

The unhappy manager on the phone needs a colorful solution. What's the best response?

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BW SMALLBIZ -- FRAUD

## The Inside Job

### Employee fraud blindsided Bob Bitz. Here's how you can protect your business

In May, 2004, Bob Bitz received a phone call from someone he'd been fortunate never to hear from before -- the Cherokee County Sheriff. The lawman was trying to track down Bitz on behalf of Citibank, which suspected fraud on Bitz's credit card. But Bitz, owner of Preferred Commercial Floor Covering in Canton, Ga., didn't have a Citi card. "I told them I didn't know what they were talking about," says Bitz. "I used to have a Citibank card, but when it expired I hadn't renewed it."

The sheriff told him that Citibank had mailed numerous inquiries to Bitz, using the address listed on his credit-card statement. Bitz said that the address wasn't his, although it sounded familiar. Then it hit him. The address belonged to his bookkeeper.

The sheriff wasted no time. He told Bitz not to say anything, then showed up at Bitz's office an hour later with a detective in tow. After 20 minutes of questioning, the bookkeeper packed her things, told Bitz she was sorry, and left.

By June, Bitz had discovered exactly how much the bookkeeper had to be sorry for. She and her husband, who both eventually pleaded guilty to three counts of identity fraud and one of theft-by-taking, had been running quite a scam. In early 2002, the bookkeeper had filled out a change of address form for Bitz's Citibank card without his knowledge, diverting all future correspondence about the card to her home. Then she and her husband racked up nearly \$70,000 worth of charges -- from a vacation at a rental cottage in North Georgia to meals at the Hard Rock Café -- on the card. The bookkeeper paid the bill with money from the company's line of credit, doctoring QuickBooks entries to cover her tracks. When contacted for this story by *BusinessWeek SmallBiz*, the bookkeeper declined to comment. "I felt outraged and betrayed," Bitz says. "I was scared to death because I didn't know how else she'd used my identity fraudulently."

That was the beginning of a nightmare from which Bitz is just now emerging. To get his finances and his business back on track, he has had to hire two lawyers and a fraud examiner, pay thousands in late fees to his vendors, cancel his health insurance, mortgage his house, and of course, reexamine the way he manages his business.

Unfortunately, small companies like Bitz's get hit much harder by employee fraud than larger ones. A company with fewer than 100 employees that experiences employee fraud suffers a median loss of \$98,000, according to a 2004 study from the Association of Certified Fraud Examiners. That's more than midsize businesses, and close to the \$105,500 loss typical in companies with more than 10,000 employees. Fraud at small companies is more likely to involve cash skimming, payroll scams, expense reimbursement schemes, and check tampering than that at larger companies.

Frequently the theft starts small, as a trickle of money that easily slides under the radar. "It's often a mundane, almost plodding kind of theft, as little as \$50 a week," says Boston-based Skelly Insurance President Thomas Skelly.

The ACFE estimates that nearly a third of frauds go unreported. Usually that's because the business owner is able to reach a private settlement with the perpetrator. In other cases crimes go unreported because the business owner is worried about bad publicity. "If fraud occurs at a small business, it goes to the reputation of the owner-manager," says Robert Dohrer, a partner with accountants McGladrey & Pullen in Bloomington, Minn. Occasionally business owners don't have the documentation they need to pursue a case in court or don't want to run up legal and accounting bills that generally average about a third of the amount recovered. Some owners simply can't accept that they've been swindled.

So it's imperative for owners to make sure they take a few simple steps to safeguard their businesses, from thinking twice about where blank checks are stored to making sure everyone takes a vacation (really). And if, despite your best efforts, you do encounter fraud, handling the situation prudently may help you recover your loss and win a court case with as little disruption to your business -- and your psyche -- as possible.

**Like many** crimes, embezzlement is often a matter of opportunity. Unwittingly, many small business owners are giving their employees plenty.

It's easy to understand how an entrepreneur, working long and stressful hours, might postpone the implementation of a proper accounting system. But without one, you may find yourself handing off financial tasks to a single trusted employee -- as Bitz did -- without providing proper oversight. Instead, set up a computerized system that generates cash flow and financial reports, then make yourself read them. Carefully. Hire an outside accountant, or, at the very least, ask different employees to look for discrepancies. Checks, account statements, and other financial information should be locked up, rather than sitting around in plain sight.

Next, train a few people in your company on the accounting system, so that more than one person is capable of using it. Then make sure everyone -- including the financial types -- takes regular vacations, and when they do, have different employees cover for them, suggests Edward Osbourne, professor of accounting at Marietta College in Marietta, Ohio. It's also a good idea to use mystery shoppers to make purchases that will let you test your cash flow systems.

Although it may seem sensible to delegate mundane tasks such as opening mail or depositing checks, those are exactly the duties that let employees collect information or skim cash. "A small business owner starving for someone who's going to take care of things that important is looking for trouble," says Talar Herculian, an attorney with Fisher & Phillips in Irvine, Calif. Instead, owners should countersign all checks, and even make bank deposits themselves. Randolph Hibben, chairman and CEO of Lake Forest Bank & Trust Co. in Lake Forest, Ill., suggests using Internet banking to cut down on the number of eyes viewing account information. He tells his small business customers to send an electronic file of all checks issued that day to the bank so it can compare the list with what has been clearing the account.

While some companies thrive on an "open books" policy when it comes to finance, it still pays to be discreet about some details. "Be careful how much information you give employees about forthcoming checks," says David Sawyer, senior managing director of Smith & Co. in Atlanta and Bitz's fraud examiner. Otherwise an employee can cut a dummy check first and empty an account.

But by far the greatest threat to a small businesses are the owners themselves: Most are far too trusting. Even longtime employees -- be they friends, neighbors, or family members -- can't be trusted absolutely. Yet they're often given carte blanche to handle company finances. That can be too tempting for someone going through a rough patch. After all, the ACFE estimates that 83% of employees who commit fraud have no criminal history. "It doesn't matter whether someone is 22 years old and has \$4,500 in credit-card debt or if they're 55 and having a problem paying bills because of college tuition," says Skelly. "If someone gets into dire financial straits, they look for cash anywhere."

**If you suspect** an employee is stealing from your company, your first call isn't necessarily to the police. After all, you want to figure out what happened as best you can before calling in law enforcement. Get your accountant to help determine exactly where things went awry and to help tally how much may have been lost. Be sure to include amounts beyond any money that was stolen, such as interest payments or late fees, says Stephen T. Mikus, a Chicago attorney specializing in civil litigation. You'll also want to check with your insurance company, because some business owners' policies provide coverage for employee dishonesty. Among those that cover employee theft are multiperil insurance policies, commercial crime insurance, and some of the special versions of a business owner's policy.

Be careful not to accuse any of your employees before you're certain about what has happened. "If you confront an employee before you've done your spade work, the employee can disappear, cover his tracks, or destroy evidence," warns Skelly. And if you're wrong about your hunch, you don't want the employee to turn around and accuse you of slander, says Douglas Frazer, an attorney with DeWitt Ross & Stevens in Brookfield, Wis.

If you've experienced a sizable loss, then the police or your attorney can contact the district attorney's office to get the ball rolling on a criminal case. You'll generally have to show a much larger loss in an urban area to get a prosecutor's attention than you would in a rural one.

Even then, many district attorneys' offices are overwhelmed and may not have the time or resources to pursue your case. You'll need to be persistent. "A district attorney will be more aggressive when the victim expresses interest in the case and a willingness to support the prosecution," says Mikus.

When the D.A.'s office was slow to move on his case, a frustrated Bitz fired off e-mails to the media and the governor. The governor's office referred him to the Georgia Bureau of Investigation, which in turn gave him a list of forensic accounting firms in Atlanta. Bitz chose Smith & Co., which provided additional documentation to the district attorney. "The D.A.'s office doesn't have the manpower or capabilities to trace all the transactions and see who actually benefited," says Bitz. "It takes a specialist to connect the dots."

Another option is to file a civil suit. Because you're paying your attorney to guide the case, you will have more say over how much and what type of restitution to accept in a civil suit. Either way, your best hope of winning lies in providing strong evidence that can't be contradicted -- generally, a paper trail. In addition to his criminal case, Bitz plans to file a civil suit to reclaim some of the costs associated with the case, which so far total about \$20,000 in attorneys' and accountants' fees.

Of course, any investigation will have an impact on your business. Fees can add up, but at least they're tax-deductible as business expenses. "For every dollar you want to recover, figure on spending 30 cents, divided between legal and forensic accounting fees," Sawyer estimates. In most cases, Sawyer says, those who win their cases can recover legal and investigative fees -- if the crooks or their families can come up with the money -- as well as payment for punitive damages.

You may want to put certain employees on leave while the case is being investigated. After all, you don't want to fire an employee who has done nothing wrong, but you don't want someone who may be guilty of fraud skulking around your company. "While the investigation is under way, tell your other employees as little as possible," advises Sawyer. "Just say: 'There are transactions we're looking into that are

important to the success of our business. We're not sure there has been any wrongdoing. You may be contacted for an interview to provide us with more information." Remind workers that any steps you take are to protect the company and its employees.

**After the fraud** at Preferred Commercial Floor Coverings was uncovered, Bitz hired a lawyer, who turned the case over to the district attorney. That was the easy part. Desperate to keep his credit rating intact, Bitz took out a home-equity loan so he could make the payments on his line of credit. He contacted his suppliers, hoping to reschedule payments, but was still hit with late fees. And though Bitz says the charges on his Citibank card are fraudulent, Citibank said it isn't liable because it didn't know that payments on the account were being made with stolen money. A Citigroup spokeswoman, Janis Tarter, says that when informed of the fraud, the bank forgave the existing balance on Bitz's account, "taking a loss of several thousand dollars." But, she says, "because the [earlier] payments of thousands of dollars were sent to us over the course of 18 months, were payable to us, and were never questioned or returned to us by Mr. Bitz or his bank, we had no way of knowing they were not legitimate. In this instance, we believe the responsibility for detecting this ongoing fraud rests with Mr. Bitz, and not with us."

The \$2 million company that Bitz had founded in 1997 was hit hard, too. Since late 2003 the bookkeeper had been telling Bitz that money was tight -- so tight, she claimed, that the business could no longer afford health insurance for its 15 employees. Bitz cancelled the policy and alienated his workers. Over the next nine months the fallout from the fraud continued to be a distraction for Bitz, and sales at the 15-person company dropped by about 25%.

Bitz finally had his day in court on Mar. 21. About a month later, the bookkeeper and her husband, rounding up money from their extended families, paid Bitz \$69,486.74 -- the exact amount certified by the forensic accountants -- and received 15 years' probation.

More than a year later, Bitz is still struggling to get back on track, and to understand why his bookkeeper betrayed him. "I treated her like she was my daughter. I can't imagine she could do this," he says. "You can't tell about people."

By Ann Therese Palmer

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