

Is there a crook in the firm?*



If you are a lawyer and you rely on another person for any aspect of processing your real estate files, you need to be aware of the ways in which you may be at risk of being a victim of fraud.¹ If you are support staff participating in the processing of real estate files, then you need to understand the ways in which you can play a part in detecting and preventing fraud. Law firms are just as vulnerable to employee theft and fraud as other kinds of businesses and fraud is just as likely to arise internally as externally. Given the nature of a real estate practice, the amount of money handled in the course of our files and the growing incidence of fraud based on real estate values and false identities, we all need to reassess our practices for vulnerabilities in our accounting, file processing and hiring/staffing policies.



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To determine if your law firm is vulnerable to fraud, consider reviewing both your hiring and supervisory practices, as well as your internal accounting controls and policies. These reviews apply equally to lawyers and support staff. In fact, all staff should be involved in understanding how fraud occurs and how to prevent it. After all, your staff is the most knowledgeable when it comes to the details of your practice and the habits of other staff.

Hiring practices

In the United States it has been estimated by the Association of Certified Fraud Examiners that employee fraud accounts for over \$400 billion in losses each year, often by a trusted employee with no prior record. A recent Ernst & Young LLP study of fraud found that more than two-thirds of companies around the world report having been the victim of corporate crime. In the vast

majority of cases (85 per cent), employees were the perpetrators of serious incidents of fraud and within that group 55 per cent were employed in management roles.²

In a small law office, staff usually handle most aspects of the accounting, billing and payment cycle, as well as the receipt and processing of trust funds. It is therefore essential to conduct an interview for new staff that includes inquiries about past employment performance, credit reports and existence of a criminal record. There are a number of steps to take as part of the interview process if the employer wishes to obtain background information and perform checks of criminal records, credit or references provided by the applicant:

1. Have each job applicant sign a consent form for a background check, including a check for criminal records, past employment and education.
2. Take the time to perform a background check. Contact your local police to conduct a Police Records Check. Contact either of the two major credit agencies: Equifax Canada Inc. (www.equifax.ca) or Trans Union of Canada (www.tuc.ca) to request credit checks.
3. Comply with PIPEDA legislation and ensure you have consent to the release of personal information clearly stated or the recipient of the request will not fulfill it.
4. Remember the provisions of the *Canadian Human Rights Act* and the *Ontario Human Rights Code* concerning questions that can and cannot be asked of an applicant for employment, as well as the provisions of Rule 5 of the Rules of Professional Conduct.
5. Verify past employment.
6. Call the references.
7. Clearly state that any false or misleading statements or material omissions are grounds to terminate the hiring process or employment.
8. If employment begins before a background check is completed, state in writing that employment is conditional upon a satisfactory background report.

Accounting controls

Basic fraud prevention begins with your accounting controls, particularly how you operate and reconcile your trust account. It is important to know and understand all the aspects of your bookkeeping and accounting system to minimize the opportunity for fraud. You must be an active participant in your firm's control process. While there is no absolutely foolproof prevention tool, following basic bookkeeping rules as set out in Law Society By-laws #18 and #19 will establish essential safeguards for your practice. It takes only minutes to review the rules and ensure your office follows them.

If you need assistance in understanding or implementing the required bookkeeping practices contact the Law Society Member Resource Centre at 416 -947-3315 or 1-800-668-7380 ext. 3315.

Internal Control Self Assessment by the Law Society of Upper Canada is an excellent guide to establishing good procedures and internal controls. A similarly useful list to follow is contained in the practicePRO booklet *Managing the Finances of Your Practice* available at www.practicepro.ca/practice/Managing_Finances_booklet.pdf.

Electronic Land Registration

With the introduction of electronic registration of land title documents in Ontario and the use of the Teraview® software, a number of changes have taken place in the practice of law and in the accounting processes employed to implement online payment of title searches, writs of execution searches, registration fees and Land Transfer Taxes. To monitor and run your practice properly, it is important to understand the accounting requirements and the delegation of rules for electronic land registration, contained in Rule 5 of the Rules of Professional Conduct and Law Society By-law 19 (sections 8.1 – 8.4). Also please note that sharing a Teraview security diskette (the access key used to search title and create or sign documents) and its password is considered to be both unprofessional conduct and illegal activity.

The Joint Committee on the Electronic Registration of Title Documents established by the Ontario Bar Association and the Law Society of Upper Canada has prepared a report entitled *e-reg™: Making it Work for You, Procedures and Practice Standards for Electronic Real Estate Conveyancing*. The summary provides an outline of the electronic land registration workflow and address practice related matters. A digital copy is available, along with the electronic land registration Practice Guidelines, on the Law Society Web site at www.lsuc.on.ca.

How to protect your law practice from fraud

Take the following steps to establish processes and controls in your office then keep reviewing and updating them as our profession learns how to identify, detect and prevent fraud:

1. Set an example – act ethically and honestly in your practice. Don't set an example of failure to report income or putting personal expenses through your practice, because your staff might follow your lead.
2. Be an active participant in all aspects of your firm's file processing, particularly the receipt and expenditure of funds into both trust and general accounts. Understand the recording processes and do your own spot audits of files and accounting records.

3. Ask your staff to identify fraud risks and suggest ways to protect against them, such as separation of duties.
4. Develop sensible hiring policies and at a minimum check references and employment history.
5. Separate the processes of creating, posting, and reconciling cheques and receipts.
6. Keep computer passwords fresh, change them periodically on a random basis.
7. Consider having two signing authorities for cheques over a certain amount. Even if one of them is a staff person who is not a legal signing authority, their signature or initialing of a cheque to validate can increase security.
8. Reconcile your accounts in accordance with requirements, verifying source documents and original bank statements.
9. Do not let accounting records fall into arrears; keep them current daily.
10. Have a sensible cheque signing policy and stick to it; at a minimum do not sign blank cheques or ones with no payee.
11. Do not sign cheques when you are distracted or in a hurry.
12. Keep your Teraview security diskettes secure by following the requirements of the Law Society and your PSL terms and conditions.
13. Speak with your accountant and your banker about steps you can take to minimize risk and install better internal controls.
14. Use the resources available from the Law Society and LawPRO in person and online to develop sound internal controls.

Most importantly – pay attention! Ask questions. If something seems out of place or wrong then investigate it and don't stop until you are satisfied. Stay alert to the kinds of external frauds such as identity fraud and value flips, as well as the internal frauds such as false invoices, misaligned cheques and non-payment of mortgages, and think about how you will not fall victim to these schemes.

Finally, talk to your staff, your friends and your clients. Let them know you are vigilant about protecting their interests and your business, and that you have processes in place to address fraudulent activity.

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This is the abbreviated version of Ms. Elliott's paper. The full version, including appendices, is available at www.lawpro.ca/news.

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