

# Are your books balanced?

Establish processes today to save you money and time tomorrow

By Dan Menzer, CPA

**M**ost insurance agencies use some form of technology system to capture the accounting information necessary to prepare financial statements and tax returns. But, is it really enough just to have the financial information available, or do you need to manage the information actively and understand the implications to your independent insurance agency?

Most systems in use today “force” a balanced set of accounting records, but they don’t ensure accuracy or integrity to the numbers presented. Whether your agency uses a product from Applied, AMS or another insurance agency automation vendor (much preferred over such general alternatives as Quickbooks or even Excel), the old rule of “garbage in, garbage out” still holds true. And like an Excel file with an incorrect formula, just because something is on the system doesn’t make it right. Someone in the agency should oversee results and take the time to interpret them, to identify successes and problems, and subsequently develop strategies to address the problems and capitalize on the successes.

Following is a rather extreme example. Revenue at “The Main Street Agency” stems mostly from direct-bill policies, so when a check arrived from one of its insurance companies in late December for \$15,250, it was assumed to be just another commission check.



While it seemed a little odd to the staff person entering the information into the system that there was only one customer name listed on the check, he figured it must have been a pretty large account. The cash went into the bank and the income was recorded. When the agency principal asked for the year-end financial information, she was pleasantly surprised at how good the month looked, but she didn’t ask any questions. Bonuses were paid before the end of the year, and the owner was happy to have an extra \$15,000 she hadn’t expected, so Christmas was pretty special that year.

About two months later, that “large-account” client called the agency, curious about the disposition of its cancellation premium since more than a couple weeks had elapsed. After a little investigation, the error was discovered, and several people had some explaining to do to the agency principal. An innocent mistake, perhaps, but it was too late to return the Christmas gifts, and the agency had to produce the \$16,000 return premium and related commission. The problem was not that the books weren’t balanced; had this been the case a system error report likely would have been generated, and the situation would have been corrected at the time. The problem was that no one took the time to notice the unusual transaction and confirm that the accounting treatment was correct.

There are countless situations where bad accounting goes unnoticed, often until significant damage to the agency’s financial health has occurred. Frequently, the errors are innocent mistakes, but others may be the result of fraud and/or conscious efforts to conceal the underlying nature of a transaction. The key to preventing problems such as these is a set of well-designed internal controls and segregation of duties, based on your respective organization.

Internal controls generally consist of independent review and oversight of the accounting process, and

adherence to segregation of conflicting duties between staff members. By circumventing collusion between staff members, the review and segregation-of-duties processes should help prevent inappropriate transactions from occurring. They also should identify any such transactions already included on the balance sheet.

Yet, when more than one person is involved in concealing the truth behind accounting transactions, fraud is nearly impossible to prevent and much more difficult to identify. For this reason alone, the agency principal must be involved in accounting review. Delegation of all duties internally is a recipe for problems.

Following are some of the essential attributes and sound-accounting processes and procedures usually associated with an environment of strong internal control:

1.) **Bank reconciliations** are completed each month on each account, independent of the receipts and disbursement process. The reconciliations include a thorough analysis of all reconciling items, which are then reviewed and approved by another person independent of the preparer. This process may also include a random scanning of cleared checks to look for any changes to payees or inappropriate endorsements. If the accounting department is too small to effectively segregate these responsibilities, someone outside the accounting area is involved in the review process.

Without the independence of the bank reconciliation, inappropriate checks or stale reconciling items can be hidden from management for extended periods of time. At month-end, a cash deposit and disbursement reconciliation process also should be established to make sure all cash transactions were recorded.

2.) **Accounts receivable and premiums payable** are reconciled to the system's subsidiary ledger reports (aged receivables and aged or just detail payables register, respectively) monthly. Depending on how the agency processes direct-bill revenue, there also should be a method for ensuring that all commission receipts are recorded as revenue in the month they are received.

Misleading receivables- and payables-balances can occur due to

uncollectible aged-customer balances, inappropriate accounting entries made to these accounts, or stale return premium items buried in the premiums-payable balances. Without performing the detail reconciliations and analyzing the components of the asset and liability balances, the reported amounts can be extremely misleading.

3.) **All other balance sheet general ledger accounts** are reconciled and independently reviewed no less than quarterly, ensuring that all balances are current and reflect true and accurate business activities.

4.) **Disbursement transactions** are reviewed and approved by a person independent of the preparer before being released for payment. No single individual should have the ability to fully execute any form of transaction.

Even the most loyal employees have been known to abuse their position of trust and use agency financial resources for their own personal gain because they had the ability to disburse funds without sufficient management oversight or segregation of duties. Think about it: Why do you advise your clients about the need for a fidelity bond?

5.) **Revenues and expenses** are reviewed in detail for variances to budget or prior periods, with explanations for unusual or large variance items.

As illustrated earlier, without the proper degree of oversight and analysis, even innocent mistakes can prove to be costly.

6.) **System-generated customer accounts receivable statements** are distributed regularly, showing all open balances or transactions to clients on a monthly basis. Although this practice isn't foolproof, it can lead to questions that uncover legitimate problems or shine light on inappropriate items occurring within a client's account.

Often, the issue of limited staffing, particularly in the accounting area, is raised as an impediment to adequate internal controls. In smaller organizations, complete segregation of responsibilities and independent approvals of transactions can be difficult. Designing a process to create an appropriate level of oversight in these situations requires creativity.

It may involve using people independent of the accounting function or resources outside the agency, such as an accountant or other business advisers. While this tactic will cost more, the cost of employee fraud could quickly outweigh all expenses associated with maintaining a proper control environment.

Yet, designing and implementing an effective process of internal controls is seldom a top priority for agency principals because they believe it adds no value or revenue to the agency. But, the opposite often is true. Having controls may require more time and expense for management and oversight of the accounting or quality review process, but it also may prevent unpleasant balance-sheet surprises at the most inopportune time. It also may help reduce or eliminate improper expenses. Furthermore, if agency principals consider a sale as the ultimate ownership exit strategy, they must be prepared to comply with a variety of Sarbanes-Oxley internal control requirements often imposed by larger firms.

Having a balanced set of accounting records, then, is seldom the end goal, but rather just the first step in a larger, critical process. Thorough financial management involves the review and analysis of the business results; the establishment of meaningful internal controls; and assisting management in setting financial and business priorities.



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