South Dakota Chamber of Commerce and Industry
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BUSINESS CONTINUATION SERIES: *EMBEZZLEMENT*

Of all the disasters included in this series, embezzlement is the toughest on the business owner/manager because it ravages the self-esteem of its victims. Sympathy abounds when your business suffers a fire, natural disaster or fatality. Being ripped off from the inside shatters trust and leaves managers feeling foolish and, as one member put it, "feeling like the newest member of the stupid club." "But we trusted them" and "they were the best" are several of the laments heard from those taken through embezzlement.

THE STORIES

Embezzlement is as random as the people who take the money. Organizations large and small, corporate and family-owned, profit and non-profit have all been "hit" by embezzlement. The term "embezzlement" is being used here in the strict sense of referring to someone who has absconded with money and has tried to cover it up, or has taken it over the course of time. This issue does not deal with the broader issue of employee theft that can include a one-time raid on a till or more common losses such as stealing inventory or unauthorized use of services.

Below are three stories from different sizes and kinds of businesses. A family-owned small business, a statewide non-profit organization and a large private institution dealing in financing and investment. As with all case studies in the Business Continuation Series, the details are a composite of several specific real life incidents.

Small Business Story - FamCo. FamCo is a small family-owned business in one of the larger towns in South Dakota, employing less than 20 people. Two brothers originally owned the business, one of which is deceased and whose son "W" now runs it. They discovered their much-adored bookkeeper had been padding her paycheck and used another method to embezzle $15,000. She was prosecuted and did make full restitution, thanks to help from relatives.

How she was caught. "W" had some extra time one evening and was paying more than the usual amount of attention to the routine of signing paychecks. He noticed the bookkeeper's check included a commission that was an obvious mistake as she was not a commission-paid employee. When asked about it she said it was a mistake, and when asked to rewrite the check she suggested it was difficult to do with the computer and offered to make the adjustment on the next paycheck.

"That was the first bell," said "W." "I know the program is awkward for making adjustments but it isn't that hard." "W" waited until after a meeting of his kite-flying club and returned to the office to review past payroll checks. She had been making this little mistake for over six months at a cost of more than $7,000. "W" wasted no time with uncertainty and dismissed her the next day, after a tearful session during which she admitted she had taken the money.

"W" believed he was on his way to ending the incident after she confessed she had taken the money. It was an accountant friend of "W" who took this case further. "You haven't found it all yet," he said. "If she admitted taking $7,000, then she took at least $14,000," the friend said, "better go look at all the checks for the past year."

A review found she had taken checks intended for purchasing office supplies, written them to herself and cashed them. "W" was upset because he remembered her asking to take a check to Office Mecca and he had made sure to write the name of the store on the check before signing it. After finding the checks it became clear that his uncle, who adored the bookkeeper and viewed her as a granddaughter figure, had simply signed the checks because he never dreamed she could steal money. As predicted, the total was just over $15,000.

Prosecution and Recovery. "W" turned the evidence over to the police and State's Attorney and waited for justice to be done. He was relentless in demanding to everyone who would listen that he wanted his money back or he wanted the book thrown at her, which would hopefully include jail time. "W" reported he found the Victim's Assistance Program extremely helpful in guiding him on how to communicate with the judge and outline his desires regarding the outcome of the case.

In the end, she paid restitution the day she entered a guilty plea and was sentenced. The judge asked if she could pay FamCo in full and she complied at that time. She was given probation and no jail time. "If you had not paid back the money you stole," the judge said before handing down the sentence, "I would have ordered you to jail for long time."

Non-Profit Story – Business League of SD

The Business League of South Dakota is a membership driven organization that promotes retail shopping, tourism, business education and legislative policies for its members. It has a board of directors and a staff of 10 people. The organization takes in over $250,000 in dues and has programs and services that bring in another $150,000. The League is always selling memberships and/or sponsorships to keep programs going and to continue their mission.

After the death of the head staff person, an auditing firm was hired to do what the military calls a "change of command audit." As the audit was getting underway, the bookkeeper came into the new president's office and confessed to taking about $12,000. Through tears she said that $4,000 had been repaid and she had a money order for the other $8,000. All she wanted to do was to pay the money back and get on with her life. She offered to resign from the staff and asked for the League to not prosecute.

The new president immediately called his Executive Board to discuss the situation then ordered a case of antacid. While eating the antacids like candy, he learned several things about the situation. First, if he didn't turn it over to law enforcement, he could be viewed as a co-conspirator and held responsible for any additional missing funds. Second, as with everyone else stricken with embezzlement, he was told there was certainly more than $12,000 missing and it was most likely at least twice the amount of her confession.

After the audit was complete, at a cost of over $40,000 plus several staff member's time for nearly four months, the total amount taken was $97,000, a full $85,000 more than the amount repaid.

Methods used to embezzle.

A busy non-profit like the League has a plethora of opportunities for someone to take money and she didn't miss many. She had taken money for over a year.

Many bills just were not paid and late notices were hidden. She failed to send in three months of the staff's retirement payments, took cash from meetings and seminars, reported those projects had lost money and produced false books showing losses. The pop machine was raided. She was trusted enough that the bank allowed her to cash one CD without a countersignature. She had taken cash advances on the organization's credit card. The postage machine was filled several times a month, but was always low on postage. She had taken the money from a number of health insurance payments then paid the bill three weeks later, using the second copy of the bill as the original. She had taken a rubber signature stamp used for correspondence and used it on checks written to herself.

The League had the accounting for its most popular program separate from the regular office accounts. This program ran a large balance and had a regular flow of money in and out as members ordered special supplies and promotional items. She had emptied the account and was transferring funds from the main account to cover some expenses and then transferring them back to regular accounts when money came in from new orders.

Prosecution and Recovery.

During the investigation and pre-sentencing phase of the prosecution there were several offers to settle with the League. The offers came like bids at some bizarre auction – first $25,000, then $30,000. Later, a plea from the family was made to accept $40,000. At each of the Board meetings there was a terrible split between groups who said take anything they offer before they simply run, and those who held out for as much as they could get, hoping to replace at least the stolen money, if not additional costs. In the end all the stolen money was repaid, but the court ordered her to repay more than $50,000 in costs incurred by the League for audits and other expenses. The restitution schedule set up will take decades to repay and there was no jail time involved in the sentence.

Impact on the League. Because its members technically own the League and its mission is so public, there was great concern that members would abandon the League once they knew the group had lost their money. The leadership did a number of things to reach out to members. Once the prosecution was secure, a letter was sent to members candidly telling them everything the group knew. The League had relied too much on one staff person in their financial controls so these mistakes were discussed and fixed. Members were told of new procedures designed to keep their money safe.

The biggest impact was on the staff and had two dimensions. There were months of lost time as records had to be reconstructed, non-financial staff members had to learn the accounting programs to answer audit questions and try to grasp the scope of the theft. Every vendor had to be called and asked how much the league owed, then a credit line was established so these bills could be paid immediately.

Most devastating was the sense of violation. The bookkeeper was one of the most trusted and beloved members of the staff. She hadn't just taken money from the organization, she had imperiled the staff's health and retirement plans and subjected them to a sense of humiliation as the public and members continually asked, "how the heck did you let that happen?" The jokes everyone else thought were so bloody cute, seemed to cut deep with everyone on the staff, making laughing impossible and holding their heads up no easy feat.

The Large Financial Institution Story: Republic Savings and Investments

"Our industry does not get hit often but when we do it is for big money," said Ben Taken, CEO of Republic Financial, as he discussed a recent embezzlement in the local region. "The total was more than $300,000 and we will never get it back," he concluded.

Because financial institutions are tightly regulated and because public trust is their most needed asset, it is common for these businesses to decline prosecution to avoid a public display of the crime. All losses over $50,000 are reported to the Federal Reserve and losses are restored to customers, either through the institution or insurance coverage.

Catching A Thief. None of our member financial institutions would discuss the methods used by the embezzlers that had taken them. The methods were very technical and so industry specific they would not be useful examples to help most other businesses avoid similar fates. Mr. Taken did, however, have some great advice for spotting trouble and his story is helpful in that regard.

The thief was a long-standing, much-trusted officer of the company. He had shown stellar performance in meeting growth targets and customer service and had a great relationship with his staff. Small signs of trouble were missed for months. His attendance at work changed, he was late more than once a week, often had to run errands during the day and seemed to have lost his jovial nature sometime over the past year or so.

"Small errors in his quarterly reports were the first sign of trouble that we noticed," Ben Taken noted. He continued to say these errors were explained away at first, but later seemed to be left hanging, or vaguely attributed to others. Finally he quit talking about his wife and family and would avoid even casual discussions about home life.

Republic finally, and reluctantly, decided to investigate some of the small inconsistencies in his region. After an initial review showed enough indications of trouble, Republic called a private investigator. "It was scary how accurate they turned out to be, even during the first phone call," Mr. Taken reported with a slight wince. "We laid out what we thought was happening and asked what they would do. They said it was time for a formal interview and perhaps a polygraph test."

An interview was arranged and after an hour and a half of questions with two investigators, the embezzler finally broke down and confessed to taking over $100,000. "I was staggered when the investigators said he had taken much more and we should keep him in questioning as long as he was agreeable." It took several weeks and working with several attorneys, but the whole story was finally told and the amount was more than $300,000.

LESSONS LEARNED

Hindsight usually does not need laser surgery to be perfect and offers the following lessons from those who were kind enough to share their glimpse of the eye chart.

Accounting Lessons.

-- Separate as many functions as possible - money MUST be handled by someone separate from the person handling the payment of bills and other check writing. If possible have the person opening the mail endorse checks, make out the deposit slip and make a record of checks received.

-- If possible, have program managers keep an informal set of records showing how their projects have done. They should get copies of checks, payments and bills.

-- Either code bills to the accounts yourself or have someone, other than the bookkeeper, familiar with operations code most of the bills and checks to minimize moving money between accounts.

-- Open bank statements yourself or have a designated person open them and check balances to make sure they are approximately correct. This need not be a complex set of books, a simple list of accounts and the previous balance should prove a good deterrence.
-- Go to the bank yourself and check signature cards several times a year to make sure there have been no additions. Same with investment tools such as CDs.

General Management Lessons.

-- The best deterrent is to know your staff and ask managers to pay attention to those working under them. There is a limit to the amount of personal questions which are proper, but keeping track of major changes in the lives of employees is generally an easy task through casual conversation and paying attention. Mood changes, major medical problems with the employee or a family member and divorce, are all situations that have been known to put pressure on someone who would otherwise never think of stealing.
-- Sudden personality changes such as becoming reclusive, or sudden lifestyle changes like new cars, lots of new clothes or travel to exotic places may be a clue that money which was "inherited from Uncle Ebinezer" might be more attributable to the death of honesty than a passing relative.

Anytime something seems strange - CHECK IT OUT!!!!

It is a difficult thing to question someone you have grown to trust and no business would survive strapping employees to lie detectors every noon hour. But many losses could have been curtailed if management had scrutinized the first few oddities rather than let a vague answer suffice. Of all the members interviewed for this edition, only "W" at FamCo reacted on the first clue and his losses were small compared to the others who ignored several signs.

Some Common Signs That Something is Wrong

Vendors calling because bills are past due, while a staff members says, "It is a screw-up at their end, I'll call 'em."

Credit card balances that are usually paid in full starting to carry over with explanations such as "Sorry I sent the check in late, it will clear up next month."

When confronting someone about an apparent mistake you are told "The computer doesn't let us fix that, we'll have to do an adjustment next month."

Customers being billed several times for the same services or claiming to have paid your bills when asked about late payments.

There are many other indications and many other accounting controls.

From a Prosecutor's Point of View.

The Chamber had a talk with one of South Dakota's Prosecutors to understand more about the process of trying to convict embezzlers and seek appropriate sentences.

Have you seen an increase in embezzlement cases?

Embezzlement is considered theft and is not tracked separately, but I would agree that we are seeing a lot more cases than 10 years ago.

How does the law view embezzlement?

Embezzlement is petty theft and a misdemeanor if less than $500 was taken. It is a felony that can be punished with 10 years in prison if more than $500 is taken. This includes money taken over time if it is part of a common scheme. The fact that someone never takes more than $500 in one theft does not make them immune from a felony charge.

Why don't more embezzlers go to prison?

It's hard to send anyone to prison for a first offense and most people caught embezzling are committing a crime for the first time. Most of the people I have prosecuted honestly believed they would pay the money back when they started.

The key to sending embezzlers to prison, which I have done more than once, is to have them taking a lot of money over an extended time or to have a substantial loss with no restitution at all. Different communities will have different results, mainly because of jail capacity at the time of the trial.

Are embezzlement sentences very stiff?

A typical sentence will include a conviction of "Grand Theft" with a three-year prison sentence, which is suspended They are placed on parole and may spend 120-180 days in jail, plus an order to repay all proven losses. If money is paid, the person will most likely not be sent to prison. If there is no restitution, then the judge can revoke parole and order prison time.

Is it your job to get victims' money back for them?

Only indirectly. The state's attorney's office is not a collection agency. Our priority is getting convictions of people who have committed crimes. We are very concerned about the victims of all crimes and their feelings about what should be done, but in the end we cannot guarantee restitution. We also won't let an offer of restitution result in dropping the charges.

Will you continue to prosecute someone who has offered to repay even if the victim asks you to drop the case?

Of course. Take the case of a professional. He/she is most likely using money taken from several businesses to repay the one that caught them. So, if we drop the charges, they have a chance to take from someone else to recover the funds they just lost! Once the case is turned over to police and our office we have to fulfill our duty and control the case.

Any advice for businesses that find out they have a problem?

Yes, several ideas. First - Don't make private arrangements. Often defense attorneys will try to get you to not pursue prosecution. If you agree to accept restitution and not to prosecute you will have chosen a civil remedy. We will not use the criminal courts to enforce that remedy. So if they renege on your deal, it is almost impossible to prosecute at that point.

Second - I recommend businesses consider using a private investigator to take confessions and to help build a case. Reputable private investigators know how to build the links that prove a connection between the crime and the person who confessed. Courts require proof of that link. A confession alone is not enough to put someone in jail. We must show that they are not simply confessing to get attention.

Private investigators are also skilled at conducting interviews and will ask questions about the crime you would never think to ask (see Lessons from a Private Investigator). There are options open to them during an investigation that are easier in private, such as the use of lie detectors.

Using a private investigator will also assure you get things done in a timely manner. Police will try very hard to get your case handled but there are times when these crimes are not as urgent as murders and other broader threats to the community.

Lessons from a Private Investigator

Embezzlers are people too - The discovery of embezzlement is emotional for both the victim and perpetrator - Careful handling of the situation can be helpful.

The Chamber met with a private investigator to discuss his experience with embezzlement cases.

Lesson One - "All I want is my money back."

It is a common emotion for a business that has discovered embezzlement to react quickly and focus on getting their money back. Often they will not be interested in prosecuting if they can get their money back. Advice - NEVER tell the suspect, even if they have admitted taking money that you will not seek prosecution. "You're going to get mad at them when you discover how much they took," said the investigator. Once businesses get over the shock and realize they've been taken, they start feeling foolish and then want at least a life sentence . . . assuming the death penalty is out of the question.

Lesson One(A) - Always take information with prosecution in mind, even if you don't think you want to file charges. You might change your mind.
Lesson One (B) - Never tell them you won't prosecute. You will most likely change your mind, plus this can be a great incentive to get more cooperation. Once you have promised not to prosecute, then change your mind, they will turn on you and make things very difficult. (See Lesson Three.)

Lesson Two - They took more.

When someone confesses to taking money it is almost a certainty they took at least twice the amount they admit.

Lesson Three - You have a window of time when they want to cooperate.

Just as the business owner delays getting mad, the embezzler feels a sense of relief at finding an end to deception and the constant stress of worrying when they will get caught. "If you treat them with some respect and kindness, they will tell you a lot," the investigator advises. When they realize they are going to be in real trouble they often get mad or scared. Then they will turn on you and change their story, renege a confession, deny things they said earlier." If you haven't built a case carefully you could lose the strongest connection between the crime and the person everyone knows did it.

Lesson Four - They keep records.

The private investigator says you'd be surprised how many embezzlers keep very good records of how much they took. "Where are your notes" is one of his first questions and many times they are in the desk or the car. Aside from a few real crooks, embezzlers always think they are going to repay the money.

Lesson Five - Learn from them.

During interviews the investigator says he works hard to understand how and why the embezzler took money the way they did. "Why not do this another way?" is a key question that will have them lead you right through the holes in your system. They know where your weaknesses are because they just got done using them. If you want them fixed, the best teacher is the guy wearing the handcuffs.

Lesson Six - There is a pattern.

Most embezzlements start because someone has a pressing need for money. They take a little then sweat being caught. After they see they got away with it they take again, still planning on repaying. After awhile the extra money has become a second job, they rely on it and can't stop taking more. Often they will rationalize they are entitled to it because of mistreatment on the job, not enough benefits or to make up for low pay.

Last Lesson - Who to watch.

Anyone who comes near your business' money can embezzle it. Put standard accounting practices in place. Never assume someone "just wouldn't do it" because you have known them forever or you trust them. Many people surprise themselves when they start stealing. Also, if someone reports something that looks funny don't overlook the possibility that they are part of the problem and trying to throw you in a different direction.

LEGAL REVIEW

By: Paul Hinderaker
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I am fascinated with embezzlement. Maybe you are, too. We read stories about the trusted employees who have stolen tens or hundreds of thousands of dollars. We wonder how that amount of money could not have been missed. We wonder where it went.

I am not talking here about the retail sector about which I read that employees steal more than shoplifters. I am talking about the business office where someone skims the cash or arranges unauthorized bank loans or forges checks or "borrows" from trust or authorizes unauthorized expense accounts.

Who are these people? In my limited experience, I have known of administrators who have refurnished their houses and fed their families at hospital expense, lawyers' bookkeepers who have supplemented their income for years, public officials who have kept all the cash, accountants who have created fictitious accounts, forged company checks, diverted payments to themselves, paid fictional employees and reimbursed unauthorized expenses. Just last month we read allegations that a Minnesota boat manufacturer CEO had stolen millions of dollars.

So What's an Employer To Do?

First, every auditor will tell you that you need double entry systems for handling your company's money. Especially in small offices where one person may be in charge of all the receipts and disbursements, or only one person knows how the computer system works, you are asking for trouble. Get your accounting and auditing systems in order.

Next, an employer may ask, "If this happens to me, can I get my money back?"

I suppose there are organized crime schemes to launder money and store it somewhere. If this could be discovered, I assume it could be recovered with the help of the FBI or the CIA.

There are top executives who have stolen funds that can be traced to luxury items that can be recovered (yachts, sports cars, vacation homes and artwork).

But most of the people we read about have succumbed to vices, which have consumed their own resources. Desperation, opportunity and creativity meet, and the money is gone. So, when the employee is confronted and confesses, and is subsequently convicted of embezzlement and sentenced to a term in the penitentiary; and when he is ultimately released, it is likely that his earning capacity has fallen like a stone and it is unlikely that he will ever be able to repay the debt.

But I have been asked to write about legal questions, not auditing procedures or the facts of life.

The first question is whether the missing money represents a civil debt or a criminal theft. I have just returned from London where I saw the musical, Les Miserables, again. In an early scene the hero, Jean Valjean, just released on parole, is taken in by a kindly Bishop. After everyone has retired for the night, Jean Valjean steals the silverware and runs into Inspector Javert. When the police take him back to confirm the theft, the Bishop swears that he not only gave Valjean the silverware, but intended to give him the silver candlesticks, too. The Bishop's actions helped Valjean overcome his criminal past and live his life on a higher spiritual and social plane. The Bishop is a hero of the play, but the Bishop's response to the theft is not typical of most employers facing a similar discovery.

I suppose there are situations where an employer may forgive the theft entirely. I suppose there may be other situations where the employer may make arrangements for the repayment of the debt, but the important distinction is that between the civil debt and the criminal theft. If the employer chooses to treat the defalcation as a debt and make arrangements for repayment, he may do so. But he may not, also, complain to the state's attorney of a theft.

In my experience, the tip-off to a theft is some event like receiving notice that taxes have not been paid or a tax return shows too little income and too many expenses. This results in an internal audit and, often, a confession; and then another confession, and another. By the way, I am told that the final confession is likely to be one-half to one-fourth of the actual amount taken.

So What is an Employer To Do?

❶ If you suspect an employee of a minor theft and simply wish to fire him, you may do so in South Dakota without revealing the reason for the termination, unless there is a union contract or employee handbook that modifies the employment at-will doctrine in South Dakota.

❷ If an internal investigation points to a criminal theft, notify the state's attorney at once. His staff or the DCI will come in and conduct a forensic examination of your books and handle the criminal prosecution from there.

❸ If you make an application for bond or insurance reimbursement for the loss, you will be required to refer the case to the state's attorney.

❹ DO NOT tell the accused that he may repay the debt; but that if he fails, you will call the state's attorney. You cannot mix the civil and criminal remedies in this manner.

❺ Finally, it goes without saying that you should keep your mouth shut. If you gossip with your friends or tip-off other employers of your unproven suspicion, you may be guilty of violating the employee's privacy.

Embezzlement is fascinating. Every case is different. As soon as you suspect an embezzlement, call your lawyer.

Preventing Employee Embezzlement”
Internal Control Warning Checklist

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One result of today’s frenzied economic times is an increase in employee embezzlement. Documented local instances include theft of case collections (covered by lapping of accounts receivable), writing of additional payroll checks, and diversion of invested funds through improper and unauthorized bank transfers. Embezzlement has taken place at all types of employers from retailers to government bodies.

Upon discovery, funds lost through defalcation can sometimes be recovered from the perpetrator, banks, clearing unauthorized transactions, or surety bond coverage. Without detection, however, the loss will generally continue unabated. Action on your part is necessary to prevent such incidents from taking place.

The checklist below is designed to help you identify those practices which constitute weaknesses in your system of internal controls. Assets should be safeguarded by limiting access to important documents, inventories, and supplies. Certain accounting duties should be segregated among employees to maintain system checks and balances.

Bank reconciliations and cash procedures should be monitored. Proper review of supporting documentation prevents unauthorized transactions. Knowing your employees helps identify behavioral changes which might be indicative of embezzlement.

“Safeguarding Assets” *(“No” indicates a potential problem)*

1. Are blank check stocks and signature stamps secured? Yes ☐ No ☐
2. Do you restrictively endorse all checks when received? Yes ☐ No ☐
3. Do you deposit your cash and checks daily? Yes ☐ No ☐
4. Do you maintain and monitor a list of property subject to theft? Yes ☐ No ☐
5. Do you maintain physical controls over inventories, shipping and receiving areas? Yes ☐ No ☐

“Segregation of Duties” *(“Yes” indicates a potential problem)*

1. Is the person handling your cash also responsible for recording the cash? Yes ☐ No ☐
2. Is the person ordering materials also responsible for receiving? Yes ☐ No ☐
3. Are two or fewer persons responsible for the accounting function? Yes ☐ No ☐
4. Is your review of the financial statements sporadic? Yes ☐ No ☐
5. Is your review of the financial journals sporadic? Yes ☐ No ☐

“Bank Reconciliations” *(“No” indicates a potential problem)*

1. Do you review cancelled checks and endorsements monthly? Yes ☐ No ☐
2. Do you compare payroll checks with employee records? Yes ☐ No ☐
3. Do you question funds transferred between bank accounts? Yes ☐ No ☐
4. Are bank reconciliations prepared on a timely basis? Yes ☐ No ☐
5. Do you review bank reconciliations monthly? Yes ☐ No ☐
6. Do you verify reconciling items? Yes ☐ No ☐

“Supporting Documentation” *(“Yes” indicates a potential problem)*

1. Do you ever sign blank checks? Yes ☐ No ☐

2. Do you ever sign checks without reviewing invoices, etc.? Yes ☐ No ☐
3. Do you ever sign checks without canceling paid invoices? Yes ☐ No ☐
4. Have funds ever been transferred between accounts without verification? Yes ☐ No ☐
5. Do you ever sign checks for new vendors without knowing or verifying their name and association with your company? Yes ☐ No ☐

"Knowing Your Employees" *("Yes" indicates a potential problem)*

1. Are any of your employees possessive of their work records and reluctant to share their tasks? Yes ☐ No ☐
2. Are any of your employees apprehensive about vacations and time off, while always being the first in the office and the last out? Yes ☐ No ☐
3. Are any of your employees living beyond their means, or in personal financial difficulty? Yes ☐ No ☐
4. Do any employees have a possible substance abuse problem? Yes ☐ No ☐
5. Do you hire employees without checking references? Yes ☐ No ☐
6. Do you permit accounting personnel to work longer than a year without taking a vacation? Yes ☐ No ☐
7. Do you have any accounting staff or key personnel who have not been secured with a fidelity bond? Yes ☐ No ☐