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Bonding employes

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future capacity of the United States to deal with any conceivable situation in finance or trade by taking as a standard the statistics of pre-war England, we are truly not yet intellectually qualified for the world leadership to which our almost incredible material power has called us.

On one of the two economic theories we must hesitate to export our goods because in the nature of things it will assist our customers to rebuild their power to produce and ultimately to export. On the other theory we must hesitate to finance solvent debtors because in the nature of things debtor countries cannot pay by goods. If we are to deny ourselves and the rest of the world the benefits of lending our surplus production because of theories that the nature of things is all wrong, because of theories that the very reasons why international trade exists are to be regarded as reasons why international trade should be strangled—then our reputation for sanity may well be questioned. The seat of industrial and financial power has passed to America, and doctrines designed to prove

that America cannot exercise that power as Europe once exercised it are absurdities.

These are the considerations which our manufacturers and bankers must ponder. For it is clear that the American taxpayer is not going to cut the Gordian knot for them by agreeing to pay the German reparation debt. He will do the fair thing by the German taxpayer and the French, the British and the Italian taxpayers. But in principle he believes that the war was Europe's war. This being so, there is no way Europe can avoid paying for it in one fashion or another. Our taxpaying public is also our investing public, and repudiation of debts would kill the foreign investment market here, with results probably much more serious to Europe than to ourselves. Fantastic theories in support of "cancellation" seem to the average man to approach dangerously near to repudiation. More than that, they stir up trouble between France and Germany and thus threaten the settlement which the majority of the citizens of both countries have loyally accepted.

Bonding Employes

THE present epidemic of embezzlements has drawn attention, among other things, to the bonding of employes. Notwithstanding the large volume of business being done every year by the numerous surety companies, it has developed that in too many instances firms and companies suffer serious losses through defalcations by employes who are not sufficiently bonded, or are not bonded at all.

Cases such as one which occurred not long ago are rare. A cashier had been misappropriating various amounts of his employer's funds over a considerable period of time, and had been depositing them intact in his savings account until he could accumulate enough for the purchase of a house. He suffered the misfortune, however, of being discovered in his nefarious scheme just as he had reached his goal and

was about to spend the money. Under the circumstances complete recovery was easily effected.

It is almost a commonplace that employes and officials occupying positions of trust should be bonded. Frequently employers have been restrained from requesting bonds by a fear that those in their service might consider such requests as serious affronts to their integrity. Nevertheless, in many instances these same employers have permitted employes to work under conditions affording ideal opportunities and even temptations to dishonesty.

The widespread use of fidelity bonds should serve as a reassurance to an employe that his honesty is not being violated by a request that he furnish a bond. The recent extensive defalcations, many perpetrated, unfortunately, by most trusted

individuals, should allay any overscrupulous feeling an employer might have on the subject.

Bonds should be sufficient in amount to cover possible losses. Employes bonded at nominal amounts for "moral effect" have succeeded in making way with funds several times the face of their bonds. And experience has shown that sizable defalcations have been committed by persons whose duties were so arranged that normally they handled no cash.

In writing a fidelity bond, the principal—the person whose honesty is guaranteed—obviously is of paramount importance. Surety companies interest themselves in all the aspects of an applicant's life and character which may assist in determining the probability of his performing his duties honestly. Frequently investigations made by surety companies are more thorough than those made by prospective employers.

The past life of an applicant for a bond and his employment over a period of years are microscopically examined. At times an employer requests that unfavorable past actions be overlooked, altruistically discounting their recurrence in the future. Experience indicates, however, that where a bond is withheld because of previous dishonesty, the employer usually is not willing to keep the man in his employ and assume the risk himself.

Traces of undesirable associates, dissipation, gambling, speculation, debts, extravagance, etc., often are causes for refusing to bond an applicant. Seemingly trivial circumstances may have far-reaching effects. It has been estimated that at least three out of every four bank defalcations are caused by the fact that an employe has become involved in speculation, and has appropriated cash or securities in order to extricate himself.

Almost equally important from the standpoint of the surety companies in writing a bond, although perhaps less apparently so, is a consideration of the

obligee—the person to whom the bond is made payable. It is necessary to inquire into the working conditions surrounding the applicant for a bond. They may have a bearing on his future integrity as vital in some cases as his past acts.

It is almost certain that persons having a tendency to dishonesty are much more likely to prove dishonest than they otherwise would, if the environment in which they work renders dishonest acts easy of perpetration. It is possible that persons inherently honest may not be able to refrain from evil deeds if they are compelled to work under conditions which virtually offer temptations to dishonesty. The principle of contributory negligence, under the common law, requires that a person bringing action for personal injuries must prove, in order to recover damages, not only that his injury was the result of another person's carelessness, but also that he himself was not guilty of such lack of prudence as to facilitate the injury. In a large number of cases involving defalcations employers have violated this principle by failure to exercise proper supervision over their employes, or to surround them with reasonable safeguards.

The importance of this phase of fidelity bond underwriting was early recognized by surety companies. During the early stages in the development of the business elaborate forms called "employers' statements" were used to gather complete information regarding an employer's accounting and auditing methods. The assured was required to furnish a minute description of the duties of an employe applying for a bond and the conditions under which his work was performed. He was asked to stipulate that the present status of affairs would not be changed during the term of the bond. It is said that one surety company included the following statement in a form to be signed by the employer: "Proper accounts are kept and adequate examination of the transactions will be made."

At renewal dates additional forms called "employers' renewal statements" frequently were required, in which the assured was obliged to reaffirm the original statement, and in addition, to certify that the employe's accounts had been checked up to date and found correct.

These statements sometimes were used by surety companies in order to escape liability. If it were found, for example, that a shortage existed prior to the last renewal date, it might be contended that the facts set forth in the renewal statement concerning the examination and correctness of the accounts at that time were false, and that therefore no grounds for a claim existed.

Conditions in this respect have gradually improved. The courts, in the litigation which necessarily resulted, have inclined towards greater justice to the assured. State regulatory bodies also have taken a hand. Competition has forced the companies to recognize the necessity of greater liberality in writing bonds. Gradual development in the science of the business has been an aid.

Surety companies continue, however, to ascertain carefully complete information concerning the working environment of bond applicants. Employers' statements are sometimes used for this purpose, but rather as an aid in determining the risk involved than as a condition precedent to the issuance of a bond.

The employer's accounting system is of vital consideration. It matters whether an adequate distribution of duties is in operation, so as to render difficult the perpetration of fraud, or whether one man is in complete control of the situation, and could misappropriate funds easily. If it is found that nothing is done to protect an employe by adequate accounting or supervisory safeguards, and that he can steal when he will, companies frequently refuse to become his surety, no matter how excellent his personal qualifications.

There are many concerns where one person controls all financial matters; where one bookkeeper has entire charge of the cash in addition to the books. Such situations virtually place a premium on dishonesty, and are undesirable risks. Precautions of organization and system facilitate bonding. They reduce the moral strain on employes. They render more remote the risk of loss with its inconveniences and consequences, the latter often more serious than the contingencies covered by a fidelity bond.

In concerns too small to permit of an elaborate distribution of duties, much may be accomplished through intelligent supervision. For example, it can nearly always be arranged to have some one other than the person in control of the cash records sign checks and reconcile bank statements. A more or less extensive system of internal check can be worked out, depending on the size of the business.

In any concern more or less frequent internal audits avail much. A cashier who may be asked at any moment to produce his cash for verification is likely to think twice before attempting any manipulations. Internal cash counts need not comprehend a complete verification of all records in the custody of a given individual. They should, however, consist of a verification, as of a certain date, of all his funds, together, probably, with a scrutiny of his records for traces of irregularity. A cashier not long ago appropriated to his own use currency from a fund in his custody, and showed his withdrawals as having been deposited in a bank account of which he had charge. He was able to conceal the shortage, which, incidentally, was in excess of the amount of his bond, for a considerable length of time, although his cash was counted at intervals by another employe. The difficulty was that the latter counted only the cash in hand, which always agreed with the records. Had he verified the cash on deposit the shortage would have been discovered sooner.

Rotation of duties is desirable where feasible. Obviously, in many instances it would be highly impracticable to attempt frequent shakeups in office personnel. However, the reason for the comparatively few bank defalcations in Great Britain has been traced to the custom of rotation of duties prevalent in many of the British banks.

There should be a rule in every business that all employes in positions of trust be compelled to take a vacation. Considered aside from the question of general efficiency, the prevention and discovery of fraud are facilitated by allowing another person to perform an employe's duties for a short while. Several kinds of fraud, notably the kiting of collections from customers, are difficult to accomplish without detection unless the defaulter is on the ground all the time. Surety companies usually are prone to regard with suspicion persons in responsible positions who consistently abstain from vacations.

The advantages of regular periodical audits by certified public accountants in this connection are too numerous and obvious to need extended comment. In the early days of accountancy the discovery of fraud usually was considered to be the chief object of an audit. Because of the great developments in the science of accountancy in late years, and the enlarged demands for work of a broader scope, there has been a tendency to relegate the discovery of fraud to a subordinate position, without, however, depreciating its importance. The recent unparalleled increase in the amount and complexity of embezzlements is evidence that the discovery of fraud ever must remain one of the main purposes of an audit. An examination by a disinterested party facilitates the discovery of a shortage in its early stages. Further, it is a source of suggestion for remedying defects in system or organization calculated to prevent irregularity in the future.

The early discovery of a defalcation is

sometimes vital to recovery under a bond. Fidelity bonds usually contain a provision releasing the surety company from liability in case of a shortage if the irregularity is not discovered before, or within a short period after, the termination of the bond. In a recent audit accountants developed irregularities in the accounts of a cashier which had been going on for nearly three years. The client had changed bonding companies two years prior to the time the shortage was discovered. It was found that the first surety company was altogether released from liability. Under the terms of its contract with the client it could not be held for any defalcation discovered later than one year after the termination of the bond, which in this case was nearly a year prior to the time the shortage was actually brought to light.

Surety companies recognize, in fidelity bond underwriting, the advantages accruing from the utilization of the services of certified public accountants. In underwriting stock exchange houses, for example, a reduction in rate is granted if the assured agrees to have regular audits made by certified public accountants. Generally speaking, surety companies dislike to bond a man whose duties involve the handling of money and the keeping of books unless he is periodically audited either, and preferably, by some outside accountant, or at least by some superior official or board within the organization.

An important objective at the present time is the reduction and prevention of loss due to theft. Surety companies are endeavoring to work toward this end by standardization of the business, careful selection of risks, dissemination of useful information, and by other means. Employers should feel a duty to cooperate by giving careful thought to their system of accounting control and audit, with a view to diminishing the possibility of future irregularities and facilitating the discovery of existing shortages.