PROTECTING Y

It *can* happen to you: guarding against theft and embezzlement

Three-step approach can minimize your risk

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SMALL BUSINESS

Marilyn worked as Sam's store manager for eight years, approving all customer returns and refunds, reconciling the daily sales drawers, and preparing the deposits. She was also charged with coordinating remodeling projects, determining pricing and payment terms, and collecting customer payments.

One day, a store employee completed a cash sale to a customer just before closing time. There were no further sales that day. The next morning, the employee noticed the previous day's drawer reconciliation completed by Marilyn. No cash was included for the day's activity—which was puzzling, since the last sale recorded was paid in cash.

Without alerting Marilyn, Sam began reviewing daily activity and trends with the help of the company's business manager. Before long, a pattern in credit card sales activity was identified.

The store's returns and refunds policy required Marilyn and customers to complete and sign a form. Though many returns and refunds had been processed, none of the required forms could be found. A closer look revealed that the unexplained refunds—always processed to one of three credit card numbers—occurred on days with cash sales. (Most of the store's sales were via customer credit or debit cards.) The refunded cards ended up belonging to Marilyn, who had posted more than $25,000 to them. Added to this was $25,000 in cash sales Marilyn stole and poorly concealed as customer refunds.

Fortunately, Sam was able to identify fraudulent activity in his company. Unfortunately, his discovery came $50,000 too late.

All businesses are at risk

Employee fraud and embezzlement have the greatest impact on owners of small, closely held businesses. In some instances, theft can lead directly to a business's demise.

There is no industry nor any size or type of organization immune from this threat. When combined with outsider fraud, such as counterfeit checks and vendor kickbacks, losses attributable to fraud and abuse can exceed 6% of annual revenues.

Virtually every business collects payments, processes credit cards, writes checks, and pays employees. Those four areas comprise a vast source of opportunities for employees to divert funds from their employers. While it may not be feasible to eliminate risk in any one of these areas, employers can institute several critical controls to minimize their risk.

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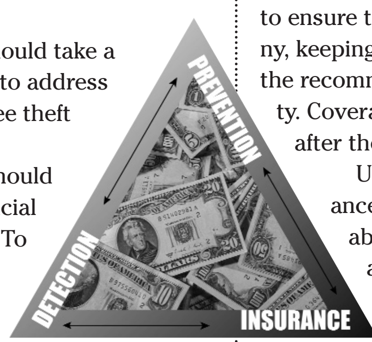
Three keys to protecting your company

Every business owner should take a three-pronged approach to address the potential for employee theft and embezzlement.



Preventive controls should be applied to every financial process in the company. To deter fraud, consider

- Requiring approvals
- Ensuring regular reviews of cash receipts and bank deposits
- Counting cash drawers mid-shift
- Requiring second signatures on checks
- Performing unannounced reconciliations

Detection measures to identify fraudulent behavior as early as possible could include

- Independent receipt of bank statements
- Independent reconciliations of deposit activity
- Random reviews for compliance with policies and procedures
- Spot audits
- Rotation of employee duties
- Comparing employee information to vendor information for address matches

The goal is to detect the schemes that weren't prevented. Had Sam required a separate review of the daily activity, including cash sales, returns, and refunds, Marilyn's activities could have been discovered sooner, limiting Sam's loss.

Employee dishonesty insurance typically enables companies to recover funds stolen by an employee. Even with expertly designed preventive controls and detection measures in place, employee theft and embezzlement remain a risk. Dishonest people seem to have an unlimited capacity for creativity when it comes to "beating the system." Often, when a substantial amount of money is stolen and identified only late in the scheme, the funds are unrecoverable except through an insurance policy.

Business owners should estimate the minimum amount of insurance coverage needed to ensure the financial health of their company, keeping in mind that $100,000 is usually the recommended minimum for any size entity. Coverage typically covers losses only after the date of insurance.

Unfortunately for Sam, his insurance agent never talked with him about employee dishonesty coverage. As a result, his commercial and general liability policies did not include any provisions for employee crime or theft. A few hundred dollars in annual premiums could have afforded Sam a full recovery of Marilyn's theft, minus a small deductible.

O U R B U S I N E S S

Workers' compensation fraud and the small employer

Simple precautions can help you avoid the cost of bogus workers' comp claims

Workers' compensation insurance is a mandatory protection. Maintained and paid for by employers, it covers medical expenses and lost wages for employees hurt on the job. Each state administers its own program. In Connecticut, the Workers' Compensation Commission oversees the laws and procedures governing workers' compensation, and the Connecticut Insurance Commissioner regulates the companies underwriting the insurance.

Workers' compensation insurance not only reimburses lost wages and pays for health and rehabilitation services but also compensates victims or their families for dismemberment or death suffered on the job. The key requirement for workers' compensation insurance to take effect is that the injury or occupational disease must have been incurred on the job.

Fraud costs everyone

Workers' compensation fraud is a growing problem that adds billions to the cost of everything we buy. The National Insurance Crime Bureau (NICB), which investigates and tracks insurance fraud, estimates that workers' compensation fraud costs business—and ultimately all of us—$5 billion per year. In fact, one of every 10 dollars spent for premiums to cover injuries suffered in the workplace is lost due to fraud.

Workers' compensation insurance is a significant expense for small businesses. According to Insure.com, a leading online insurance reference, a small employer with 10 to 20 employees pays between $7,000 and $10,000 per year for coverage on average, depending on claim experience and the risk classification of the jobs involved. Since most workers' compensation insurance premiums are experience-rated (i.e., the insurance company adjusts the premium based on claim costs), at least part of the cost of phony claims is passed to employers in the form of higher premiums.

Types of workers' compensation insurance fraud

The most frequent type of workers' compensation fraud is the faked workplace injury: (1) a bogus injury, (2) a real injury suffered off the job, or (3) an injury that's exaggerated so that the employee can prolong his or her absence from work.

The scope of workers' compensation fraud, however, is not limited to fake workplace injuries. Employers commit fraud when they try to obtain lower premium rates by lying to insurers about the number of employees covered, past injury claims, or the type of work that is actually performed.

Workers' compensation fraud schemes also frequently involve medical provider fraud. Medical providers commit insurance fraud when they falsely certify disability claims or bill workers' compensation insurers for medical services not actually provided.

What you can do

Small business owners can take some simple, prudent steps to combat fraudulent workers' compensation claims. Here's what the Coalition Against Insurance Fraud recommends.

1. Examine a job candidate's work history, background, and references carefully. Some workers' compensation fraudsters are professional or serial perpetrators with a history of false or exaggerated workers' compensation injury claims. Look for, question, and verify gaps in employment or frequent job changes.
2. Publish your workers' compensation policies and educate your employees about the cost and impact of workers' compensation insurance on your business. Employees need to understand that their employer, not the insurance company, ultimately pays the costs of injuries.
3. Educate managers and supervisors on accident procedures and claim policies.
4. Take complaints about working conditions seriously and do what you can to address them. Disgruntled employees are a major source of workers' compensation fraud.
5. Take advantage of workplace safety training and awareness programs offered by your insurance carrier.
6. Implement safety management and loss control programs. Perform periodic reviews of the injury risks involved in workplace activities and correct safety problems immediately.
7. Alert your insurance company's special investigations unit (SIU) to claims you suspect as being fraudulent.
8. Display your insurer's fraud hotline number.

The Connecticut Insurance Department Fraud Unit and the Connecticut Workers' Compensation Commission can assist you in resolving suspected fraud. Contact the Connecticut Insurance Department at 1-860-297-3933 or ctinsdept.fraudunit@ct.gov, or call the Office of the Connecticut State Treasurer Workers' Compensation Investigative Unit at 1-800-566-5888. ■

Embezzlement

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The lesson for employers when it comes to employee fraud and embezzlement is to avoid complacency. Maintain constant vigilance and never simply trust that employees are ethical. To quote Ronald Reagan, "trust but verify" is the best policy.

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