



BEST PRACTICES FOR FRAUD PROTECTION

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There is no lock so strong that a determined thief cannot breach it. Theft happens. Frauds occur. What matters is that you have consistently applied reasonable oversight and created and followed good procedures in your day-to-day practice. Hopefully you have a sufficiently high amount of insurance in place to cover any loss. I recommend not less than one half of the average balance of all fiduciary accounts combined. What is most important is that should fraud occur, your good reputation and license to practice remain undamaged.

Many lawyers mistakenly believe that the biggest firms are those which are most vulnerable to fraud because they are highly complex organizations, handle a high volume of transactions, and have a lot of people involved in the process of moving money in, out and within the firm.

The reality is that larger firms are less vulnerable, thanks to oversight and procedures. One of the first rules of good financial management is a separation of duties. People who handle money in don't handle money out. People who work with the trust account(s) don't have access to the operating account, and vice versa. Small firms don't have enough people on staff to achieve true separation of duties.

In larger firms, multiple people "touch" money between receipt and deposit. For example, one person may open envelopes with client checks and make a list and perhaps a copy of each check. Another person makes application to the client account receivable. And yet another may make the physical deposit. With so many hands involved making tallies that must all reconcile, it would take a lot of collusion to commit fraud. Fraudsters are normally afraid to let anyone in on their actions or plans. The same multiple steps usually apply to money out--approval of invoices, issuing of checks, recording client costs and so forth.

In larger firms there is normally a person designated to ensure all the separate tallies match and reflect in various financial reports consistently. It may be an office administrator, controller, or a partner. In small firms, there is limited oversight. There often aren't enough non-billable hours available for a partner to do

the job. There is often no office manager. People tend to handle all parts of transactions and are trusted beyond question. That's not really a good thing.

The reality is that good people sometimes do very bad things. They do so because of exigent circumstances and because they have an expectation they will not get caught. Often there is a good intention that the theft is temporary and will be repaid before anyone notices. The reality is that it rarely works out that way. Temptation becomes too strong to resist when it seems likely one will escape detection.

The purpose of the majority of procedures and oversight is to provide a strong audit trail, and to take away expectation one can commit fraud without detection. Some of you may need to tighten the reins a bit. There will be push-back. Be prepared. Remember that it's your license on the line. You have responsibilities under Rule 5.1, 5.2, 5.3 and 1.15. Temporarily dealing with hurt feelings from an employee who now feels you are less trusting is more than worth adequately protecting your license. And if you need to, I give you permission to respond, "Ellen made me do it!" Following is my short list of essential procedures and oversight that are particularly important to follow for solo to midsize firms.

- Whoever is responsible for opening mail that contains checks should make a listing of each check. Use a simple table. With the date received at the top, all that needs to be listed is the name on the check, check number, and amount. The total for the day should be at the bottom of the table.
- Hopefully the person responsible for allocating the funds to the proper accounts is different from the person who opened the envelopes. At the end of the day, there should be a listing of deposits into operating and trust accounts, with totals for each. This listing would be similar to the table above but also include the client name applicable to each check. Those deposited into the operating account would show the invoice number being paid. Those deposited into trust would have an explanation.

Checks that cannot be processed due to a need to research should be separately listed as being researched prior to application. For example, what appears to be an incorrect or duplicate payment should not just be deposited if the reason for receipt is unclear.

The amounts deposited into operating and trust require printing of a simple report, assuming the firm uses software.

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- Someone — office manager or partner — should make sure that the total of deposits and held for research amounts equal what came in the door.
- In keeping with the comment above about printing reports, I strongly suggest that firms today use software to track and report on funds moving in and out of the firm. Manual bookkeeping, especially under the newly revised trust accounting requirements, is not adequate to the task.
- Perform criminal and credit checks on anyone you hire who will be involved in handling money.
- Periodically and randomly — meaning not at easily identified intervals — open your own mail, answer your own phone and ask for the bank statements unopened. (Not all at the same time.) If you get your statements electronically, have them come to you first and forward them to bookkeeping.

What to look for:

- Angry letters from clients or outside counsel regarding money that has not arrived, or statements which don't reflect their past payments.
- Angry phone calls of the same nature.
- Pick a deposit from the bank statement at random. Ask to see the backup. Double check to see that checks were applied to the proper client accounts. Fraudsters usually avoid detection by shuffling money around to cover their tracks.
- Look at the number of cancelled checks at random. Make sure the payee on the front matches the endorsement on the back. Fraudsters often change the name after the check is signed. Or, checks get cashed at suspicious locations rather than being deposited into a business account as one would expect.
- Get rid of all signature stamps.
- Question anything and everything, including those things that don't make sense, as well as just to keep someone on their toes, because they can't predict what you will ask to see next.
- Keep an eye out for lifestyle changes of those who handle money at your firm.

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- Use fraud-proof checks which cannot be photocopied or have names lifted off once printed.
- Do not permit any wire transfers without full authorization. Independently verify the source of any wire transfer request, no matter how legitimate it appears.
- Do not accept any last-minute changes to payment instructions without investigating to make sure it's legitimate.
- Require and check identity for anyone coming to the office to pick up a settlement check.
- Do not release funds from trust until the deposit has *cleared*. There is a difference between cleared and available. Available funds are provided as a courtesy of your financial institution. They have a right to claw back the money if the underlying deposit doesn't clear. A fraudulent bank check can take a full month or more to reach the clearing house and return uncollectible.

I could easily add more to this list and am happy to do a follow-up article to include any procedure or method of oversight you use at your firm. Just drop me a line at lawpractice@pabar.org to share. If you need help implementing any changes, I stand ready to be of assistance to PBA members.

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