wall street accountant.

By taking the trial balance for the month previous to that of the audit the ledger accounts and balances would be established, and by checking the entries for the current month the irregularities and substitution of other ledger leaves would be apparent and the necessity of a detailed audit of the accounts disclosed.

Furthermore, a check of the long and short positions as shown

by the customers' accounts with the stocks and bonds record would show that the accounts were irregular.

Example No. 6

Principal was manager of the Indianapolis branch office of a Chicago stock brokerage house. He admitted a shortage of about $45,000. The shortage accrued through the unauthorized trading by him in the accounts of two of the big customers of the firm. His books agreed at all times with the firm's Chicago books, but statements sent to these two customers by the Chicago office were intercepted by the defaulter and false statements were made up by him showing the balance each would have had if principal had not traded on these accounts. Then, to keep these customers in good standing with the margin clerk at the Chicago office, principal reported having received securities to be held as collateral. It was only when the Chicago office sent to check the collateral that principal's depredations were discovered.

It is evident that all trades in the Indianapolis office were made through the head office in Chicago where all accounts with customers were kept, Indianapolis records being subsidiary thereto. Cash receipts and disbursements would be deposited in Indianapolis and reported to Chicago. Stocks and bonds purchased for customers would be in Chicago either in box, in loans or in transfer. Chicago would draw on Indianapolis from time to time. All loans would be made in Chicago. Stocks and bonds held for safekeeping could be either in Chicago or Indianapolis.

In order to keep the two customers' accounts in good standing, the Indianapolis manager would report having received certain securities as collateral which he had placed in his box. On receipt of this information, Chicago would make the customers "long" and securities in box in Indianapolis as the offset.

The non-existence of said securities would be revealed when the accountant would make up his own securities record. It is possible that the Indianapolis manager might try to cloud the issue by asserting that the missing securities were in transit, but this could be readily verified by communication with the Chicago office.

Example No. 7

Defaulter, who was the manager of a bank, drew numerous cheques for office expenses, proceeds of which he pocketed. To

cover these charges he put these items in suspense and then transferred them into the personal account of the president of the bank, who never checked up his account and never knew how it stood. By this method the defaulter was able to get away with approximately $30,000.

In auditing a bank, the accounts on the general ledger should be analyzed by the accountant. If this is done the washing of items in the manner outlined in the problem is quickly disclosed.

Generally speaking, it is unusual for banking institutions to make payment in cash for items of expense, unless the amount be very trivial. This being the case, disbursements of the character mentioned would call for close scrutiny and explanation. The frequency of the disbursements and the lack of supporting vouchers would, in the writer's opinion, arouse suspicion as to their authenticity, particularly as they were eventually charged to an individual's account.

Example No. 8

The defaulter was a teller in the savings department, an employee who had worked his way up through a period of years from office boy in the banking department to teller in the savings department, and could therefore be expected to be familiar with the accounting system of all departments of the bank. His method consisted in entering the deposits as and when received on the depositors' pass books and on their savings account cards but omitting to enter the amount on his teller's lists and omitting to account for the money to the banking department. The above procedure would of course throw the trial balance of the savings account cards out of balance with the banking department control account. To prevent its discovery, it would appear that whenever a proof of the balance in the savings department was to be made, fictitious debits for the amount of the shortages at that date were made to accounts known to be inactive and the trial balance was thereby reduced to the amount called for by the control account. After serving their purpose, these fictitious entries and the adjusted balances were erased and the original figures re-entered. By confining these operations to ledgers sections "4" and "5," ample time was afforded to make the adjusting entries while proofs were being taken of ledgers "1," "2," and "3." Undoubtedly the above procedure was facilitated by the fact that the defaulter acted both as receiving teller and book-

keeper, also by the fact that he was later allowed to take off the trial balances. Total loss was $14,986.20.

This problem emphasizes the fallacy of permitting an employee of any banking institution to occupy a dual position and to allow the same person to take off a trial balance.

To detect manipulations of this character the pass books should be called in for comparison with the account cards. If the officials deem this inexpedient then the whole of the account cards should be taken away from the teller when least expected, the deposits and withdrawals listed and compared with the general ledger control. Then the jig will be up.

Example No. 9

Defaulter bought all of the postage stamps used by house. He was a trusted employee in the "cage," and all his requisitions were O.K.'d by his immediate superior. He secured money from the cashier from time to time with which to purchase stamps. Some of the stamps were used for the registered mail going direct from the "cage," but the larger part, as a rule, was used by the mailing department. Defaulter supplied this department with stamps, taking receipts from the mail clerk. All money paid to the defaulter for the purchase of stamps was charged to a "stamp-postage" purchase account on obligee's books (an asset account). Periodically he would prepare a journal voucher relieving the "stamp-postage" account and charging "expense account." To this entry he attached the vouchers received from the mail clerk and to cover his shortages which amounted to approximately $20,000 arising from his failure to use the money for stamps in the way it was intended to be used, he would prepare vouchers similar to those taken from the mail clerk and forge the mail clerk's name to them.

In the first instance the increased expenditures for postage should have been sufficient to warrant investigation.

The writer maintains that casual inspection of vouchers is insufficient. Signatures on vouchers of this kind call for close scrutiny. If this is done the caligraphy of the perpetrator eventually betrays him.

Example No. 10

The head bookkeeper of a bank, by switching credits from a large account to a small account of another customer, permitted

the latter to overdraw his account approximately $7,000, of which head bookkeeper later received a share.

Statements of customers' accounts should be made up by other than those in charge of the individual ledgers, and upon their completion they should be handed to the bank auditor who should mail them personally.

Illicit withdrawals in the manner described cannot continue indefinitely if the above safeguards are in operation.

Example No. 11

The trusted manager of a New York dry goods store took quantities of merchandise from his employer and with it stocked a store of his own in an adjacent street. Business increased yearly in the store in which the manager was employed, but yearly balances showed dwindling profits and finally startling losses. The proprietor reluctantly was persuaded to employ detectives to trace the trusted manager, and the rival store was soon discovered.

The simplest sort of inventorying and auditing would have disclosed the shortage in merchandise while the losses were still small.

Example No. 12

A $25 a week clerk in the employ of a New York wholesale grocer, through conspiracy with a driver and outside confederates, stole and resold large quantities of incoming merchandise. The proprietor, paying a rare visit to the shipping room, noted that this poorly paid clerk wore a silk shirt. Investigation disclosed that the clerk was living in a $3,500 apartment with servants and an automobile.

The making of an inventory would have disclosed these peculations.

Example No. 13

A branch manager, in collusion with a dishonest attorney, divided with that attorney collections secured from various debtors' accounts which had been turned over to that attorney for collection by manager. The attorney would collect such accounts, but report them as uncollectible. This report would be sent to the home office by the manager and the accounts marked off. These operations were carried on for three years before accidental discovery was made and the surety company paid a bond of $10,000 on this loss.

Careful checking by an accountant of individual accounts and

confirmations mailed to all customers, especially those whose accounts had been reported as uncollectible, would have disclosed these peculations.

EXAMPLE NO. 14

A young man employed as bookkeeper and cashier in a large refrigerating company, by overlapping items, managed to make away with $25,000 in cash in a period of two years. A part of the concern's business was to lend money on cased eggs placed in cold storage, and to release the eggs when the loan with interest and storage charges was paid. The bookkeeper-cashier upon receiving such payments would issue an order releasing the cases involved, credit the customer's account and charge a corresponding amount erroneously to some other accounts, consequently leaving his cash balance as if the amount manipulated had not been received.

At the time this young man was employed, it was the practice of the concern to have quarterly audits and inventories made by certified public accountants. This was continued during the first two years of the new bookkeeper's employment, by which time he had become a trusted employee, and was bonded in the sum of $1,000. At the suggestion of someone the quarterly audits and inventories were abandoned, and thereafter each month the bookkeeper-cashier prepared a trial balance of his books which was accepted by the treasurer as correct.

Two years later the employee failed to report for work, and it developed that he had left home. A new bookkeeper was employed but demanded that an audit be made before he took over the books. A six weeks' audit disclosed irregularities and a shortage in the original employee's accounts of more than $25,000.

A continuation of the quarterly audits and inventories would have disclosed irregularities of this sort had they been attempted. The case indicates that the irregularities would not have been attempted if the inventories and audits had not been abandoned.