

# Employee Theft On The Rise In Recession

Risk managers, underwriters urged to work together on loss mitigation programs

BY STEVEN BALMER

**W**ITH BUSINESSES scrambling to survive as the recession dampens revenues, freezes credit and stalls growth, employee theft may serve as an increasing drag on profitability that risk managers cannot afford to ignore.

In fact, a report issued by the Association of Certified Fraud Examiners puts the cost of occupational fraud from 2006 and 2007 at 7 percent of annual revenues—with more than a quarter of cases involving losses of at least \$1 million. Small companies with fewer than 100 employees saw a median loss of \$200,000, according to the report.

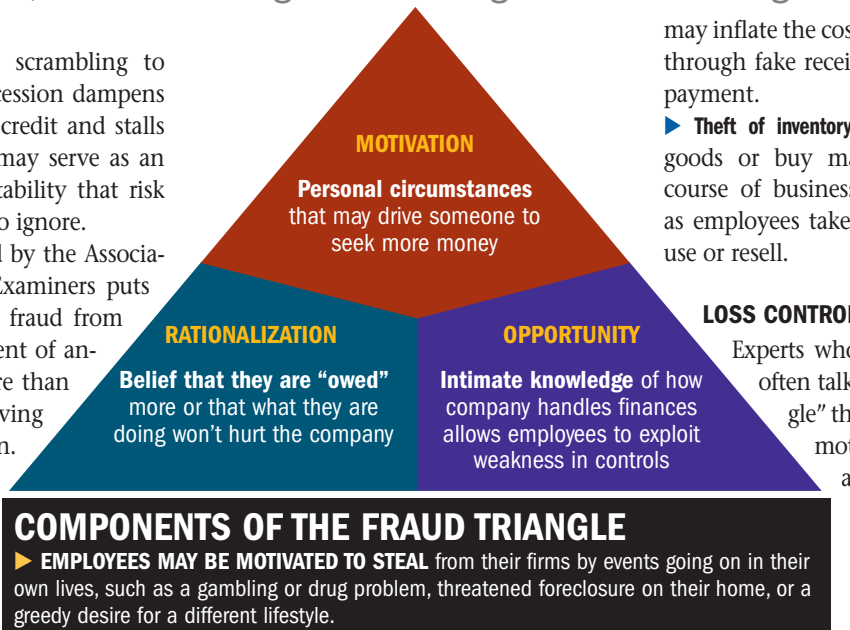
In another survey, about 20 percent of firms polled by the Institute for Corporate Productivity and HR.com said they had noticed a recent rise in theft by employees.

Underwriters can play a key role by addressing the issue of employee theft as they evaluate businesses. They can point out a particular firm's exposure and urge these potential customers to adopt more stringent financial control practices.

Critically important for both underwriters and risk managers is recognition of the most common types of loss involving employee theft, and understanding of the most effective strategies for its prevention. There are five types of fraud most commonly used by workers to steal from their employers:

► **Embezzlement:** Employees who simply siphon off money from a business usually accomplish it in one of two ways—reaching into the till to take cash directly, or forging signatures on company or customer checks that they can then deposit in their own accounts.

► **Phantom vendors:** Employees may set up a fictitious vendor, produce fake invoices and begin sending payments to themselves. A variation is for an



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.

Experts who study employee theft often talk about the "fraud triangle" that is involved in losses—motivation, rationalization and opportunity.

Employees may be motivated by events going on in their own lives, such as a gambling or drug problem, threatened foreclosure on their home, or a greedy desire for a different lifestyle. They may rationalize their theft by deciding their employer has treated them poorly, that the business will continue to be profitable despite their thefts, or that a kickback is not "really" taking anything away from the firm.

While organizations may have limited control over motivation or rationalization,

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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 or

## HIT LIST

### Theft Prevails In Some Sectors

BY STEVEN BALMER

**S**EVERAL INDUSTRIES are particularly vulnerable to employee theft, including:

- **Religious groups and nonprofits:** Typically these organizations have high levels of trust and low levels of control. What's more, they often rely on volunteers who come and go, creating an environment where theft can occur without immediate detection.
- **Health care:** These are hot spots for employee theft for different reasons. The

health care industry has tremendous amounts of money flowing through, presenting many opportunities for fraud—such as falsified medical cases, theft of drugs, altered billing and kickback schemes.

- **Trucking and warehouse operations:** These organizations frequently have problems with disappearing goods. Theft can occur as an individual act, or collusion between drivers and warehouse workers who find ways to work together to steal inventory. ■■

they can make a difference by cutting down on opportunities for theft to occur.

For example, employees may feel safe stealing because they know their firm's weaknesses, can figure out a way to take advantage, and believe they won't be detected. Those organizations with careful controls in place that are rigorously followed send a deterrence signal to employ-



▶ **Steve Balmer** is the product manager for crime-related insurance products for Travelers' Bond & Financial Products in Philadelphia.

ees that theft will be discovered.

Business owners should consider taking these important steps:

▶ **Isolate duties:** Even in a two-person or three-person office, splitting up the job of taking money in and sending it out for deposit at a bank is critical. The person authorizing expenditures should not be the same person writing the check to pay for them. Books kept by one person should be reconciled by another.

▶ **Scrutinize processes and decisions continually:** Once a system of controls is in place, make sure it is followed by checking every business transaction, new vendor and bank statement.

▶ **Perform thorough background checks:** Those hired to handle financial matters should be thoroughly checked. The Association of Certified Fraud Examiners study found that 12 percent of those involved in fraud had been previously fired by an employer for fraud-related conduct.

Underwriters who emphasize the importance of these steps during their evaluations can help risk managers protect their bottom line.

In addition, an effective risk management partnership between insurer and customer can pay off for both by lowering loss claims and reversing the upward trend of employee theft. ■

**LOSS CONTROL**

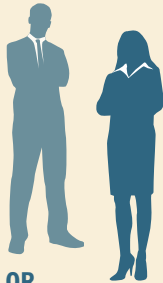
**Segregation of Duties in Small Businesses**

Splitting up who handles taking money in and sending it out for deposit at a bank is critical. Books kept by one person should be reconciled by another.

**2 PERSON OFFICE**

**BUSINESS MANAGER**

- Record accounts receivable entries
- Mail checks
- Write checks
- Record general ledger entries
- Reconcile bank statements
- Record credits/debits in accounting record
- Approve payroll
- Receive cash
- Disburse petty cash
- Authorize purchase orders
- Authorize check requests
- Authorize invoices for payments



**CEO OR OWNER/MANAGER**

- Sign checks
- Sign employee contracts
- Complete deposit slips
- Perform interbank transfers
- Distribute payroll
- Reconcile petty cash
- Approve employee time sheet
- Process vendor invoices

**3 PERSON OFFICE**

**OFFICE MANAGER**

- Process vendor invoices
- Receive cash
- Mail checks
- Approve invoices for payment
- Distribute payroll
- Authorize purchase orders
- Authorize employee time sheets
- Approve payroll
- Disburse petty cash



**CEO OR OWNER/MANAGER**

- Sign checks
- Sign employee contracts
- Complete deposit slips
- Perform interbank transfers

**BOOKKEEPER**

- Record accounts receivable entries
- Reconcile petty cash
- Write checks
- Record general ledger entries
- Reconcile bank statements
- Record credits/debits in accounting records