

Commercial Insurance Update

Topics Affecting Buyers of Commercial Insurance

MSP C 10/2001 – “Managing the Employee Dishonesty Exposure”

October, 2001

Managing the Employee Dishonesty Exposure

Employee dishonesty involves employees stealing their employers' assets. Although most employers feel that this could not happen to them, the fact is that it happens more often than people think, and the perpetrator is generally a long-term, trusted employee.

You can purchase employee dishonesty coverage to protect you from this exposure, but whether or not you purchase the insurance, there are steps you can take to significantly reduce your exposure to loss.

I encourage you to **complete the checklist that begins on page two**. Any “no” answers are an opportunity for improvement in your current procedures.

Although you can't eliminate your employee dishonesty exposure (unless you get rid of all of your employees), you can significantly reduce the likelihood of such a claim through the implementation of internal processes and procedures.*

Six Thieves

Non-Profit Employee Dishonesty

*by John W. Sullivan, CPCU
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Increasingly, Non-Profit Organizations are subject to loss through employee/volunteer theft. The following scenarios are actual occurrences. The testimonials affirm the importance of crime coverage. More importantly, they speak of the need for effective controls/safeguards to manage risk and preserve precious agency assets.

Thief One

The insured's employee failed to deposit agency funds over an eight month period; the embezzlement was discovered in early 2001. The ex-employee has been reported to the local authorities; a claim of **\$4,727** is pending.

Thief Two

The insured's employee misdirected agency funds to his personal account rather than depositing

monies to the agency's checking account. The ex-employee is in jail; the pending claim amount is **\$5,561**.

Thief Three

The agency's employee issued checks to fictitious accounts. Upon receipt of the original checks from the bank, the perpetrator would alter the checks, making them appear to relate to agency business. This claim is currently valued at **\$30,000**.

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Employee Dishonesty Internal Controls Questionnaire

If space provided does not permit complete explanation of answers,
or of any alternate safeguards or conditions, please continue on separate sheet and attach.

Important Instructions

If question is NOT applicable to this business, place a CIRCLE around the checkbox for "NO."

	Yes	No
Receipts		
1. Where currency is a significant part of the daily mail receipts, are two employees, working together, assigned to the opening of the mail?	<input type="checkbox"/>	<input type="checkbox"/>
2. If cash sales are a significant part of the business volume, are cash registers with locked controls used?	<input type="checkbox"/>	<input type="checkbox"/>
3. Does the department or person responsible for incoming receipts prepare a daily listing of checks or currency?	<input type="checkbox"/>	<input type="checkbox"/>
4. Is the listing prepared in the function described in Question 3 checked by a responsible employee other than the employee preparing the listing, and confirmed with the daily deposit slip to make certain that the receipts were accurately recorded and promptly deposited?	<input type="checkbox"/>	<input type="checkbox"/>
5. Are the employees performing the functions described in Question 3 separated from the cashiering and accounts receivable and payable functions?	<input type="checkbox"/>	<input type="checkbox"/>
6. Are all receipts routed to the cashier's department intact, and are receipts deposited intact daily?	<input type="checkbox"/>	<input type="checkbox"/>
7. Are the receiving and paying cashiering functions segregated?	<input type="checkbox"/>	<input type="checkbox"/>
8. Is the cashiering function segregated from the accounts receivable and payable functions?	<input type="checkbox"/>	<input type="checkbox"/>
Disbursements		
1. Are all disbursements made by check?	<input type="checkbox"/>	<input type="checkbox"/>
2. Are all checks countersigned?	<input type="checkbox"/>	<input type="checkbox"/>
3. Where facsimile signatures are used, are the plates and the affixing of the facsimile controlled by responsible employees, other than employee(s) affixing the written signature?	<input type="checkbox"/>	<input type="checkbox"/>
4. Are authorized check signers segregated from the accounts receivable and payable functions?	<input type="checkbox"/>	<input type="checkbox"/>
5. Are the documents underlying the payments being made attached to the checks for review when they are signed, and do they provide for departmental approvals and audits?	<input type="checkbox"/>	<input type="checkbox"/>
6. Are paying documents properly cancelled to preclude their reuse?	<input type="checkbox"/>	<input type="checkbox"/>
7. Is the mailing of checks under the control of responsible employees, other than the employees originating, approving or reviewing the payments?	<input type="checkbox"/>	<input type="checkbox"/>
8. Is the bank reconciliation function segregated from the receiving and paying cashiering functions, and also segregated from the general ledger, cash receipts and disbursement functions and the accounts receivable and payable functions?	<input type="checkbox"/>	<input type="checkbox"/>
9. Are the monthly bank statements received from the banks with the cancelled checks delivered, unopened, to the person responsible for the reconciliation function at the end of the month?	<input type="checkbox"/>	<input type="checkbox"/>
Petty Cash		
1. Is a separate petty cash fund maintained in a fixed amount, and is the responsibility for this fund restricted to one custodian?	<input type="checkbox"/>	<input type="checkbox"/>
2. Is the fund reimbursed at regular intervals by issuing a check for the total amount of paid vouchers?	<input type="checkbox"/>	<input type="checkbox"/>
3. Is the custodian required to record a daily or weekly balance showing the detail of the fund balance?	<input type="checkbox"/>	<input type="checkbox"/>
4. Is the fund counted, on a surprise basis, by someone other than the custodian?	<input type="checkbox"/>	<input type="checkbox"/>

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(Continued from p. 2)

Employee Dishonesty Internal Controls Questionnaire (continued)

	Yes	No
Accounts Receivable		
1. Are all sales invoices pre-numbered and accounted for over a sales register?	<input type="checkbox"/>	<input type="checkbox"/>
2. Are subsidiary ledger accounts maintained showing the activity in the customer's accounts?	<input type="checkbox"/>	<input type="checkbox"/>
3. Is a monthly trial balance of customer's accounts taken and reconciled with the general ledger control account?	<input type="checkbox"/>	<input type="checkbox"/>
4. Is an aged trial balance prepared by accounting personnel, other than those responsible for the collection function, for the use of management, and is this trial balance reconciled with the general ledger control account?	<input type="checkbox"/>	<input type="checkbox"/>
5. Is the billing and collection function segregated from the accounts receivable accounting function?	<input type="checkbox"/>	<input type="checkbox"/>
Payroll		
1. Is a separate payroll bank account maintained in a fixed amount and reimbursed in the exact amounts charged against it?	<input type="checkbox"/>	<input type="checkbox"/>
2. Does this firm observe all controls outlined under the cash disbursement questions above?	<input type="checkbox"/>	<input type="checkbox"/>
3. Are paychecks distributed to employees by someone not in the payroll department, and are any undistributed checks returned to the management (<i>not</i> the payroll department)?	<input type="checkbox"/>	<input type="checkbox"/>
4. Does this firm use time clocks, time sheets or job reports that are periodically spot-checked against the payroll checks?	<input type="checkbox"/>	<input type="checkbox"/>
5. Are the authorized check signers segregated from the detail payroll function?	<input type="checkbox"/>	<input type="checkbox"/>
Miscellaneous		
1. Are all negotiable securities deposited in a safe deposit box subject to joint control?	<input type="checkbox"/>	<input type="checkbox"/>
2. Is the purchasing function segregated from the paying and receiving function?	<input type="checkbox"/>	<input type="checkbox"/>
3. Where inventories are a significant item on the balance sheet, are perpetual inventory records maintained?	<input type="checkbox"/>	<input type="checkbox"/>
4. Are surprise physical inventories taken periodically by someone <i>not</i> in the stock department?	<input type="checkbox"/>	<input type="checkbox"/>
5. Are procedures reviewed by an accounting or audit function for internal control checks and balances prior to implementation?	<input type="checkbox"/>	<input type="checkbox"/>
6. Are the planning, procedures, accounting and audit review functions segregated from the operating function?	<input type="checkbox"/>	<input type="checkbox"/>

Disclaimer: This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

Winter in Southern California

Winter months in Southern California are mild compared to the severe weather conditions experienced in other parts of the country. Even so, our winter storms can still produce freezing temperatures, high winds and heavy rains.

Each year, local businesses suffer damage to structures and property, as well as business down time due directly to weather-related causes. In many cases, these losses could have been prevented through routine inspection and maintenance procedures.

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Six Thieves *(continued from pg 1)*

Thief Four

This claim involves an agency employee who issued checks to terminated employees. In turn, he would deposit the checks to his personal account. The pending loss amount is **\$63,258**.

Thief Five

A dual signature requirement was overlooked by a number of affiliated individuals, which al-

lowed the perpetrator to issue agency checks to false accounts and alter bank statements to conceal the theft.

Documentation places the loss at **more than \$190,000**, of which the policy limit of \$100,000 has recently been paid.

Thief Six

The agency's financial manager was responsible for fund raising. This loss in amount of **\$25,610** involves pledges that were transferred as credits to the credit card accounts of the perpetrator.*



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Winter in Southern California

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Here are some prevention tips based on years of industry data about property losses caused by winter weather.

- Roof structures and roof coverings should be checked regularly to assure that they are in good condition. Any sign of defects or water leaks should be repaired as soon as possible.
- Roof drains should be inspected often to assure that they're clear and allow a free flow of water runoff.
- All storm drains should be clear and sump pumps functional to permit full flow of runoff.

- In areas subjected to possible freezing, portions of your property that have water pipes or fire sprinkler systems (including attics, hallways, stairways and areas above ceilings) should be heated to at least 40 degrees Fahrenheit.
- All temporary heating devices should be listed or approved by Underwriters Laboratories and properly installed to avoid injury or property damage.
- Check backup power equipment to make sure it's in proper working order.
- Since many weather-related losses occur during weekends and seasonal plant closures, make sure that any alarms function properly and that emergency plans cover plant closure situations.*