

## Fall 2003

### Fighting Employee Fraud in Law Firms

The Association of Certified Fraud Examiners (ACFE) recently reported that occupational fraud cost businesses about \$600 billion in 2002, or \$4,500 per employee. Small businesses with fewer than 100 employees, including many law firms, are most vulnerable.

While attorneys often advise their clients on matters related to employee fraud, they may overlook the fraud going on in their own firms.

#### Occupational Fraud in General

Occupational fraud falls into one of three categories: asset misappropriation (86%), corruption (13%), or fraudulent financial statements (5%). (Sum of percentages exceeds 100% because some cases involved more than one type of fraud.) Cash is the most sought-after asset, most likely because cash has a defined value and is easily transported and converted. Fraudulent statements are the most costly, though, with median losses of \$4.25 million per scheme.

Because fraud is a "crime of opportunity," ACFE says that well-educated, senior, male executives commit the most costly frauds. These employees tend to have higher ranks, which correspond to control over greater amounts of assets. In turn, rank tends to be based on age, gender, and education.

The average scheme in the ACFE study went on for 18 months prior to detection. Most perpetrators continue their scheme until a compelling reason to quit arises, such as discovery or fear of discovery.

#### Preventing, Detecting Fraud

Law firms can significantly reduce the costs of fraud with some simple measures. First and foremost, every firm should segregate its cash-related functions (e.g., receiving and disbursing funds, signing checks, reconciling accounts). A single employee should never be given responsibility for all these functions.

In addition, law firms should have the monthly bank statements delivered sealed to a trusted partner, who should scrutinize them for declining deposits, unfamiliar payees and other unusual transactions. Firms also should consider retaining a financial professional to conduct annual reviews of their cash accounts and bank statements.

Law firms need to be especially concerned about misappropriation of funds held in trust and escrow accounts. A partner with too much control over these accounts can cause a firm substantial financial loss and irreparable harm to its reputation.

No single person should have control over both the assets held and the records used to track them. Law firms also might consider purchasing employee dishonesty insurance.

The ACFE cited several other tools as particularly effective in combating fraud. Coworkers are often aware of fraud schemes, so an anonymous tip line or similar mechanism should be established. Background checks of employees should be conducted.

Finally, firms should both engage in internal audits and retain outside CPAs to conduct external audits. CPAs also can perform overall analyses of internal controls to uncover weaknesses. It's not enough to establish internal controls; they must actually be used.



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