Who’s Minding the (Small Business) Mint?

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The world of the typical small business owner can be a hectic place. The days are filled with seemingly endless activities, most of which are designed with the same goal in mind — to make the business a profitable enterprise. Demands on time frequently conspire to prevent the accomplishment of greater, more productive, tasks. Not uncommonly, the days seem to end before they have gotten underway. Working hours turn into days, days turn into weeks, weeks turn into months, and months turn into years. When is there time to get it all done? When is there time to devote to the truly critical items, those things that feed the lifeline of the business? And, by the way, what are those things?

Certain owner responsibilities should qualify as critical – items that cannot be overlooked or neglected. At the top of the list are the small business owner’s responsibility for the regular review and analysis of the bookkeeping, banking and financial records of the business and the careful supervision of the employees who handle them.

While the business owner is tending to the affairs and general fiscal health of the business, he typically must delegate handling of the daily receipts and deposit activities to others. A small business owner is charged with a host of time-consuming responsibilities, including those of getting new business, servicing existing business, closing out old business, resolving issues with personnel, solving problems with customers or clients, and watching the ever-changing landscape of the competition, to name a few. The prudent small business owner will add at least one more item to that list of priorities: monitor the bank accounts, and closely.

In a common small business scenario, responsibility for daily bookkeeping matters is turned over to an on-site bookkeeper who discharges his or her duties with considerable leeway and little supervision. These duties often include such day-to-day business activities as writing checks, making deposits, handling payroll matters, paying suppliers, transferring funds between accounts and maintaining petty cash reserves. While it is true that the world is full of competent, reliable bookkeepers whose integrity and efficiency remain unchallenged, it is also true that there are those whose actions in the unsupervised handling of financial accounts become, for a variety of reasons, less than exemplary. The alert small business owner will always find time in an otherwise
crowded schedule to exercise regular supervision of the company's bookkeeping personnel, and to review the monthly bank statements and copies of canceled checks for all business bank accounts.

Many situations exist today in which an employee having access to bookkeeping records can alter, forge or fraudulently endorse checks or other instruments flowing in and out of a business. For purposes of illustration, consider the simple but relatively common scheme whereby the bookkeeper of a small business pursues over time a planned pattern of deceit by forging the owner's name to company checks payable to “cash,” and then cashing the checks at the company's bank where he/she is known to be an employee of the business. Suppose further, that this activity goes undetected over a period of years until the business owner finally discovers and discloses the forgery scheme.

Too frequently, small business owners seek false security by relying on assumptions that are destined to fail. Two of the more common are:

1. that bookkeeping personnel would not or could not forge signatures on company checks
2. and if they did, and the forged checks were cashed by the bank, then the loss could simply be recovered from the bank

These ideas find support in the law under the general premise that a person is not liable on an instrument (i.e., a check) unless he signed it. However, this thinking does not complete the analysis. The law in North Carolina as well as in other states imposes certain duties on the bank customer, in this case the small business owner, such that the customer's failure to comply with those duties shifts the burden of loss from the bank to the customer. In the illustration at hand, for example, if the business owner's failure to use ordinary care in supervising the bookkeeper substantially contributed to the making of the forged checks, the business owner could be prevented from recovering his/her loss from the bank.

Courts have routinely held that employers who do not closely monitor and regularly check on the activities of employees charged with handling company finances and given free access to company checks and bank statements are negligent in failing to detect forgeries that may occur. Likewise, allowing the same employee who has possession of the company checkbook to reconcile the company's bank statements without supervision constitutes negligence on the part of the employer. A business owner has a duty to use ordinary care in supervising employees, and when a bookkeeper is authorized to both write checks and to reconcile the company books and records, a periodic review or audit by another person should be performed.

Another duty imposed by law on the small business owner as a bank customer is the duty to discover and report unauthorized signatures, forged checks or other unauthorized alterations to checks. Here the law requires that where a bank sends or makes available to its customer a statement of account, the customer must use reasonable promptness in examining the statement to determine whether any payment was improper because of an unauthorized signature. If the customer reasonably should
have discovered the unauthorized payment, the customer must promptly notify the bank. The law gives the bank customer a reasonable period of time, not exceeding thirty (30) days, within which to examine the account statement and give notice to the bank of any irregularities.

Courts have commonly held that the bank customer's duty to exercise this care is triggered when the bank provides sufficient information to the customer for review, including a statement of account showing payment of items with either return of the items paid or information sufficient to allow the customer to reasonably identify the items paid. The customer is then in jeopardy of bearing the loss when he/she fails to discover and notify the bank of unauthorized transactions. Applying these rules to the small business owner, courts would have little difficulty rejecting most excuses for the owner's failure to detect a forgery of his own signature, particularly in light of the fact that since the owner is most familiar with his own signature, and should know whether or not a particular check was authorized, he is in a better position to prevent unauthorized account activity than the company's bank which likely processes thousands of transactions in a single day.

In conclusion, with respect to matters pertaining to the use of business bank accounts, the small business owner would be well-advised to include time in an already busy schedule for the regular supervision of employees, and the periodic review and analysis of the bookkeeping, banking and financial records of the business.