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Employee Embezzlement: Maximizing Your Recovery

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This is the first of four articles Stephen A. Pedneault will write on employee embezzlement.

Medical and dental practices frequently top the charts of the most vulnerable and victimized organizations when it comes to employee embezzlement. Chances are if your practice has not suffered a loss through an employee theft scheme, you know at least one fellow practitioner who has traveled down that unfortunate road.

While some practices have implemented controls for preventing and detecting employee theft and embezzlement chances are they are out of date or no longer being followed. That complacency can prove costly.

Over the next year, we will be focusing on different aspects of employee embezzlement, highlighting opportunities common within practices along with providing practical measures that you can easily implement to prevent or detect schemes. Other related topics will include what you should (and should not) do in the event your practice detects a potential issue, and how to ensure some form of financial recovery for your practice's loss.

Recovering from a loss

In writing a series of articles, most writers would logically start at the beginning, setting the stage by identifying the problem within the first article. Employee theft and embezzlement within a medical practice is a real issue that could financially damage or destroy your practice's cash flows.

Next, each successive article could highlight different aspects or features of the problem, such as identifying different schemes as well as the measures that could be implemented to counter each risk.

The final article logically would be a conclusion to the problem, a summation of the prior articles that could also provide advice and tips towards a successful resolution should the problem ever occur. In the event theft or embezzlement is detected, contact your practice's attorney and develop a strategy to investigate the scheme.

Unfortunately, when it comes to fraud and embezzlement, you don't have the luxury of waiting for that last article to know what to do if you discover a potential fraud. Over the next 12 months medical practices around the country will fall victim to a financial crime at the hands of one of their employees.

That is why this first article in the series is dedicated to maximizing your financial recovery after an employee has stolen or embezzled from your practice.

Insurance

The most common source of financial recovery after encountering employee embezzlement is through a claim filed with the practice's insurance company. Today, many employers have such coverage for employee theft, but having it just is not enough to ensure the maximum financial recovery after a loss. Two specific aspects of this type of coverage will help determine how well your practice is covered.

How much is enough?

The first aspect has to do with adequacy of coverage. In short, the amount of your coverage must exceed the loss or your practice can't fully recover what they've lost. A general rule of thumb is to maintain a sufficient level of coverage to minimize the impact an employee theft could have on the practice's cash flows. The calculation will be subjective to each practice.

To set an appropriate level of coverage, practice managers will need to work with physician owners as well as accounting and their insurance agent to ensure the financial health of the practice after an employee theft. In our experience, that coverage should never be below \$100,000, but how do you determine just what's right for your practice?

For example, if the practice's employee crime coverage is maintained at a minimal level of \$25,000, when the practice detects that one of its employees diverted \$250,000 over a period of time, the most the practice can recover through insurance is \$25,000. The recovery only represents 10% of the practice's actual loss. In that scenario, coverage clearly was inadequate.

However, if the practice had maintained \$300,000 of coverage, the potential existed that the practice could have recovered the full loss, as the coverage amount exceeded the loss amount. The other consideration is that the coverage goes forward from a point in time forward.

For example, using the \$25,000 coverage, the practice decided a year ago to increase their coverage to \$300,000. The increased coverage went into effect at that date forward (and not retroactive). Subsequently the practice discovered a theft that occurred over the last three years. The period of the theft before the increase would be limited to \$25,000, and the period of theft after the increase to \$300,000 would be recovered at the higher coverage level.

Not all insurance is created equal

The second aspect of insurance is deciding the type of coverage. Most practices believe that they are fully covered with a standard commercial package. This is not true. Yes, a standard commercial package usually contains provisions for financial recovery once a claim has been filed and has been fully investigated by the insurance company. But it does not reimburse the practice for any

expenses incurred in investigating and prosecuting the loss. These expenses can be significant.

A surprising number of practices choose not to pursue the investigation of an employee theft simply because of the cost to investigate. These costs can erode away the practice's cash flows. Many cases are simply not pursued because they see it as "throwing good money after bad."

But there are coverage options that include provisions to reimburse the victim for any out-of-pocket costs incurred in quantifying a loss. Under this type of coverage, not only is the loss recoverable, so are the costs incurred to investigate and quantify the loss. Policies of this nature often contain language that the costs must be reasonable and must be approved in advance to be reimbursed.

The good news for a practice that maintains this type of coverage is that the practice will still have to spend some of those remaining limited funds to quantify the loss, but it will be able to get those costs back from the insurance company once the claim is filed.

So how does a practice get the best policy along with adequate coverage? Add these discussion points to the list of questions for the next meeting with the practice's insurance agent. And have that meeting sooner rather than later. As mentioned earlier, this type of coverage is effective prospectively from the date and time coverage begins.

Beyond Insurance

Often there is little to no hope of recovering the funds siphoned from the practice by an employee. The money is gone. It's been used to solve the personal financial crises or need of the perpetrator that led them to the crime. But there is the possibility of recovering some of the funds if the perpetrator has real estate, vehicles, investments and retirement accounts.

While any identified real estate may be fully encumbered — especially in the current economic climate — some equity could remain within the property. Retirement accounts, while protected assets of the individual, could also be voluntarily surrendered by the suspect as a means towards restitution.

If your practice is victimized, do not wait and see what will be covered and paid by the insurance coverage. Contact counsel and consider beginning immediate actions to preserve any assets of the suspect.

In today's environment, there is no guarantee that the insurance company will pay the claim. Companies are scrutinizing those claims more heavily in the hopes of denying them or reducing their impact. Merely filing a claim is no guarantee of it being paid, so begin any and all actions you might need to go after any available assets from the perpetrator immediately. The idea is to file a claim before any of the perpetrator's identified assets are gone.

Counsel for the practice should strongly consider initiating a civil claim (lawsuit) on behalf of the

practice, and preserve (freeze) any identified assets of the suspect as quickly as possible, pending the completion and outcome of the investigation. In the event the insurance claim is denied and the perpetrator has assets, those frozen assets may be the only remaining means of recovery to the practice.

Improving chances of recovery

Despite your best efforts to minimize the risks, there is a good chance that your practice will fall victim to theft or embezzlement by an employee. Because of this, practices need to do all they can to improve their chances of recovery. That means maintaining adequate insurance policies that includes coverage for not only the loss but also the costs to investigate it.

Beyond insurance, the practice should strategize with counsel to identify any other means of potential recovery and to secure those means pending the ultimate resolution of the matter.

The adage “plan for the worst, and hope for the best” certainly applies here.

Where do we go from here?

In the next three articles, we will cover the following topics:

- Securing a positive outcome while minimizing your practice’s exposure In response to a theft or embezzlement
- Payments, credits, adjustments and accounts receivable: the Devil is in the detail
- Disbursements, payroll and expenditure of funds: where are your practice’s exposures for unauthorized use of funds?

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