Don't Be a Sitting Duck for In-Firm Theft

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"That could never happen to my firm." Or could it? No lawyer knowingly takes on a partner or hires an employee whom he or she believes will steal from the firm or its clients. And yet it happens each year to firms that have no safeguards in place. Let's review a few painful examples.

Think the unthinkable; put safeguards in place to protect yourself from theft and embezzlement by employees and colleagues.

The firm in name only. Pickles, Finster & DeVille is a general practice law firm in Rug Ratsville. The five partners in the firm, Angelica, Chuck, Phil, Lil, and Tom, have practiced together for over 15 years. The partners value their independence and shun the administrative burdens that come with a partnership. As a result, they operate as if they were sole practitioners who share office space. Pickles, Finster & DeVille rarely has firm meetings and does not maintain firm-wide procedures on mail intake, check issuance, client billing, and related matters.

Angelica, Tom, Phil and Lil willingly designate Chuck Finster as the firm's treasurer because no one else wants the job and Finster has an aptitude for numbers. Additionally, Finster is a highly regarded member of the community who serves on several charitable boards. In short, his partners have no reason to fear leaving the firm's finances in Finster's hands.

Finster represents Client One in a personal injury matter arising out of an accident between Client's car and a diaper delivery truck. Finster files a complaint on Client One's behalf, but the case is later dismissed for want of prosecution. Finster had previously assured Client One that he could win a settlement in the $100,000 range.

Rather than confess his error to Client One and his partners, Finster takes $25,000 from the recent settlement of Client Two's matter and gives it to Client One. He manufactures a bogus settlement agreement and informs Client One that $25,000 was the best he could do.

A month later, Finster takes funds from Client Three's trust account to make up the shortfall in Client Two's account. In the meantime, Client One has grown increasingly suspicious and consults another attorney. When Finster realizes that his misdeeds will be uncovered, he disappears, leaving his partners to clean up the mess.

The invisible partner. Cleaver & Associates, Ltd. is a successful plaintiff's tort firm owned by Ward Cleaver. Ward has two associates, Edward Haskell and Clarence "Lumpy" Rutherford. Haskell is the senior associate at the firm and has been working at Cleaver & Associates for 12 years. Cleaver has intimated for years that he plans to make Eddie a partner but has done nothing thus far.

As Ward edges toward retirement, he hands over several products liability and medical malpractice cases to Haskell and delegates many of the firm's administrative responsibilities to him, including financial matters. Haskell views these new responsibilities as his big break to impress Cleaver and at long last obtain partner status.

Determined to win his cases, Haskell authorizes costly depositions and engages multiple experts for an upcoming products liability trial. When the trial unexpectedly results in a verdict for the defense, Haskell is unable to pay the experts. Haskell cannot muster the guts to admit his mistakes to Cleaver. Instead, he makes the fatal decision to take funds from another settlement and use them to pay the bills. He continues to rob Peter to pay Paul until caught by an astute client. (In the aftermath, Lumpy is promoted to partner, much to his surprise and delight.)

The trusting solo. Perri Mason is a sole practitioner with an active general practice. Her trusted and longtime secretary, Dell Reese, handles virtually all administrative duties for the office, including opening mail, depositing checks, and paying bills. Although Mason signs the checks, she rarely looks at the names of the payees. A series of personal problems lead Reese to do the unthinkable — he begins issuing checks to bogus vendors and pocketing the money. Mason does not uncover the embezzlement until she applies for a loan and the credit check reveals several past due bills.

The lawyers in these examples were all shocked by the betrayal of trusted partners and employees. In each instance, they could hardly have predicted the deceptive behavior of otherwise competent and loyal co-workers. The best way to protect yourself and your firm against such conduct is to institute the following strict financial controls.

Establish mail-handling procedures. Instruct the staff member who opens mail to immediately endorse all checks with a "for deposit only" stamp. The checks should then be photocopied for filing. Checks should be deposited daily and locked in a secure drawer until they are taken to the bank.

Lawyers should also instruct the staff to deliver any mail from the bank *unopened* to the partner in charge of finances for review. A common embezzlement scenario involves the office employee who writes checks for his or her own benefit and then take the incriminating evidence out of the bank statements.

Review all bank statements. Once the bank statements have been delivered to a partner unopened, they should be reviewed for irregularities such as deposits that were reduced by cash withdrawals. Then examine all canceled checks for forgeries and investigate the reasons behind any missing checks. Finally, the firm should reconcile all of its different accounts, including client trust funds and the firm's general operating account. If the partners don't have the time or inclination to do the reconciliation, hire an outside accountant (who carries malpractice insurance) to do it for the firm.

Firms with more than one partner should have their accounts audited. Delegating the sole responsibility for the firm's finances to one lawyer is a recipe for disaster, as is demonstrated by the first two claims discussed above.

Keep track of firm expenses. Require each invoice to be authorized by a partner or the office manager. The authorizing person should initial the invoice and specify the amount to be paid. The invoice should be detailed enough to clearly identify the products or services purchased; a handwritten slip of paper requesting a check to "XYZ Corporation" is not enough. As a further protection, take care never to sign a check without the authorized invoice or other proof of expense, such as a settlement statement, attached to it.

A separate individual should then review the firm's expenses on at least a quarterly basis to detect any radical changes in firm expenditures, such as payroll, office expenses, or travel costs. If the person authorizing invoices or reviewing quarterly expenses does not recognize the payee, he or she must take the time to make inquiries. Another typical form of embezzlement is for the perpetrator to make checks payable to fictitious vendors.

Don't put all your eggs in one person's basket. As indicated above, a key to financial safety is decentralizing accounting duties. Decentralizing makes it harder to embezzle or convert funds. For example, the person who cuts the checks should not be the same one who reviews the bank statements (unless, of course, a sole practitioner performs both functions). Similarly, the person who authorizes a particular invoice for payment should never sign the check. If the size of the firm permits, require more than one signature for all checks over a certain amount.

Keep checks in a secure place. Store blank checks for both client trust fund accounts and the firm's general account in locked areas, such as a locked cabinet. In addition, keep the client trust fund checks and firm checks in separate locations and order the checks in different colors. These practices make it more difficult to confuse the two types of checks and issue the wrong one.

No cash. Never allow checks to be written from your client trust fund account to cash. Instead, pay yourself by writing a check to your firm. Pay costs on behalf of the client directly to the entity in question, such as a county recorder or service provider.

Furthermore, discourage clients from paying your fees in cash. If you must accept cash, have another employee witness the cash transaction. Then issue a receipt to the client that is acknowledged by the client's signature and attested to by the employee witness.

Never, ever sign a blank check. Are you nuts or something?

Take precautions with computerized accounting systems. While computerized accounting can be highly effective, these systems require safeguards as well. First, give only a few individuals access to your accounting program and stored financial information. You also may want to exclude certain financial records, such as payroll information, from the general office network.

Second, at least one partner should know how to use the accounting program and generate reports. If a staff person is the only one who understands the system, how can you be sure that the information isn't being altered? Finally, make sure that all financial information on the computer is backed up regularly in case of a computer crash or power outage.

Get coverage for losses. Know that professional liability policies often exclude coverage for such conversions or thefts. Consider purchasing a fidelity bond to insure against partner or employee theft.

Consult with a financial professional. Have firm accounts audited annually by an outside accountant or auditing firm. (Fear of detection is a great prophylactic.) A financial or accounting professional can also assess the weaknesses in your current accounting procedures and recommend safeguards.

Don't think it can't happen to you. Stop being complacent. Firms that have no safeguards against conversion or embezzlement are the most likely targets.

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