

jane's column

SMALL BUSINESS

Internal theft can destroy years of small-business owner's work

It's every business owner's worst nightmare: spend years of hard work building a business, only to discover an internal theft puts the business in jeopardy.

"The best way to prevent someone from robbing you blind is not to hire them in the first place," said **Gary Zeune**, founder of The Pros & The Cons in Columbus, Ohio, believed to be the only speakers network in the U.S. for white-collar criminals.

To screen out the bad apples, Zeune recommends doing a credit check on all job applicants.

"People with financial problems are more likely to steal," said Zeune, "so are people with drug, alcohol, and gambling problems."

The law requires employers to make a clear and conspicuous disclosure to an employee or job candidate that a consumer credit check will be conducted. Informing job applicants up front of the check is also an effective screening technique.

"Half the people who see that (notice) hand the application right back," said Zeune, a CPA and fraud expert who's been teaching accounting for more than fifteen years.

Even if you screen your employees, it's no guarantee against being ripped off. He says there are three things needed for an employee to steal: need, opportunity and rationalization. This is known as the "triangle of fraud."

Employees who steal often feel exploited or underpaid.

"They think, 'they're paying me ten dollars an hour, and they're making seventy off me.' It's a great justification."

To reduce negative feelings, Zeune recommends owners find a way to make the employee's interests align with the business owner's. For Zeune, that means offering his assistant (his only employee) \$20 an hour, and five percent of net profits. "That way, I know she has my interests in mind, because her interests are the same," he said.



SUCCESSING
IN SMALL BUSINESS®
by Jane Applegate

Business owners should also make sure there are strong internal controls in place to protect the money. The same person should not handle incoming and outgoing funds. Zeune suggests having your business bank statement sent to you at home so you can review the transactions. Look for unusual transactions, but also be on the alert for missing expenses (like not paying sales tax). No matter how busy you are, review and sign every check that goes out.

In an all-too-common scenario, a second-generation family car dealership in upstate New York lost almost three-quarters of a million dollars when their comptroller embezzled funds set aside to pay state sales tax. The owner's son, who was willing to share his story without identifying his father, said his dad doesn't like to talk about what happened because it was so painful.

"They trusted this guy, thought he was nice," said the son. "My dad never did a background check on him. He used to come over to our house on holidays."

A background check might have revealed the employee's cocaine possession charge and suspicious business affiliations in his past.

"[The comptroller] never took a vacation," recalled the son. "He also opened all the mail, making it easier to cover his tracks."

The embezzlement was discovered one Saturday when the father stopped in to the office and opened a letter from the state tax authority that began: "This is your third notice."

It was a challenge to convince the state that the business owner himself had not been involved in the fraud. In the

end, the crooked comptroller was sent to jail for seven years, but the owner never recovered any of the lost cash. He had to mortgage his property to pay the back taxes, and the business closed just two years later, destroyed by the burden of such a big debt.

"That theft affected my entire family," said the son. "They all relied on the business."

While employees commit fraud and theft, business owners too, are not immune to crime. Larry, (not his real name), owned a sporting goods store in Utah. He embezzled \$70,000 by making false credit card charges after he discovered how easy it was to fake a credit card processing error. Larry, who had to pay back the money as well as spend time in jail, said in an interview, "Most of us try to be honest and fair, and don't want to hurt anyone. But circumstances dictate our actions."

Like many small business owners, Larry had cash flow problems. He began using his merchant account (which processed credit card transactions), to provide himself with short-term loans, which he would charge and then refund. After a few months, Larry's bank account was up to \$60,000, but he didn't really pay much attention. When the fraud was finally detected by the credit card company, the company froze all of Larry's assets, and suspected every transaction after that.

"The Secret Service was here to investigate," he said. "They thought I stole \$350,000."

When he was "borrowing" the money, he said, "I really never thought it was a crime. I never realized how much of a difficult situation I was putting myself in."

Larry was convicted and sentenced to ten months for his fraud. He spent two weeks in the county jail before being released to a halfway house.

"It was terrible," he recalled. "We wore the bright orange suits, we were behind bars, the chains, the crummy food. I was mixed in with murderers and all levels of bad deed individuals...That was probably the worst two weeks of my life."

Because he was forbidden from dealing with money as a condition of his sentence, he hired someone to manage his store until he could be reinstated.

While he was in jail, Larry's wife decided to divorce him. "I lost my son out of the deal," says Larry. "And, even though it was years ago, people still walk in to the store and say 'I heard about you.'" Larry finds himself often giving into customers who argue for a refund, saying, "I don't want any kind of trouble."

If you really want to sleep at night, consider buying insurance to protect your business from fraud and theft. Even with insurance, you are not totally protected, though.

"All this stuff is very difficult to prove," said Tom Skelly, a Boston-based insurance agent who specializes in helping small business owners. "But once you do prove it, the insurance company will go after the thief to try and recover the money."

Skelly said employee dishonesty insurance is fairly inexpensive and can be added to your basic business insurance package. Skelly suggests common sense controls, including frequent cash deposits, dual signatures on big checks, and balancing the books frequently.

"You'd be surprised how many small business owners just look at the money that's in the cash register at the end of the day and say 'okay,'" Skelly said.

Tips on avoiding fraud and theft

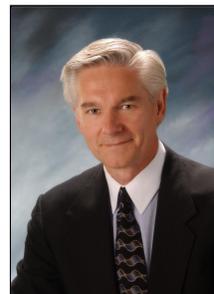
- Conduct a background and credit check on all new employees (make sure you notify new employees and obtain written permission to conduct the checks)
- Make efforts to reward employees through profit sharing or by offering other incentives
- Compensate employees fairly
- Separate accounting and check writing functions between employees and owners
- Have the business bank statements sent to the owner's home
- Consider adding theft insurance to your business insurance plan

Reporting by Sarah Prior.

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