A DICEY SITUATION: BETWEEN A ROCK AND A HARD PLACE

Jack Alastair, the sole proprietor of The Law Chambers of Alastair, notified Insurers of a possible employee embezzlement in his law firm. In his notification, Jack apprises that his accounts officer, Elena, had committed criminal breach of trust by failing to bank in their clients' money into the law firm's Clients' Account but instead into her personal bank account.

What Jack Discovered of Elena

Jack's story goes as follows – he perceived that there was a shortfall of funds in his Clients' Account when he attempted to disburse funds following a client's instruction but was informed by the bank that there was insufficient amount for the transfer. This came as a surprise to Jack as he thought the accounts were well managed and duly audited.

As Elena had absolute control over the law firm's bank accounts, Jack questioned her on this matter. Elena explained that she was unaware of this and that the insufficiency of funds may be due to unrecorded transfers of monies from the Clients' Account since the ledger was last updated nine months ago.

Still unsuspecting of Elena, Jack instructed her to form an internal investigation to identify the source of the issue and if there were any discrepancies along with it. Indubitably, the investigation failed to determine the cause.

Jack became suspicious of Elena's conduct because her investigation report was vague and evasive in its details. He decided to hire an external auditor. From this, Jack learned that Elena has been siphoning money from the Clients' Account. The auditor's report indicated that Elena has been sporadically failing to bank-in the clients' money over the past two years despite issuing receipts to the clients. Upon lodging a police report against her, Jack found that there has been a report made against Elena from her previous employment. The previous report was for an alleged embezzlement of company's funds.

What Insurers Discovered of Jack and His Law Firm

A loss adjuster was appointed by the Insurers to assess Elena's alleged embezzlement. What the adjuster found turned the tables on Jack's half-truth as it unveiled more issues with the firm's accounts. It was discovered that Elena's embezzlement seemed to have occurred as an opportunity from Jack's ill practice of withdrawing large sums of money from the Clients' Account for undisclosed purposes.

In the adjuster's final report, it was submitted that the balance available in the Clients' Account would have been sufficient for Jack's attempted disbursement. The insufficient funds were due to the issuance of two cheques, each for RM150,000, by Jack as payment to the same reference number of a "client's file".

Further investigations found that these monies were being transferred to individuals and companies who were not clients of the law firm, but for personal loans and as funding for a separate business that Jack has interests in.

The Insurers declined this claim due to the Insured's misconduct of mismanagement of Clients' Account and non-compliance of proper risk management procedures set out in the COI.

Word to the Wise

1. Rules 7 and 8 of the Solicitors' Account Rules 1990 specifically states on the drawing of money from the Clients' Account. Any withdrawal besides the stated is strictly prohibited. Lawyers are strongly advised not to meddle with funds in the Clients' Account until and unless consent is given by the specific client.

2. Law firms must maintain a separate account ledger for each client's money held in trust (a simple spread sheet with relevant information would suffice). This is to ensure that specific funds can be identified accordingly.

3. If you wish to avoid the hassle of manually updating your account ledgers, there are more tech-savvy methods such as practice management software available. Research shows that the usage of practice management software in law firms save billable hours and operates more efficiently.

4. A breach of the Solicitors' Account Rules 1990 could render the Insured Practice's Professional Indemnity Insurance to be repudiated as indemnity does not extend to a lawyer's misconduct.

5. Lawyers have a professional duty of notifying their clients of how and when the clients' funds are being used. It is important that the law firm keep an accurate and detailed record of this. As best practice, the law firm's invoice should include an accounting summary of the client's trust funds entailing details such as total work done, outstanding payment amount and remaining client trust balance.

6. Lawyers are accounted for their actions and inactions to their law practice. Their misconduct could contribute to financial loss. Partners of a law firm especially must realise that they are the first line of defence in preventing and detecting employee embezzlement.

7. Monthly account statements must be reviewed carefully every month to ensure that there are no discrepancies. Early detection of any inconsistencies may help rectify the issue with little to no repercussions.

8. Employers must properly supervise their employees. Avoid extending full control to subordinates without proper supervision. It is your company and your reputation on the line!