

PRACTICE ALERT 1/2008

EMPLOYEE EMBEZZLEMENT OF LEGAL FIRM'S FUNDS

Office & Client Accounts

Employee embezzlement is a growing threat to legal firms. Members should be alerted to the fact that in 2007 and 2008, there was an increase in the number of employee embezzlement cases (as reported by several legal firms to the Insurer of the PII Scheme).

In our previous article, we highlighted the means to recognise signs of employee fraud – traits to look out for and indicators that your firm could be a victim of embezzlement. We include here case studies to illustrate some of the reported cases under the PII mandatory scheme.

Case 1: Employees Pocketing Cash Paid In by Clients

Firm's chief conveyancing clerk not only managed the day to day handling of conveyancing files but also collected fees and disbursements from clients. Clerk in question would usually ask for cash payments from clients, issue them receipts and keep the money. This went undetected for 10 months until a client called the lawyer to complain about the slow progress of his file. By this time, approximately RM100,000.00 had already been embezzled.

Case 2: Employees Drawing On Legal Firm's Accounts but Keeping the Monies

Sole proprietor's accounts clerk was his brother-in-law, J. Monitoring and management of all accounts matters were entrusted to J alone. J began to forge vouchers (sometimes using a real file number, other times a fictitious file number). Having secured the lawyer's signature on the voucher he would withdraw the cash and pocket the money.

Case 3: Employees Forging the Lawyer's Signature(s)

Accounts clerk forged cash cheques in small amounts over a period of two (2) years. Approximately RM80,000.00 was withdrawn from both the Office and Client accounts before the partners realised anything was amiss. The accounts clerk had disappeared by then.

Case 4: Employees Transferring Funds Between Accounts to Cover Shortfalls

C, a secretary cum conveyancing clerk, often stayed late at the office on the pretext of finishing work and very rarely took leave. Due to C's seniority, staff did not raise issue with the firm's partners when she told them not to deal with her files without her prior permission. C was in fact forging vouchers (payees listed on vouchers were fictitious).

The misappropriation of funds went undetected for three (3) years as C would track the affected accounts and transfer funds from other accounts to cover shortfalls when payments became due. Discrepancies were only discovered when the partner personally attended to a redemption for a client's charged property. In total, C absconded with RM700,000.00. Investigations revealed that C's husband was a compulsive gambler.

The cases illustrated in this Practice Alert were declined by Insurers as the firms involved had not only breached the terms of the Certificate of Insurance but also the Solicitors' Account Rules 1990.

Case 5: Lack of Supervision and Familiarity

B was the administrator cum accounts executive at X's Firm. Monitoring and management of all accounts matters were entrusted to him. X and his partners trusted B implicitly as he was X's brother-in-law. In 2007, it was discovered that stakeholder monies had not been released to clients despite numerous written requests.

Investigations later revealed that B was a compulsive gambler and began embezzling stakeholder monies in 2001 to fund his gambling habit. Auditors failed to detect the discrepancies as the accounts and reconciliation of accounts was done by B.

Case 6: Sole Signatory to Cheques

V was the sole signatory in a partnership. V found out that their accounts staff had misappropriated up to RM600,000.00 of client monies. Firm had also inadvertently overpaid a client by RM300,00.00 from another client account. Unbeknownst to his partner K, V began to mitigate the losses by utilising new client monies to cover the shortfall of approximately RM1 million. K only found out about the embezzlement after V stopped turning up for work.

Tools for Thought

- 1** Partners must adopt a proactive approach towards their firm's accounts management!
- 2** However well-versed your accountants and accounts staff are, ultimately it is the partners who are accountable for the firm's accounts and financial position!
- 3** If you allow staff too much freedom with no separation of duties and supervision, it is safe to say that temptation may lead to theft.

Case 7: Pre-Signed Cheques

Firm was a partnership founded by Z. Firm's accounts had two signatories, Z and his brother, T (non-lawyer). Z's partner was a "salaried" partner and not made a signatory. Firm's administration was left to T. D, the accounts clerk was given sole responsibility for the firm's accounts. When Z went on sabbatical, T became the sole signatory to the firm's cheques.

As he was not at the office every day, T pre-signed Office and Client accounts cheques for the day to day running of the firm. By the time Z returned from sabbatical a year later, D, utilising the pre-signed blank cheques had embezzled RM800,000.00 from the Office and Client accounts.

Tools for Thought

Under Clause 12(e), Certificate of Insurance 2008, Insurers will indemnify a firm and its employees for claims involving misconduct

providing the following risk management procedures are satisfied:

- 1** Entries in the client cashbook and client ledger of each branch maintained pursuant to Rule 11(2) of the Solicitors' Account Rules were copied and exchanged;
- 2** Bank statements of client accounts and office account of each branch office are sent by its bank direct to the principal office as well as the branch office;
- 3** Withdrawals, transfers and cheques on client bank accounts must have two (2) signatories. To stop operation of an account or the cancellation of any transaction, one (1) signatory will suffice; and
- 4** In all other respects the Firm complies with the Solicitors' Account Rules 1990 and the Accountants' Report Rules (as amended from time to time).