

healthcare report

VICTOR O. SCHINNERER & COMPANY, INC.

Information and Risk Management Ideas for Healthcare Professionals

COMBATING THE INCREASE IN EMPLOYEE CRIMINAL ACTIVITY

The Contraction of the Economy Creates Systolic Risk

PART IV

Welcome to the fourth part in a special multi-part series on the effects of the down economy and how healthcare organizations can manage the risks that come with increased financial pressures on employees who might act in a criminal manner against their employers. This fourth issue discusses the criminal activities to which healthcare organizations are exposed and the likelihood of such activities increasing as employees become financially at risk and employers become less vigilant because of staffing or auditing constraints. Go to www.DandORx.com/riskmanagement.html to read the first three issues on directors and officers (D&O) liability, employment practices liability, and fiduciary liability.

Healthcare organizations have long been the target of criminal activities such as embezzlement, theft of drugs and supplies, purchasing schemes involving kickbacks, accounts payable fraud involving "ghost" vendors, employees and purchases, payroll fraud, and the theft of cash. Now, more than ever, there is a likelihood that some employees will resort to criminal activities due to personal financial pressures. Because of the need for healthcare organizations to cut their budgets, strong management and audit controls that reduce the risk of criminal activity may have been constricted.

Both Motive and Opportunity Factors Are Increasing

While criminal activities are motivated by greed and personal gain, the state of the economy has made employees feel financially threatened, leading them to take advantage of employers in often unplanned ways. Such challenges often lead to unsophisticated efforts to steal money or assets.

The increase, however, is not just

in unrefined criminality. Healthcare organizations are victimized by creative solutions to steal, embezzle, or convert employer assets. Schemes to take advantage of weaknesses in an organization's financial controls or management systems involve creative dishonesty. From fictitious employees, dummy accounts payable, non-existent suppliers, and doctored inventory records, fraud and embezzlement in the workplace are on the rise, occurring in even the best work environments. These efforts can go on for years, and the impact on an organization can be enormous in terms of profitability, financial viability, and reputation.

Most healthcare organizations are extremely complex in their purchasing and payment procedures, but many do not have the sufficient levels of protection and auditing necessary to prevent insider criminal activity. Crime-related losses are not typically covered by most property insurance policies; crime protection insurance is a necessary component for any business.

With insurance coverage for criminal activities, a healthcare organization's assets can be protected at the time of a crime's discovery if elected. Coverage in this instance would apply regardless of whether it occurred prior to or during the policy period.

Employee Dishonesty Is Costly and Pervasive

Studies have shown that it is often employees who have been identified as loyal and trusted who have the best opportunity to steal over a long period of time. While common theft of items such as office supplies and cash can be disruptive, long-term theft schemes can take enough to jeopardize an organization's financial survival.

The development and maintenance of robust, enforceable internal controls should be a priority for any commercial entity. Yet such systems, no matter how well-planned and conducted, often do not prevent employees from engaging in fraudulent activities. Following are examples of criminal activities committed by employees.

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HEALTHCARE CRIME LOSS CASE STUDIES

Fraudulent Consulting Expenses

In a mid-sized hospital, a human resources (HR) manager recommended the hiring of an outside consultant to assist in reducing the hospital's modifier on workers' compensation claims, thereby reducing payments. At the HR manager's suggestion, senior hospital management approved the hiring and congratulated her for her money-saving idea. The HR manager then set up a phone consulting firm and billed the hospital for this and other consulting services that were never provided. The fraud, which cost the hospital more than \$500,000, was detected after two years when the accounting department questioned the billing amounts.

Inventory Theft by Inadequate Purchasing Control

A purchasing manager of a nursing home had been ordering medical supplies beyond the nursing home's needs and selling them for personal profit. The lack of a strong inventory control system kept the discrepancy in stock from being identified, and the deficient purchasing controls allowed the manager to steal the inventory without any alteration of shipping and receiving records. The nursing home's chief financial officer finally discovered the continuing theft of more than \$150,000 in inventory.

Payment of Nonexistent Employees

The payroll clerk for a physician's group added several relatives to the payroll. The paychecks were direct-deposited into the phony employees' back accounts. The scam lasted for three years before the payroll clerk left the group and the replacement payroll clerk discovered the scheme. By that time the payroll payments to the nonexistent employees totaled more than \$300,000.

False Invoices from Phony "Mirror" Vendors

In a medical laboratory with annual revenues of more than \$35 million, the head of accounting approved payments to several vendors with fictitious names that were similar to those of actual vendors under contract to the medical laboratory. The phony or "mirror" vendors were so close in name to legitimate companies that the slight difference in names was not uncovered for more than two years. By that time more than \$650,000 had been diverted.

Supply Theft through Waste Disposal

A waste management firm collected medical waste from several city hospitals. At one large hospital, an employee related to the manager of the waste disposal firm arranged to have unused, valuable medical supplies picked up at the same time as the waste. The hospital's controls over the outgoing waste and usable medical supplies were fairly loose and the scheme was able to continue without detection for years. Once discovered, the theft was determined by an outside auditor to have converted close to \$600,000 in supplies into the pockets of the waste management firm and the employee.

Source: Chubb Group of Insurance Companies

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LIMITING YOUR EXPOSURE

How can you limit your exposure to employee theft? There is no fool-proof way to prevent theft of corporate assets, but there are measures you can take to limit it. Here's a short-list to get you started:

- Enlist senior management to embrace controls and to support their enforcement fairly.
- Management's vigilance is the greatest control of all, so make it part of your corporate culture.
- Have an independent CPA complete an annual audit of your healthcare organization. If they provide you a list of corrective measures to take, implement them on a regular basis, and update them as your organization grows or changes.
- Set up an internal audit committee. This team should work as liaison between management and your CPA and help create an appropriate program. It should be independent of management and major shareholders/constituents of the organization, thereby allowing it to function separately.
- Make sure all locations are audited and monitored, including any outside the United States.
- Use reference checks during the hiring process to screen out potential problem employees.
- Look for criminal histories and any gaps in previous employment.
- Check all locations where a prospective employee has lived, not just their last area of residence.
- Require all employees to take an annual vacation of five days or more.
- Watch for any significant lifestyle changes of employees.
- Create a system for employees to report potential embezzlement quietly, and at little risk of being found out by coworkers. Consider providing an incentive to those who help stop theft.
- Use a lock-box for receipt of checks and cash if possible.
- Make it difficult for employees to steal on their own. Try to separate duties:
 - Employees who have access to inventory should not be the same people who count it.
 - Employees who handle bank deposits and withdrawals are different than those who reconcile bank statements.
 - Require two signatures on checks (countersignature procedures).
- An important part of any exposure reduction program is purchasing a comprehensive commercial crime insurance policy.