



## **CORRESPONDENT BANK ACCOUNTS**

Recently BancInsure paid two large fidelity claims involving correspondent bank accounts. One of the claims was in the amount of nearly \$850,000 and the other was approximately \$675,000. Those familiar with bank operations should realize the potential for very large dishonesty losses with correspondent bank and Federal Reserve accounts, if proper internal controls are not in place. Without proper internal controls, employee embezzlements can and will occur. These two claims vividly point this out.

The two claims are very similar. Both banks have approximately \$180 million in assets and approximately 70 employees. In both cases the dishonest employees had been employed by the bank only a few years, as opposed to the “long term trusted employee.” In both claims, the employee responsible for making entries into the accounts for correspondent banks was also responsible to reconciling the accounts. In one claim there was no apparent internal independent review of the accounts or reconcilements. In the other claim, there was a cursory review by the dishonest employee’s supervisor.

Both embezzlements were carried out in the typical fashion of embezzlements involving correspondent bank accounts. Fictitious entries were made in correspondent bank accounts and were offset by deposits to checking or savings accounts controlled by the embezzler, issuance of cashier checks or by the withdrawal of cash. In one claim a portion of the funds may have been used to fund cancer treatments for the embezzler’s uninsured boy friend with another portion transferred out of the country. In the other claim the funds were used to support the lavish life style of the embezzler and her extended family.

One may be tempted to think that the existence of a large embezzlement would be apparent on a correspondent bank reconciliation form. This is not the case. The embezzled amount is simply “hidden” in the amounts representing checks forwarded to the correspondent banks for collection. The embezzled amount is rolled forward to the next reconciliation.

In one claim, the independent outside auditor failed to detect the embezzlement, and on the other, the embezzlement was detected when the original auditor was replaced by a new auditor who utilized more thorough audit procedures. The point to this is that bankers should not rely on their outside auditors to detect embezzlements.

The key to preventing this kind of embezzlement is the classic internal control principle of separation of duties. That is, the employee responsible for making accounting entries should not be the one responsible for reconciling the account. Another useful tool is

employee account reviews. It is surprising the number of embezzlers using their checking accounts at the bank to transfer the proceeds of their embezzlements.

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BancInsure | 5005 N. Lincoln Blvd. | Oklahoma City, OK 73105 | 800-682-1630 405-290-5678 | [www.BancInsure.com](http://www.BancInsure.com)