

# Fraud: The threat from within

The lawyer leaves the office on a Friday night, wishing his long-term, still hard-at-work law clerk a great weekend. He comes back to the office on Monday to a quickly unfolding nightmare. His trusted employee does not show up for work. He soon discovers that his client files and trust records are missing and ultimately realizes that trust funds are gone as well.irate mortgagors and mortgagees start calling, demanding mortgage funds and discharges but his trust account has been depleted of funds which were earmarked for those purposes. In some cases, he discovers that the mortgages are fraudulent or have never been registered. Everyone is looking to him for having breached a trust owing to his clients.

This is not the storyline of the next legal thriller. This is reality. While value, title and identity fraud are now commonplace in commercial and real estate transactions, and lawyers tend to be much more alive to these issues when meeting with new clients, they may not appreciate that long-term employees are also responsible for millions of dollars of losses each year.

## Fraud by trusted long-service employees

The time for background checks of these employees had long-since passed. They have usually been employed with the same law firm for upwards of 20 years. They have intimate knowledge of their employer's law practice, clients, schedules, signatures and trust records. They are usually relatively autonomous and are rarely supervised (if at all) by their employer.

Sole practitioners and small firms are particularly vulnerable to employee fraud. Sole practitioners, especially those with a high-volume real estate practice, often significantly rely on their administrative support team. Their clerks, bookkeepers and assistants are often the ones that "run the practice."

Generalists who do not limit their practice to real estate files but also handle litigation matters are possibly at an even greater risk. As a result of being out of the office and in court some of the time, they may give their employees authority to meet with and sign up clients, sign cheques and register documents through Teranet. The employees often have the lawyer's e-reg® passwords in order to close transactions in breach of Teranet security protocols and the Rules of Professional Conduct.

Hundreds of thousands of dollars of client trust funds often pass through their trust accounts each month. Based on LAWPRO's claims experience, the relatively easy access to these funds becomes irresistible to their employees.

## Warning signs

There are often warning signs which are overlooked or even ignored. Lawyers are often reluctant to accept that an employee, especially a long-term one, has done any wrong.

But the signs are there: The employee's opulent lifestyle, for example, may not accord with what he is earning. The employee may be acting erratically or in a manner different from his previous behaviour. He may find himself explaining away or apologizing for numerous inconsistencies in the books and records when they are brought to his attention by the lawyer. He may be meeting or associating with people who are known to the lawyer to be of unsavoury or suspicious character. He may take few, if any, days off so that a replacement cannot find out what he has been up to.

If enough indicia of fraud are present and the lawyer fails to turn his or her mind to it or take steps to question or deal with the employee, the lawyer's conduct may amount to wilful blindness and may jeopardize any coverage that may have been otherwise available to that lawyer under the LAWPRO policy.

How can you avoid becoming a victim of employee fraud?

1. Start by being mindful of Rule 5.01 of the Law Society Rules of Professional Conduct and the commentary to that Rule which deals with supervision of employees and the electronic registration of title documents. **Never give anyone your Teranet PSP and password.**
2. Never authorize your employees to sign cheques on your behalf and never sign blank cheques for any reason. If you do, you will be in breach of Part IV, section 11 of By-Law 9 which deals with Trust Account Transactions. Only your partners should have authority to sign your trust cheques. Your surplus trust cheques should be securely stored where no employees can access them. Large trust cheques should require the signature of two partners.
3. Implement internal controls and safeguards in your law practice. Although by no means an exhaustive list, the following controls should be implemented to protect yourself from employee fraud:
  - When something seems out of place or unusual, ask questions until you get to the bottom of the inconsistency.
  - Fraudulent employees often work alone and are protective of their "turf." Avoid having one employee responsible for all accounting and bookkeeping functions. Inconsistencies are more likely to be discovered if multiple employees are handling the banking and bookkeeping entries.

- If vacation or illness forces you to be away from the office, your office should either be shut down or another lawyer should be engaged to monitor your practice and staff while you are away.
- Other employees may have significant insight into a particular employees' behaviour. Listen carefully to what your other employees may be telling you ... and trust your instincts.
- Stay involved in the reconciliation of your accounts and reconcile your accounts on a monthly basis.
- Consider whether fidelity insurance or bonding your employees would protect you.
- Purchase excess insurance.
- Consider hiring a consultant to review your internal controls and suggest changes.

Lawyers who carefully supervise their staff are less likely to be caught by surprise by employee fraud. A sloppily-run practice is a breeding ground for employees who may feel they are underpaid or have a real or perceived grievance which they may wish to remedy by biting the hand that feeds them.

No matter how busy your practice, do not abdicate responsibility for running your office to your staff. Take an active role in managing your risk by implementing as many internal controls as is practical. It is ultimately each and every lawyer's responsibility to manage and control their own practice in order to protect themselves and their clients from dishonest employees.

See page seven of the *Managing the Finances of Your Practice* booklet for a more complete list of internal controls ([www.practicepro.ca/financesbooklet](http://www.practicepro.ca/financesbooklet))

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# Avoiding the bad apple

## Screening new staff during the hiring process

Productive and honest staff are a critical part of every law firm. From an internal control and fraud prevention point of view, you want to make sure from the very start of the hiring process that you avoid hiring anyone that has skeletons in the closet.

To help you arrive at your shortlist, consider searching the Internet via Google and other search tools for information on job candidates that look promising. Don't overlook checking MySpace, Facebook, LinkedIn or other similar Web 2.0 social networking type sites for information.

Ask everyone you interview for multiple and appropriate references that will allow you to make all necessary inquiries into the candidate's background, both in respect to skills and experience, but also with respect to issues that may be of concern. Don't stop at just reading over the list of references – no matter how impressive it may be. Contact all references and make appropriate enquiries of them.

In addition to reference checks, other background checks to be considered are:

- education verification
- employment verification
- proof of eligibility to work in Canada.

If you are hiring a lawyer, check that he or she is a member in good standing of the Law Society, and has an appropriate level of competence, as confirmed by checks of discipline and claims records.

For employees who will have access to financial or other sensitive information, consider doing a criminal background check and a Credit Bureau and identification verification. This task is far easier if you use a background checking service such as BackCheck, ADP or ISB Corporate Services.

Note that these background checks will require the consent of the job candidate (get a duly signed consent form). The information you obtain must be used only for employment related purposes compliant with human rights, labour, and privacy laws, as applicable.

Follow-up with the candidate on anything that raises any concerns, and do not hire the person unless any concerns you have are explained to your complete satisfaction.

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