



Most business owners and managers are highly attuned to the threat of loss from outsiders and use a variety of methods to reduce this risk: everything from locks on the doors, to security guards, to complex electronic monitoring systems.

Often, less attention is directed to reducing the risk of theft by an insider, an employee who defrauds the company of money. Most people want to trust their employees and rightly so. However, it only takes one wolf in sheep's clothing to do a lot of damage. Depending on the person's position in the company and the length of time the theft continues, substantial amounts can be stolen. Owners and managers often have a tendency to believe "it can't happen here." Unfortunately, employee fraud happens everywhere. No risk reduction measures can be guaranteed to keep it from ever happening or detect every instance.

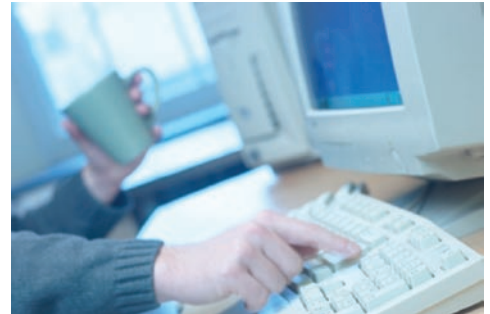
That said, loss control experts recommend two general approaches to reducing vulnerability to theft by insiders: measures to decrease the probability that employees will commit the crime and to increase the perceived probability of discovery and punishment. These are described below.

1. Have an anti-fraud policy. Experts say many employers wrongly assume they don't need to talk about insider theft, since their employees know it is wrong. In fact, a strong, writ-

Seven Tips to Reduce the Risk of Employee Fraud

ten anti-fraud policy, published in the employee handbook and/or posted on employee bulletin boards, helps prevent insider theft. It communicates the employer's intent to maintain an honest, ethical environment, not one where "everybody does it [steals]."

2. Encourage employees to report suspected fraud and tell them how to do it. Employees need to know how to report any suspicion of fraud or theft. Honest employees will usually report fraud when there is a good policy for doing so. Without such a policy, they are more likely to say nothing.
3. Maintain an atmosphere of trust and loyalty. Expectations influence behavior. When you expect employees will steal, some are more likely to do so, reasoning that there is no point in behaving honestly if you are already suspected of being dishonest. Maintaining an atmosphere in which employees feel trusted and valued and are rewarded for loyalty helps prevent insider theft.
4. Promote ethical business practices. The typical employee thief is a first-time criminal who rationalizes his or her behavior to avoid having to face up to their criminality. Employees who have this moral weakness are more likely to act on it in an environment where they see the business engaging in unethical practices. When the company emphasizes and rewards ethical business practices the risk of insider theft goes down.
5. Compartmentalize duties. When the same person both approves and pays invoices, it is especially easy for a dishonest employee to submit phony invoices and then pay them. Compartmentalizing duties helps to prevent this type of scheme.



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Welcome to the Dare Insurance Agency Newsletter!

We are pleased to bring this informative newsletter to you. In this and future issues, we will select articles we believe are timely and helpful to you in conducting your business or personal affairs. Should there be certain topics you would like addressed please let us have your suggestions and we will do what we can to get them published.



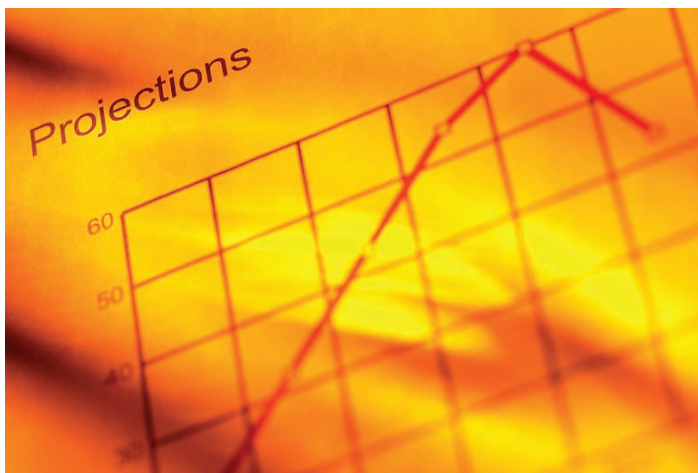
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Disability Insurance and the Buy-Sell Agreement

If you own a small business, you've probably heard the term "buy-sell agreement." In fact, your attorney or accountant has probably mentioned the need for one a time or two.

Buy-sell agreements do several things. Their three main functions are to ensure an orderly transfer of your business when you die; set a value on the business for transfer and tax purposes; and plan the succession of an owner who is disabled and can't contribute to the bottom line.



Let's look at the disability provisions that should go in a buy-sell agreement...

- Income replacement
- Overhead expense payments
- Ownership interest

There are, correspondingly, three types of disability insurance that should be considered for inclusion in the terms of your buy-sell agreement.

Disability Income Insurance (DI). This is insurance that provides a monthly benefit to replace income paid to a disabled person (owner or employee). The premium tends to run about 1-2% of the person's annual salary for salary replacement through age 65, and the benefit is usually paid tax-free provided the recipient paid premiums out of his/her pocket. If the company pays the premium, the cost will be higher but the premium is tax-deductible for the company and the benefit is taxable to the recipient. It is very expensive to continue to simply pay the salary of someone who can't contribute, even if that someone is the owner, so DI is a low-cost way to protect an asset—the owner's income—while protecting the company's cash flow. There are many features available to enhance policy benefits—we can help you decide what's right for you.

Business or Professional Overhead Expense Insurance (BOE/POE). This is an important coverage for a business with a sole owner. DI insurance replaces income, but does not pay the day-to-day costs of continuing to run a business when the owner is disabled. Rent and utilities and salaries don't just go away. If there is a chance the owner will return to the business, this insurance will increase the likelihood there will be a business to come back to. If disability triggers sell provisions of a buy-sell agreement, these payments will ensure there is a viable entity to sell.

Disability Buy-Out Insurance (DBO). If the disabled owner is unable to return to work, DBO insurance will enable the business or the buyer under a buy-sell agreement to purchase the disabled person's interest in the business at a pre-determined monthly, annual, or lump sum payment level. DBO insurance does not preempt DI insurance, so the disabled owner gets a fair price for his or her business interest and continues to receive the agreed-upon DI payments.

It's easy to skip these provisions in buy-sell agreements—in fact, many attorneys only look at the buy-sell agreement as a way to maintain liquidity and pass the business interest at the death of an owner. Yet, you are two to four times more likely to become disabled while working than to die (depending on what industry statistics you use and how old you are now). Doesn't it make sense to protect your ability to earn a living? After all, that's probably your most valuable asset.



Workers' Compensation: Calculating Your Premiums



Standards for workers' compensation insurance policies are set by the National Council on Compensation Insurance (NCCI), which utilizes more than 700 codes for specific job descriptions to assist in figuring insurance premiums. These codes are applied to information submitted about your business by your insurance agent. Standards are further complicated by varying state-to-state regulations.

This seemingly complicated process understandably causes many employers confusion and concern about their workers' compensation policies. Therefore, understanding the basics of workers' compensation plans and how your premiums are determined is important.

Your first year's premium, based on an estimation of your company's payroll and the type of business you operate, will be estimated by your insurer. At the end of the first year, the insurance company will do an audit to determine a more accurate premium, based on a year of payroll information and your business classification.

Because it is difficult for a new business to predict what its first-year payroll will be, any necessary adjustments during the end-of-the-year audit are important to make. Working closely with your insurance agent will ensure your premium reflects your needs.

Fortunately, there are a handful of private companies that work to ensure accurate premium calculations. Independent premium auditors specialize in finding overcharges in workers' compensation premiums. Such overcharges can occur when payroll is reported to the insurance company incorrectly, showing too many workers in risky jobs, or when a business is misclassified as a higher risk workplace than it actually is.

Even though states mandate workers' compensation, they don't set the premiums but merely approve the rates that prescribe a certain dollar amount in workers' compensa-

tion premiums for every \$100 of payroll. Some states allow discretionary credits, which allow insurance companies to discount premiums offering tremendous assistance to insurers in a competitive workers' compensation marketplace.

Accurate payroll records are essential in determining premiums. However, payroll is not the only component of remuneration. The NCCI also considers employee commissions, bonuses, overtime, holiday, vacation, sick pay, incentive plans, profit-sharing plans, payments for tool reimbursements, the value of rental housing and lodging provided by an employer, and the value of store certificates or merchandise given to employees.

After the first year, your premium is based on your workplace injury rate; so it is likely you will see a change based on your company's experience with workers' compensation claims. Obviously, good record keeping, paired with good communication with your insurance representative, is the key to ensuring your workers' compensation premiums are in line with your needs.

Help Yourself:

- Discuss every aspect of your business thoroughly with your agent. Your premium will be more realistic the more honest you are. If your payroll or business description changes during the year, you can always change your workers' compensation policy to reflect these changes.
- Some states exclude officers, owners, partnership, and sole proprietors from required workers' compensation coverage, and so if you want to cover any of these people with your policy, you may have to request such coverage specifically and pay for it additionally.

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6. Ask your accountants for help in detecting fraud. Among the methods accountants often recommend are accounting controls, built-in detection mechanisms, and reconciliation of records. Frequent audits that include steps to uncover fraud increase the probability of discovery. Be sure that accountants understand that you view the discovery of insider theft as an aspect of their duties and services. Use your accountants to survey either all employees or randomly chosen employees from time to time asking whether they are aware of any misappropriation of company money, property, or resources.
7. Investigate any tips about employee fraud. Many employee fraudsters are first brought to their employer's attention as a result of a tip from an unhappy spouse or

significant other. These tips should be objectively investigated. Sometimes employers ignore such tips, because they trust the employee in question, only to find out later that the tip was right and the amount of the theft could have been cut down by taking the initial tip seriously.

In summary, to reduce the risk of insider theft, the employer's stance should be one of trusting employees in general not to steal, while at the same time being proactive about measures to help keep any rotten apples out of the barrel. Most employees will never engage in schemes to defraud, but there are always some who will and, unfortunately, they are often the very people the employer would be least likely to suspect.

A Quick Guide to Understanding Insurance Policies

There is little disagreement among policyholders that an insurance policy is an insanely boring piece of literature. Too often we get our policy and until we have a claim, it is filed with barely a second glance. Is there a way to make reading insurance policies more interesting and more productive? Let's try.

To make your policy interesting to read, we are going to go on a scavenger hunt. Find a pen, pencil, or highlighter; open up your policy; and let's begin. We will break down the typical insurance policy into the following parts: 1.) Declarations, 2.) Definitions, 3.) Covered Perils, 4.) Exclusions, 5.) Conditions, and 6.) Endorsements or Riders. Get used to looking in this particular order, regardless of how your policy is arranged. Because of the nature of insurance policies, you will not overlook anything by going out of the policy's inherent order; so do not worry about jumping from page to page.

1. **Declarations** - The declarations page(s) comprises the who, what, when, and where of your policy. Look for the named insured, the address, limits of coverage, deductible or retention levels, and listings of forms that might apply to your coverage as well. Make sure that all the personalized information is correct and all the forms match the ones quoted with your policy. This should always be your first stop.
2. **Definitions** - Not all policies have a definition section, but most have defined terms. Hunt down the definitions in your policy, see what the defined terms mean, and to be truly thorough, find those defined terms as they are used in the policy to see if the definitions make sense.
3. **Covered Peril(s)** - Regardless of what type of policy you have purchased, it will always have a specific covered peril or list of covered perils. It may be called "Coverage Agreement," "Covered Perils," or something similar. (NOTE: A typical auto policy has as many as six distinct coverages, each with their own terms, conditions, exclusions, and so

on.) Coverage agreements can also include additional coverages related to the covered peril, i.e., legal defense and other expenses paid by the company in a liability policy.

4. **Exclusions** - Virtually all policies have exclusions, which are usually found in a section entitled "Exclusions" or "What We Do Not Cover." Common exclusions include exposures that are deemed uninsurable by law or uninsurable by the insurance company. Punitive damages, for example, are not insurable in some states because of the act that precipitated the punitive damages. Other exposures, such as asbestos liability, are simply undesirable to the insurer and excluded accordingly. Often, policies have "carve outs" built into the covered peril section or elsewhere in the policy, so look for these exclusions too. For example, the policy might have a definition section with a definition for "Damages" or "Covered Damages." Damages might be stated to include monetary loss suffered by a third party (for a liability policy) and defense costs, but not to include fines, penalties, or punitive damages assessed against the insured.
5. **General Conditions** - All policies have what are called general conditions or common policy conditions if there is more than one coverage section to the policy. Typical conditions that apply are "Policy Territory," "Cancellation," and "Other Insurance" clauses.
6. **Endorsements or Riders** - Many policies have endorsements or riders added to the basic policy to account for variations by state, updates to the basic form, or elements that are peculiar to your situation and require tailoring of coverage.

Now that you have gone through your policy, the final step is to ask questions. If there are no questions, move on to the next policy, start with the declarations and don't stop until you hit the riders. I guarantee it will be a page-turner!

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