Small Businesses Face Greatest Risk for Fraud & Embezzlement

By Christopher T. Marquet
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Every organization large or small, public or private, for-profit or non-profit, is subject to fraud, waste and abuse. Anecdotal evidence strongly suggests that economic factors, such as poor economic times, may increase the frequency of fraud, including employee theft, specifically embezzlement. However, our research suggests that small businesses face a greater risk for this kind of business fraud than do larger entities. An analysis by [Marquet International, Ltd.](www.marquetinternational.com) of more than 1,000 major embezzlement cases over the past three years reveals that the vast majority of the victim companies are privately held, small and medium-sized businesses.

We believe the primary reason for this phenomenon is that small businesses tend to concentrate their finance activities with one or perhaps a small group of individuals who have significant control over all company finances. Our research also indicates that more than 60 percent of these embezzlement cases are caused by employees with principally finance/ bookkeeping responsibilities. Moreover, based upon our research, finance and bookkeeping employees are four times as likely to embezzle as the next category of employee, general managers. It is logical, therefore, that organizations with few finance personnel and weak business controls, will be at greatest risk for embezzlement. Consider the following very recent cases in the news:

> On December 5, 2010, Karen Marie Sosa, 44, formerly of Nutley, New Jersey, was sentenced to 7 years in prison for embezzling some $545,000 from Lynnes Nissan where she had been employed as an accounts payable clerk. According to prosecutors, Sosa was keeping for herself cash receipts intended for the parts and services department of the dealership instead of depositing them into company accounts. Her scheme reportedly spanned a 2 year period between 2007 and 2008.
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> Also on December 5, 2010, Heather E. Wylie, 39, of Butte, Montana, was sentenced to 30 years in prison with 10 years suspended for embezzling $154,579 from a local attorney, Dan Sweeney, for whom she had been employed as a bookkeeper. According to authorities, Wylie forged checks payable to herself and was requiring clients to pay cash which she would then pocket. The scheme spanned more than a three year period from December 2004 to April 2008.
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> On November 28, 2010, Jill M. Sznajder, 44, of Greene Township, Pennsylvania, was sentenced to 16 months to 7 years in prison for embezzling an admitted $163,120 from Pustelak Masonry, where she had been employed as an administrative assistant and bookkeeper. According to authorities, Sznajder issued herself numerous extra weekly paychecks, insurance-premium payments and vendor checks as well as unauthorized pay raises and loans from the company.

Sznajder's scheme reportedly spanned an 8 year period, from 2001 through 2009. Pustelak Masonry owner Bill Pustelak believes Sznajder actually stole about $256,000 based upon his own internal investigation.

These examples are quite typical cases taken from our *FraudTalk* blog which illustrate some of the common factors involved in major embezzlement cases these days – small business victims, the prevalence of female perpetrators, finance/bookkeepers as perpetrators, duration of the frauds spanning more than four years, on average, and common schemes. Our research also suggests that the most common embezzlement schemes include the following:

- Forging checks payable to cash, oneself and/or to personal vendors
- Pocketing cash receipts meant for deposit into company accounts
- Issuing extra paychecks and/or bonus checks through payroll to oneself
- Submitting fraudulent expense reports for reimbursement
- Submitting fraudulent invoices from phony or legitimate vendors
- Abusing company credit card accounts for personal use
- Electronic transfers of company funds to personal accounts and/or vendors
- Pilfering company equipment and/or inventory

Non-profits, including religious organizations, also face a similar risk as they tend to have fewer resources and small finance departments with weaker business controls in place. In fact, we found that these types of organizations comprised more than 10 percent of all the major embezzlement cases analyzed. This is a fairly high percentage, given the sheer number of businesses, financial institutions, government agencies and other organizations that were victims of major embezzlements in the past three years.

The risk to small and midsized businesses can be catastrophic. Many businesses with significant losses over multiple years have had to cut benefits, lay off personnel, postpone expansion plans or shutter themselves entirely. Some long-time family businesses have been utterly destroyed. Nevertheless, there are some proactive steps small businesses can take to minimize the risk of embezzlement. These include, but are not limited to:

- Do not allow a single individual access to all aspects of company finances. Make sure there is a division of duties in the finance department.
- Regularly rotate responsibilities for bookkeeping personnel.
- Require bookkeeping personnel to take time off and vacations. Embezzlers often take little or no vacations to perpetrate their schemes.
- Do not allow bookkeepers to take work home.

- Require two signatories on outgoing checks above a certain nominal amount. The signatories should be different individuals from the check preparer.
- Examine cancelled checks regularly. One common method of embezzlement involves the forgery of checks. Another is to have them payable to the embezzler or their personal vendors.
- Maintain unused checks in a lockbox. Be sure all checks, purchase orders and invoices are numbered consecutively and reconcile any of those missing.
- Conduct regular as well as random audits. Owners should take a hands-on management approach by physically spending time with the bookkeeping department.
- Audit petty cash regularly.
- Audit credit card charges regularly.
- Audit expense reports regularly.
- Be sure each payment, electronic or otherwise, is backed up with appropriate documentation.
- Backup financial records daily.
- Make and reconcile daily deposits. Use a "for deposit only" stamp for check deposits. The person recording cash receipts should be different from the one making the actual deposits.
- Bank reconciliations should be made by a different person than those that handle cash receipts and cash disbursements.
- Know who your vendors are. Embezzlers often create phony vendors and submit fraudulent invoices for payment.
- Examine payroll records regularly. Some embezzlers issue themselves extra paychecks and bonuses through the payroll system.
- Investigate customer and vendor complaints promptly. If vendors are not being paid as expected, it may be a sign that the payment checks are being diverted.
- Conduct pre-employment background checks for all personnel with fiduciary duties.
- Prosecute perpetrators, creating a permanent record future employers can find.

While employee theft is all too common in today's business climate, prudent steps, such as those outlined above, can help minimize the risk. While small businesses may find some of these steps difficult to implement, they are well worth the effort given the potential downside.

Christopher T. Marquet is Chief Executive Officer of Marquet International, Ltd., an investigative and security consulting firm based in Boston, Massachusetts. He can be reached at (617) 733-3304 or chris@marquetinternational.com. Marquet International publishes its annual Marquet Report on Embezzlement which can be found on our website at www.marquetinternational.com.