IS YOUR FIRM SAFE FROM FRAUD?

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The simple answer is NO. There is a common misconception that only large firms are particularly vulnerable to fraud. Certainly, when fraud occurs at a large firm it often turns out to be sizable by the time it is discovered. But the reality is that larger firms tend to have better internal controls to help avoid fraud. In addition, they have more people involved in the paperwork on transactions, which in fact serves to deter fraud, as it requires collusion to accomplish. It is the solo and small firm practitioner who is most vulnerable to fraud. In addition, the small to mid-size firm which has experienced rapid or recent growth may also be particularly vulnerable, as the firm may be utilizing procedures and systems which are no longer adequate.

If you are a solo or small firm practitioner and are thinking you have nothing to worry about because you have used the same secretary or bookkeeper for the past 10, 20 or however-many years, think again. A startling number of frauds committed are by long-term trusted employees. People we trust implicitly. People we don't think to question.

I recently exchanged stories with my peers at other state bar associations. Let me share just a few to clarify.

> *A secretary at a five attorney firm made up phony vendor bills for active vendors, and "paid" these bills with checks. After an attorney signed the check, she used a correcting typewriter to lift off the vendor's name and put in her own. Then she cashed the check. When the bank statement arrived she put the check back into the typewriter, lifted off her name, and put the vendor's name back on. This went on for 6 years, and averaged $60,000 per year.*
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> *A probate paralegal overpaid estate bills by $100 on estates where there were no spouses or close relatives to ask questions. She then pocketed the refunds.*
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> *At a small firm, partners didn't question any disbursements charged to clients. An associate charged personal supplies, entertainment, and extensive travel expenses to contingent fee cases, and netted them out at settlement. This went on for a long time.*

There are dozens more examples which could be included. But it's easy to see that in each case a combination of trust and lack of oversight created a situation which made fraud easy.

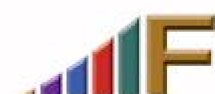
When it becomes easy to commit fraud, otherwise good honest employees can be tempted to go astray. That's right. And sometimes exigent circumstances make good people do bad things. So good fraud control must start by taking away that temptation. It should make it seem like it would be impossible to commit the fraud without getting caught.

A really dishonest determined person, one who you may later discover defrauded previous employers, can rarely be stopped. I liken it to a home security system, which can deter most thieves, but no matter how sophisticated, cannot deter the real professionals. It is the same with fraud control. But it's up to you to do whatever you can to deter fraud, and detect it if it happens. There are some fairly easy ways to do so.

Any accountant will tell you that different people should handle money coming in and going out of the firm — they should not be handled by the same person. That's easy to do if your firm is big enough to have several people involved in bookkeeping. If not, there are some alternative steps you can take. Each month, or randomly not less often than, on average, once each three months, a partner should receive the bank statement(s) unopened. Look first at the payee on each check, and the endorsement on the back. Look for discrepancies. Next, look for payee names which you do not recognize, excessive numbers of checks to a particular payee (who may be in collusion with someone within your firm), or excessive or unexpectedly large checks to a firm employee. Next, look for any wire transfers in or out of the account which you did not authorize. Finally, make sure the deposit amounts match the deposit slips, that all deposits actually made it to the bank. If you are using time & billing software, you should randomly check to match the credit applied to your client's accounts with the amount deposited. One sure sign of fraud is "shuffling" of money from one client account to another to cover up.

Depending on the volume of checks deposited, you may only have time to spot check one or two deposits, or even part of a deposit. The point is that if you are doing this, especially if you are doing it randomly, a potential thief cannot know what you will or will not check, and therefore has no reasonable assurance that he/she will be able to avoid detection. Just be sure to check ALL bank accounts, including, of course, your trust account.

Partner oversight should always be involved in reviewing final distributions, settlement sheets, and so forth. There should never be disbursements approved without proper partner approval just because they are chargeable to clients. Clients should receive a detail listing of expenses, so that they can identify and raise concerns about costs which don't seem to belong on their file. If a POA is used to execute a settlement check, an actual copy of the settlement check should be mailed to the client, attached to the settlement



statement. And finally, neither you nor your partners should EVER sign a check when you are distracted, and should not sign checks which do not have underlying documentation clipped to them (such as a check request, or vendor bill) if you don't know what they are for. If you have attorneys in your office who are so busy they simply sign checks when presented without ever asking any questions, you should consider removing them as signatories on the account(s).

Many attorneys hesitate to ask questions or implement proper controls because they don't want to imply to a valued employee that they may lack total trust. But keep in mind that it is *your* license to practice on the line, it is *your* fiduciary obligation to your clients to safeguard their trust funds, and it is *your* firm's economic survival at stake. If you haven't communicated that clearly to everyone at your firm, you should.

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