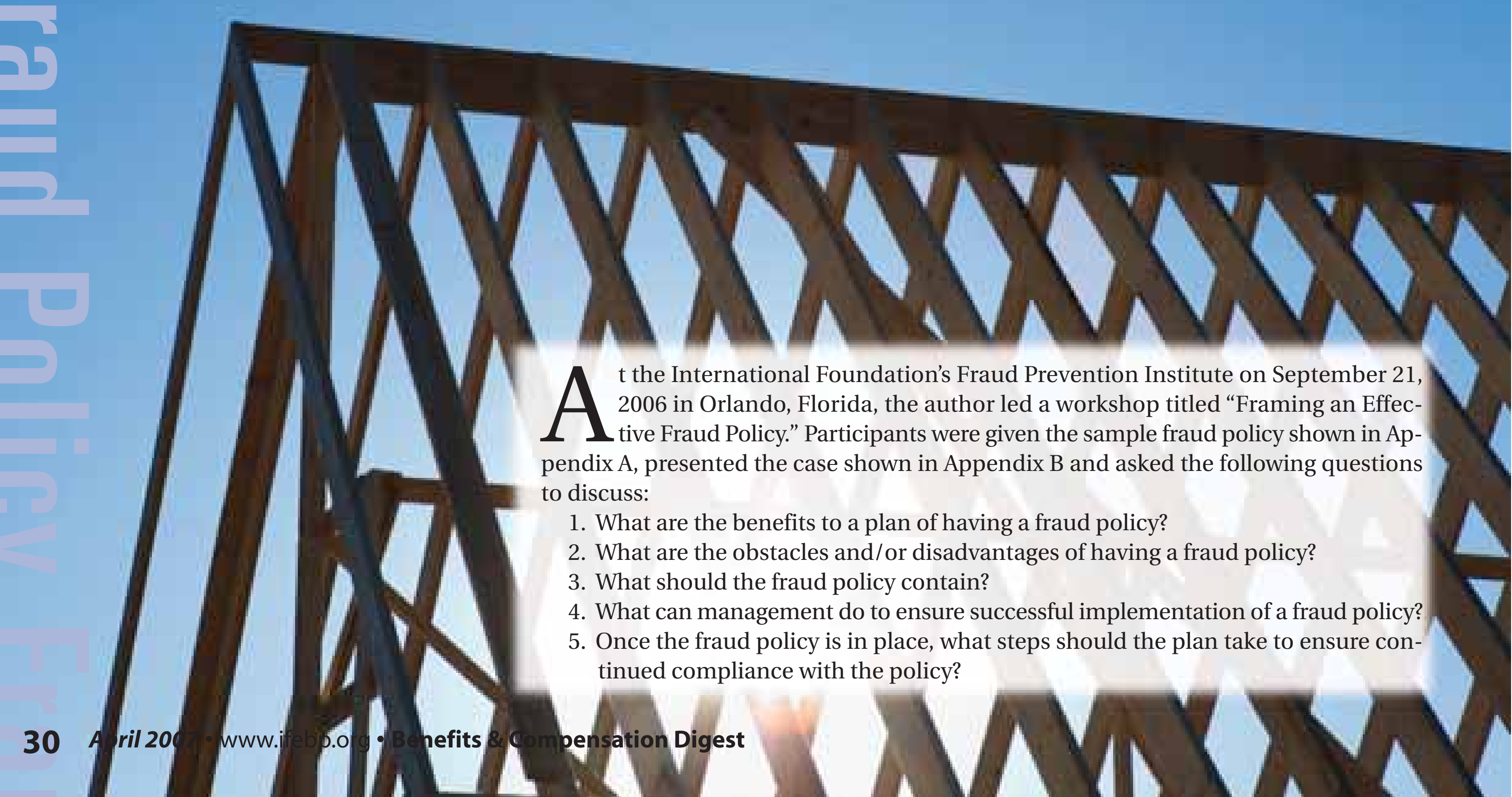
Framing an Effective Fraud Policy

An effective method of establishing a policy for an organization is to have a brainstorming session. This involves gathering all those who will be responsible and having that group generate items for inclusion in the policy. In this article, we used the ideas of the participants in an International Foundation of Employee Benefit Plans-sponsored seminar about establishing an effective fraud policy for an employee benefit plan.

Framing an Effective Fraud Policy

by Lawrence R. Beebe



At the International Foundation's Fraud Prevention Institute on September 21, 2006 in Orlando, Florida, the author led a workshop titled "Framing an Effective Fraud Policy." Participants were given the sample fraud policy shown in Appendix A, presented the case shown in Appendix B and asked the following questions to discuss:

1. What are the benefits to a plan of having a fraud policy?
2. What are the obstacles and/or disadvantages of having a fraud policy?
3. What should the fraud policy contain?
4. What can management do to ensure successful implementation of a fraud policy?
5. Once the fraud policy is in place, what steps should the plan take to ensure continued compliance with the policy?

6. Once the fraud policy is in place, what should the plan do when fraud is discovered?

The consensus answers that the groups had to these questions were very enlightening and will serve as the basis for the remainder of this article.

Benefits

What are the benefits to a plan of having a fraud policy?

1. It prevents fraud. The group felt that having a policy was, in itself, a deterrent to fraud. If the plan has a fraud policy and makes everyone aware of that policy then less fraud may occur. To put it another way, having a fraud policy may keep people honest.
2. Due diligence. Is it reasonable in this day and age to expect a plan to have a fraud policy? A well-run plan wants to show the world that it has all the necessary bells and whistles including a well-thought-out fraud policy.
3. Early detection. Having a fraud policy, in itself may not prevent the fraud, but it may minimize the loss. The fraud policy should make everyone in the plan more aware that fraud may occur, and it should give the person who suspects fraud a methodology for reporting his or her suspicions. Early detection is essential in minimizing fraud when it occurs.
4. Protects the trustees. The trustees of a plan are ultimately responsible for everything that happens within a plan. The trustees need assistance from other personnel, and they need well-thought-out policies and procedures to ensure that their mandates are being followed. The fraud policy is a notice by the trustees to all concerned that they take fraud prevention seriously. An effective fraud policy protects all those associated with the plan, including employees, participants and vendors.
5. Creates an awareness that fraud can occur. Many people have the idea that fraud just isn't possible within their plan. Fraud is what happens to the plan "next door," but not to us. Estimates are that fraud occurs as often as 3-10% of the time in health claims. If fraud does occur with this frequency, then it is occurring within every organization. The plan that has a healthy skepticism regarding fraud and also has an effective fraud policy should minimize fraud.
6. It is in the best interest of the plan to have a fraud policy. There is no requirement that a plan have a fraud policy just as there is no requirement that a plan have many other policies and procedures. Is a well-run plan more likely to have a fraud policy than a plan that is not so well-run? The author believes that having a fraud policy is part of "the best practices" of a well-run plan.
7. A fraud policy is a legal document and this aids the plan when sanctions are necessary. Many plans have employees, trustees and vendors sign an acknowledgement that they have read, understand and will abide by the plan's fraud policy. If a violation of the policy then occurs, it is difficult for the violator to plead ignorance.
8. Tone at the top. Having a fraud policy puts everyone associated with the plan on notice that the trustees have adopted a fraud policy and they expect everyone to adhere to it. Many frauds occur because no one in the organization takes fraud seriously. In fact, in some organizations, the top officials in the organization are those committing the fraud. Having a fraud policy is a signal that the organization, from the top down, takes fraud seriously and is determined to prevent it from occurring and to detect it if it does occur.

Obstacles

What are the obstacles and/or disadvantages of having a fraud policy? The group did not like how this question was worded. They pointed out that there are no disadvantages to having a fraud policy, and that every organization would be better served by having such a policy. This left obstacles as the only deterrent. What are the obstacles?

1. **Organizations and those that manage them are change-resistant.** There are those who would say that if the plan has been successful over many years without a fraud policy, why is such a policy necessary now? There are also some who might argue that having a fraud policy might put the wrong ideas in people's minds.
2. **Failure to follow the policy.** A plan might implement the perfect fraud policy for the organization. However, it is just a piece of paper or a worthless document. A fraud policy, to be effective, must be adhered to and must have regularly scheduled monitoring to ensure that it is effective. Any plan adopting a fraud policy must make sure that a mechanism is in place to ensure the policy is being followed.
3. **Time and expense.** A common excuse for not having a fraud policy is that it takes too much time to produce and that it therefore will cost the plan money. The counterargument to this is relatively easy. What will happen when fraud does occur within the plan? When the fraud occurs, the cost to the plan in terms of both time and money is likely to be enormous—far greater than the time and money to implement the policy. The resulting publicity for the plan, if fraud occurs, will just compound the problem. Having a fraud policy represents an ounce of prevention. Prevention in this case is the most effective procedure in avoiding the fraud that may occur without the policy.
4. **Having a fraud policy slows productivity.** An argument against any policy is that it prevents the organization from accomplishing its mission in the most effective and efficient manner. All organizations, however, are subject to certain rules and procedures. A fraud policy helps ensure that the plan is adhering to certain ethical principles in how it governs itself. We should not expect less from any organization in society.

Contents of the Fraud Policy

What should the fraud policy contain?

1. An overall statement that sets forth the standards that should be followed by the employees and the trustees of the plan. This would include a description of the proper method of conducting plan business and the

Continued on next page

Appendix A

A Fraud Policy for a Multiemployer Plan

Plan Fraud Policy

The plan and its employees must, at all times, comply with all applicable laws and regulations. The plan will not condone the activities of employees who achieve results through violation of the law or unethical business dealings. This includes any payments for illegal acts, indirect contributions, rebates, and bribery. The plan does not permit any activity that fails to stand the closest possible public scrutiny.

All business conduct should be well above the minimum standards required by law. Accordingly, employees must ensure that their actions cannot be interpreted as being, in any way, in contravention of the laws and regulations governing the plan's worldwide operations.

Employees or others associated with the plan who are uncertain about the application or interpretation of any legal requirements or who observe violations of the plan's fraud policy should refer the matter to the audit committee of the board of trustees, which, if necessary, should seek the advice of the plan's attorney. If an employee is not comfortable referring the matter to the administrator, then the employee should directly contact the plan's attorney.

General Employee Conduct

The plan expects its employees to conduct themselves in a businesslike manner. Unprofessional activities are strictly prohibited while on the job.

Employees must not engage in sexual harassment or conduct themselves in a way that could be construed as such, for example, by using inappropriate language, keeping or posting inappropriate materials in their work area or accessing inappropriate materials on their computer.

Conflicts of Interest

The plan expects that employees will perform their duties conscientiously, honestly, and in accordance with the best interests of the plan. Employees must not use their position or the knowledge gained as a result of their position for private or personal advantage. Regardless of the circumstances, if employees sense that a course of action they have pursued, are presently pursuing or are contemplating pursuing may involve them in a conflict of interest with their employer, they should immediately communicate all the facts to the audit committee of the board of trustees.

Outside Activities, Employment and Directorships

All employees share a serious responsibility for the plan's good public relations, especially at the community level. Their readiness to help with religious, charitable, educational and civic activities brings credit to the plan and is encouraged. Employees must, however, avoid acquiring any business interest or participating in any other activity outside the plan that would or would appear to:

- Create an excessive demand upon their time and attention, thus depriving the plan of their best efforts on the job.
- Create a conflict of interest—an obligation, interest, or distraction—that may interfere with the independent exercise of judgment in the plan's best interest.
- Engage in party-in-interest transactions that are prohibited under the Employee Retirement Income Security Act (ERISA).

Relationships With Contributing Employers and Suppliers

Employees should avoid investing in or acquiring a financial interest for their own accounts in any employer organization covered by the collective bargaining agreement that results in contributions to the plan, or that provides goods or services or both to the plan. Such an investment or interest could influence, or create the impression of influencing, their decisions or the performance of their duties on behalf of the plan.

Gifts, Entertainment and Favors

Employees must not accept entertainment, gifts or personal favors from contributing employers to the plan or from investment advisors or any other service providers for the plan. Similarly, employees must not accept any other preferential treatment under these circumstances because their position with the plan might be inclined to, or be perceived to, place them under obligation.

(Continued on next page)

Appendix A

A Fraud Policy for a Multiemployer Plan (Continued)

Kickbacks and Secret Commissions

Regarding the plan's business activities, employees may not receive payment or compensation of any kind, except as authorized under the plan's remuneration policies. In particular, the plan strictly prohibits the acceptance of kickbacks and secret commissions from investment advisors or others. Any breach of this rule will result in immediate termination and prosecution to the fullest extent of the law.

Plan Funds and Other Assets

Employees who have access to plan funds in any form must follow the prescribed procedures for recording, handling and protecting money, as detailed in the plan's operational manuals or other explanatory materials or both. The plan imposes strict standards to prevent fraud and dishonesty. If employees become aware of any evidence of fraud and dishonesty, they should immediately advise the audit committee of the board of trustees so that the plan can promptly investigate further.

When an employee's position requires spending plan funds or incurring any reimbursable personal expenses, that individual must use good judgment on the plan's behalf to ensure that good value is received for every expenditure.

Plan funds and all other assets of the plan are for plan purposes only and not for personal benefit. This includes the personal use of plan assets, such as computers.

Plan Records and Communications

Accurate and reliable records of many kinds are necessary to meet the plan's legal and financial obligations and to manage the affairs of the plan. The plan's books and records must reflect in an accurate and timely manner all business transactions. The employees responsible for accounting and recordkeeping must fully disclose and record all assets, liabilities or both and must exercise diligence in enforcing these requirements.

Employees must not make or engage in any false record or communication of any kind, whether internal or external, including but not limited to:

- False expense, attendance, financial, or similar reports and statements
- False advertising, deceptive marketing practices or other misleading representations.

Dealing With Outside People and Plans

Employees must take care to separate their personal roles from their plan positions when communicating on matters not involving plan business. Employees must not use plan identification, stationery, supplies and equipment for personal or political matters.

When communicating publicly on matters that involve plan business, employees must not presume to speak for the plan on any topic, unless they are certain that the views they express are those of the plan and it is the plan's desire that such views be publicly disseminated.

When dealing with anyone outside the plan, including public officials, employees must take care not to compromise the integrity or damage the reputation of either the plan or any outside individual, business or government body.

Prompt Communications

In all matters relevant to customers, suppliers, government authorities, the public and others in the plan, all employees must make every effort to achieve complete, accurate and timely communications—responding promptly and courteously to all proper requests for information and to all complaints.

Privacy and Confidentiality

When handling financial and personal information about customers or others with whom the plan has dealings, observe the following principles:

1. Collect, use and retain only the personal information necessary for the plan's business. Whenever possible, obtain any relevant information directly from the person concerned. Use only reputable and reliable sources to supplement this information.
2. Retain information only for as long as necessary or as required by law. Protect the physical security of this information.
3. Limit internal access to personal information to those with a legitimate business reason for seeking that information. Use only personal information for the purposes for which it was originally obtained. Obtain the consent of the person concerned before externally disclosing any personal information, unless legal process or contractual obligation provides otherwise.

Appendix B

Fraud in a Health and Welfare Plan

The Case

A claims supervisor at a multiemployer health and welfare plan began submitting fictitious claims to the plan in the names of legitimate covered participants who had the same common last name. The supervisor managed to code each file so that the approved claim, accompanied by the check in payment for the amount due, was sent directly to him. Instead of sending the payments out, he deposited the checks in his personal bank account. The plan discovered the defalcation when a plan participant claimed that he had not exceeded the maximum benefit level for a particular type of benefit.

The plan did not have a fraud policy. The plan, in questioning plan employees after the defalcation, was told the following by the employees:

1. "I thought the supervisor was up to something, but I didn't know who to go to in the plan to report it."
2. "I don't have any responsibility to be a whistle-blower."
3. "Good for the supervisor. I always thought that upper management was getting rich, so why shouldn't he get his cut too?"
4. "I suppose I am naive, but I just didn't think that anyone here would steal."
5. "I didn't think that (the supervisor) would steal. He is the plan's hardest working and most loyal employee."

conduct expected from plan employees.

2. A description of those areas where employees must act in the best interest of the plan and avoid fraudulent conduct. Those areas include:
   - Potential conflicts of interest
   - Outside activities, employment and directorships
   - Relationships with contributing employers and suppliers
   - Gifts, entertainment and favors from contributing employers and service providers
   - Prohibitions against kickbacks and secret commissions.
3. A definition of fraud. The fraud policy and what the plan considers fraud to be should be clear to all who read it.
4. Who to contact when a plan employee or trustee finds or suspects fraud. People are very reluctant to come forward when they suspect fraud. If the fraud policy details exactly who to contact to report the fraud and details the procedures for reporting the fraud, then the person with the suspicions is much more likely to come forward.
5. The consequences and/or sanctions of committing the fraud. A person may not be deterred from committing a fraud by reading in a fraud policy what the sanctions are. An employee who does acknowledge signing for and reading the fraud policy is not likely to argue later that he or she did not know how serious the plan was concerning fraud and that he or she did not know that fraud was likely to have serious consequences.
6. A whistle-blower policy. The seminar participants felt that the fraud policy should have a provision offering to protect individuals who come forward within the organization to report potential fraud. Too many times in the past, the person who reports fraud has been unjustly sanctioned or terminated by the organization as a troublemaker. A whistle-blower policy alerts everyone that this plan takes fraud seriously and will protect those employees who report suspicious activity.

A fraud policy constructed in accordance with the above suggestions from the seminar participants will look somewhat different than the fraud policy in Appendix A. That is what is great about having a brainstorming session within your plan to write your own policy. The result of your brainstorming session will be a fraud policy that fits your plan.

Successful Implementation

Once the plan's fraud policy is written and is in place, what can the trustees and administrators do to ensure that the implementation phase of the process will be a success?

1. **Communication.** There should be a great deal of publicity within the plan when the fraud policy is established. A cover letter from the trustees explaining the fraud policy and stating how important the trustees consider the policy is essential. A notice on the plan's bulletin board(s) will also help. After the policy is in place it cannot be forgotten. Frequent references to the policy in communications with plan employees (and suppliers) is also a must.
2. **Signatures.** When the plan employee (or vendor) is given a copy of the plan's fraud policy, the employee should sign a form acknowledging that he or she has been given the policy, has read the policy and pledges to adhere to it.
3. **Hotline.** Establishing a hotline that plan employees and vendors can use to report suspicious activity will lead to a greater likelihood that fraudulent activity within the plan will be reported. An independent person within the plan (e.g., an internal auditor) should be assigned the responsibility of monitoring the hotline, and the detail of any hotline activity should be reported regularly to the trustees.
4. **Training programs.** Handing a plan employee a fraud policy and telling that person to read it and follow it is likely to be ineffective. If that same person attends a program designed to educate the individual about fraud then the whole program is more likely to be effective.
5. **When potential fraud has been reported.** The person reporting the fraud should be given feedback. The plan should acknowledge that a report has been filed and a later acknowledgement that the plan has

taken appropriate action to resolve the reported activity.

Continued Policy

What steps should the trustees take to ensure continued compliance with the fraud policy?

1. **Operational audit**. The trustees should periodically have an operational audit performed by a knowledgeable insider or by an objective outside organization such as an independent certified public accountant (CPA). The purpose of the operational audit, not to be confused with a financial statement audit, is to ensure that the plan is operating efficiently and effectively. An operationally sound plan is much less likely to have fraud occur.
2. **Audit committee**. An audit committee is a committee of the board of trustees. The primary duty of the audit committee is to act as a liaison between the board of trustees and the plan's external auditors. The audit committee would also be the perfect body to be in charge of monitoring compliance with the plan's fraud policy. The audit committee could meet regularly with plan personnel who monitor compliance with the plan's fraud policy. The audit committee would also recommend to the board of trustees any changes to the fraud policy.

When Fraud Is Discovered

The audit committee may be the body within the plan that takes action when fraud or possible fraud is discovered. What actions should the audit committee take when fraud is reported besides the investigation of the fraud?

1. **Notify the trustees.** The trustees should be notified immediately when suspected fraud is reported and should then be kept aware of progress in the investigation until the matter has been resolved.
2. **Notify the insurance carrier.** Unless the insurance carrier is notified as soon as fraud is suspected, the plan's insurance coverage may not be effective.
3. **Notify the plan's legal counsel.** As soon as there is strong suspicion of fraud within the plan, legal counsel should be consulted. The person or people who may have perpetrated the fraud should not be confronted until legal counsel has approved the process.
4. **Notify law enforcement.** To pursue criminal and/or civil action in connection with the fraud, law enforcement should be notified as soon as possible.
5. **Disclosure of the fraud may be necessary in returns filed with the Department of Labor and/or the Internal Revenue Service.**
6. **Update the fraud policy.** Once all other matters associated with the fraud have been undertaken, the audit committee (or the trustees) may want to review the fraud policy to determine if it needs to be updated as a result of the fraud.

Conclusion

The participants in the seminar did a terrific job of analyzing a plan's fraud policy. The suggestions they made in response to the questions that were asked, can serve as a strong message to establish and preserve an excellent fraud policy for an employee benefit plan. **B&C**

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