Case in Point: Employee Embezzlement

Trusted Employee Gnaws Away Profits at Termite Control Firm

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The author, a university instructor, reads a newspaper account of an embezzler, interviews the firm's owner, and shares the results with his class. Here are warnings to business owners and lessons for fraud examiners.

That morning at breakfast, I read in the local newspaper about Joanne Rodrigues, 54, the former office manager at Aloha Termite and Pest Control, who had embezzled nearly $900,000 from the company. She had been sentenced to one year in prison, placed on five years of probation, and ordered to pay restitution for the money she had stolen in 3 1/2 years.[1]

I decided that I would take the article to a fraud class I would begin teaching that evening in the MBA program at Chaminade University in Honolulu, Hawaii, because it included some embezzlement basics but also raised some questions.

Following her indictment, Rodrigues claimed she had a gambling problem. However, the deputy city prosecutor said the problem was "purely greed." The article said Rodrigues wrote checks to purchase chemicals for the business but then cashed the checks herself. Company owner Shawn Murray said he considered Rodrigues a dear friend; she was godmother to his firstborn child. "She would always show me the numbers, and they looked OK. She was paying the bills, and she assured me not to worry, that we would get through these tough [economic] times, and we would get through them together. All the while, she was pocketing every penny she could."

As I read the article, I couldn't help thinking about how much in common this embezzlement case had with so many other cases with which I was familiar:

- It was a closely held company.
- The owner gave full authority to an employee to handle the company's finances and trusted the employee completely.
- There was minimal or no review of the employee's work.
- The employee was extremely close to the owner and felt like "family".
- The employee embezzled from the company and nearly sent it into bankruptcy.

As the class and I studied the case that night, we were left with two important, unanswered questions: How was Rodrigues caught? How was she able to keep up the embezzlement for 3 1/2 years without being caught?

I wanted to answer those questions and get more information about the case, so I called Murray. He willingly accepted my request for an interview and we met at his office a few days later. I learned several details.

Murray started the termite and pest control company in Honolulu six years earlier, after working for other companies in the extermination industry for 25 years. Shortly after he started the business, Murray hired Rodrigues (we'll call her JR) as his sole bookkeeper and office manager. He had met her at another company where they both had worked. Murray didn't perform background checks on her before hiring her and gave her complete authority over the finances of the company. He paid her well and promised to make her an owner in the company.

JR began embezzling her first month. She started first with small amounts and eventually increased her takings. After three years, she embezzled $78,000 in just one month. In 3 1/2 years, JR had embezzled approximately $1.2 million. The Honolulu Police Department documented the loss at $900,000, but the company showed an additional $300,000 in missing funds.

JR embezzled the money by writing checks to herself and friends, to vendors for personal expenses, and to petty cash. She also made unauthorized draws on the company credit card. The funds were deposited into her and a friend's personal bank accounts and coded to "purchases of materials" on the company's books.

During this time, the company was struggling financially. It was cutting expenses, laying off employees and borrowing money to stay in business. Murray and his outside CPA concentrated on reviewing financial statements prepared by JR, but they never considered looking at any underlying documents. Murray was seriously considering selling the company or declaring bankruptcy.

JR had maintained complete control over all accounting records and didn't want other employees to have anything to do with them. But a 23-year-old office employee found the fraud when he thought to review some cancelled company checks.

Murray immediately terminated JR and brought in the Honolulu Police Department. After an investigation, indictment, and prosecution, JR was convicted of theft in the first degree, forgery, and money laundering.

Murray spoke to her three previous employers and found that that JR had embezzled in each job. (Of course, her employers hadn't done any background checks on her before hiring her.) He hasn't recovered any of the $1,200,000 yet. However, he doesn't hold out much hope because JR really does have a gambling problem, spent all the money she embezzled, and her only asset was a used car.

Murray is slowly paying his debts "incurred from the embezzlement" and trying to restore the confidence of his creditors and customers.

The ordeal emotionally stressed Murray and his family. They operate their company as a family business, so it greatly hurt them when a trusted family member took advantage of their trust. Murray began drinking and he and his wife separated for a time. They told me they will never be able to completely get over this incident.

Though Murray harbors some resentment toward JR, he and his wife feel sorry for her because of the mess she has made of her life. However, they both believe that she will embezzle again if she has the opportunity.

The embezzlement has taught Murray some valuable lessons. He's attempting to establish some internal controls that might deter future embezzlements in his company. We discussed various areas in which the opportunity for fraud is possible such as employers using truck credit cards for their personal vehicles and using company equipment and supplies to perform work as independent contractors. Murray acknowledged that opportunities for embezzlement are still possible in his company and he needs to be constantly alert.

My last question to him was, "Why are you willing to talk to me?" He said that, as bad as the embezzlement has been to him personally, the company, and his family, he hopes that others will learn from it. Here are a few simple lessons that Murray hopes others like him will learn:

- Trust your employees but verify their work. Regularly have someone oversee the work of employees handling financial transactions.
- Set the right tone in the company so that all employees know that dishonesty won't be tolerated.
- Require that all bank statements arrived unopened to the owner. Review both the front and back of all checks.
- Use your understanding of the business to conduct investigations whenever actual results are different than you think they should be.

EMBEZZLEMENT INCLUDES A MULTITUDE OF SINS Embezzlement is defined as the wrongful taking or conversion of the property of another for the wrongdoer's benefit. (Misapplication, which is the wrongful taking or conversion of another's property for the benefit of someone else, often accompanies embezzlement but is a separate and distinct offense.)

Here's a summary of the more common schemes.

False Accounting Entries Employees debit the general ledger to credit their own accounts or cover up customer account thefts.

Unauthorized Withdrawals Employees make unauthorized withdrawals from customer accounts.

Unauthorized Disbursement of Funds to Outsiders Employees cash stolen/counterfeit items for outside accomplices.

Paying Personal Expenses from Bank Funds An officer or employee causes a bank to pay personal bills and then causes amounts to be charged to bank expense accounts.

Theft of Physical Property Employees or contractors remove office equipment, building materials, and furnishings from bank premises.

Moving Money from Customers' Dormant or Inactive Accounts Persons with apparent authority create journal entries or transfer orders not initiated by customers to move money among accounts. The Encyclopedia of Banking and Finance defines dormant accounts as "bank or brokerage accounts showing

little activity, presumably with small [balances] without increasing. ..." It's not possible to contact the account holder. These accounts are transferred to dual control and recorded in an active accounts ledger. State statutes usually provide for escheat (or forfeiture) to the state after a period of years.

The Encyclopedia of Banking and Finance defines an inactive account as an account with a bank, which shows a stationary or declining balance and against which both deposits and withdrawals are infrequent; or an account with a broker, which shows few transactions, either purchases or sales. If the bank can't establish contact with the account holder, then the account would qualify as a dormant account as defined above. However, if there's a risk of misuse on the account, such as an account holder who's quite elderly or incapacitated, then the account should be qualified as an inactive account.

Unauthorized, Unrecorded Cash PaymentsA director, officer, or employee causes cash to be disbursed directly to self or accomplices and doesn't record them.

Theft or Other Unauthorized Use of Collateral Employees steal, sell, or use collateral or repossessed property for themselves or accomplices.

Source: ACFE's Fraud Examiners Manual ©2007

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[1] "Woman in Embezzling Case Sentenced to Year." *The Honolulu Advertiser.* Jan. 11, 2005.