



## The Employee Dishonesty Headache for Employers

### **Overview**

In this period of recession, fraud and dishonesty by employees has become an even greater problem for employers. Employees have financial problems which are exacerbated by our economy. In addition, people have issues in their lives including family problems, addictions, accidents, illnesses or just plain greed. Here are some statistics provided by a leading international accounting firm that may surprise you:

80% of workplace crime is carried out by employees

One in every four employees has either committed or witnessed workplace fraud

One in every four employees committing workplace crime has been with their company for more than 10 years

Only one in three of those who have witnessed workplace crime bother to report it

Fraud and abuse costs U.S. businesses more than \$400 billion annually

Fraud and abuse costs employers an average of \$9 a day per employee

This is the most alarming statistic of all:

The average organization loses 6% of its total annual revenue to fraud and abuse committed by its own employees

Many employers do not realize how vulnerable they are to financial loss caused by the fraudulent acts of their employees. A common response from an employer is, "My employees are like family, they would never steal from me," or "my business isn't the type where employees steal anything." How far from the truth!

### **What are the most common causes of employee fraud?**

Embezzlement: Employees who simply siphon off money from a business usually accomplish it in one of two ways: stealing available cash directly or forging signatures on company or customer checks that they can deposit in their own accounts.

Phantom vendors: Employees may set up a fictitious vendor, set up bogus employee time cards, produce fake invoices and begin sending payments to themselves. A variation is for an employee to form a partnership with an actual vendor to split money that is paid for work that is not performed or supplies never delivered.

Vendor kickbacks: A business may overpay for its supplies or services if a vendor is providing payments to an employee so that its bid will be accepted over other more competitive bids.

Padded expense accounts: Employees may charge the company for personal items charged to company credit cards or may inflate the cost of legitimate expenses through fake receipts or lax protocols for payment.

Theft of inventory: Companies that sell goods or buy materials to use in the course of business may see “shrinkage” as employees take items home, either to use or resell.

### **What can employers do to protect themselves from this risk of loss?**

There are two steps that should be taken. The first step is to establish a loss prevention program. The second step is to obtain employee dishonesty insurance.

### **What should a loss prevention program include?**

A loss prevention program for employee dishonesty involves many factors. It is important to understand the causes behind most claims in order to help prevent them. Three areas have been proven to be key factors: opportunity, financial or emotional pressure and employee attitude.

**Opportunity:** Even the most honest employee can be tempted to steal if proper controls are not in place and if given the opportunity.

**Pressure:** Economic pressures caused by such things as drug or alcohol dependency, gambling problems, divorce, and serious illness can create a situation where an employee becomes desperate enough to steal.

**Attitude:** An employee who feels they have been treated unfairly may think that the company owes them something and they have a right to take it. This often occurs when someone doesn't get the raise or promotion they feel they deserve or when the company starts layoffs and they think they are going to lose their job.

The following steps can be taken to monitor and control these situations:

1. Institute an internal audit system for all financial records.
2. Have an independent accountant perform a full audit annually.
3. Make sure that bank accounts are reconciled by someone other than those who handle deposits and withdrawals.
4. Have countersignature procedures for checks.
5. Make sure there is a joint handling of any securities.

6. Have strict security procedures for all computer operations.
7. Institute formal management procedures.
8. Institute a formal employment policy for hiring new employees.

A CPA firm or your outside accountant can help with establishing employee “checks and balances” for the business. Each business has different exposures to loss. A trained, qualified outside person can assist in identifying those exposures and establishing the correct procedures to reduce the opportunity for employee theft. After the procedures are in place management must follow up consistently with regular monitoring techniques to discover any potential losses.

### **What is Employee Dishonesty insurance?**

This insurance protects the employer from financial loss due to the fraudulent activities of an employee or group of employees. The loss can be the result of the employee’s theft of money, securities (which includes checks) or other property of the insured. Of course policy coverage may differ between insurance companies. The employer, the named insured on the policy, is the main entity insured. The “who” of coverage may also include all current or former employees, partners, members, directors, volunteers, trustees, seasonal employees and temporary workers at your direction or control. Employee dishonesty coverage is really a fidelity bond. The normal form of coverage is a blanket policy which will cover fraud committed by any employee of a company even though there may be many locations.

If the business has access to other customer’s money, securities or property, the policy can be endorsed to include third party coverage. With the third party endorsement coverage is extended to a customer or client with whom you are under contract to perform services. As an example, if employees enter customer’s homes or businesses or if the client is a resident in a long-term care facility, coverage is provided for employee theft from the third party.

The limit of coverage will depend on the potential for loss. Some businesses that handle large amounts of cash or securities will require very high limits. It is necessary to try to determine the maximum loss potential remembering that the largest losses take place over a long period of time. A person who steals from the company using false names or employee timecards may steal a very large amount of the employer’s funds over many years. In such a case, the loss is considered one loss by the insurer.

Employee dishonesty coverage can be added to another insurance policy, such as the property or the fiduciary liability policy. The coverage may be extended to include forgery or alteration, funds transfer fraud, computer fraud, credit card fraud and money order and counterfeit fraud. Deductibles may range from \$0 to \$50,000 or higher in some cases. Higher deductibles reduce the rate per \$1,000 of coverage.

### **What do employers do when there is a loss?**

An employee dishonesty loss is one of the most difficult claims to prove. An insurance carrier will require proof that the loss actually occurred before any claim payment is paid. When a loss is suspected, the insurance carrier should be notified of the potential for a claim. Accounting or inventory records are usually a key component in proving a loss. If a loss is suspected, it may be a wise decision to involve a CPA or accounting firm to study the evidence and help with the proof of an actual loss. When it is time to prove a loss the value of efficient loss control methods and monitoring become a huge help. The evidence should be verified and a proof of loss prepared before the actual claim is reported.

When the evidence has proven a loss has occurred, it is time to confront the employee(s). In many cases police assistance is necessary. A confession by the employee is very helpful in the settlement. When the loss can be proven from the evidence provided by company records and a confession is obtained, a settlement with the insurer will be much easier to reach.

It is our recommendation to all of our clients that employers exercise the two steps to protect their company from employee theft. First, establish an effective loss control program including monitoring on a regular basis. Second, include employee dishonesty coverage in a policy with broad coverage and a limit high enough to cover the maximum exposure to loss in your insurance portfolio.