

Fighting fraud:

implement appropriate internal controls

*Ed note: The following is excerpted from **Managing the Finances of Your Practice**, the sixth in a series of booklets published by practicePRO, LAWPRO's risk management initiative, to help lawyers more effectively manage the risk associated with law practice. The booklet is available in PDF format at www.practicepro.ca/financesbooklet.*



Ideally, your office should have clearly established internal controls for handling and documenting all types of financial transactions. These internal controls are really just policies and procedures that direct what steps should be taken when various financial transactions occur. Although a lack of internal controls does not necessarily constitute a breach of the Rules of Professional Conduct or By-laws, you may consider implementing internal controls to assist your efforts to comply.

The following are some suggested internal controls you may consider implementing at your office¹:

Cheque requisitions

When dealing with cheque requisitions for both your general and trust accounts, consider the following:

- All cheque requests are accompanied by a signed cheque requisition evidencing approval.
- Only certain designated lawyers may authorize trust account payments.
- Only certain designated individuals may authorize general account payments.

- Firm personnel responsible for preparing cheques are instructed not to prepare cheques unless the requisition includes a signature of approval.
- Supporting documentation (such as an original invoice, reporting letter, statement of receipts or disbursements) accompanies the cheque requisition, where possible.
- Original copy of the invoice is stamped paid (to prevent an individual from using an invoice more than once to obtain funds).
- Photocopies of invoices are not generally accepted as support for cheque requisitions.

Cheque signing policies

When dealing with cheques requisitions for both your general and trust accounts, consider the following:

- Cheques in excess of a threshold amount require the signatures of two partners.
- Cheques are never to be signed in blank.
- Cheques made payable to financial institutions include details of the transaction.

- Cheques are in numbered order and the sequence is checked.
- At least one of the individuals signing the cheques always reviews the request for payment to determine if the request relates to trust funds and reviews the client file, to determine:
 - validity of the request for payment;
 - reasonableness of the amount requested;
 - if sufficient funds are available to pay the amount of the cheque; and
 - that an accounting to the client for receipts and disbursements is completed.

Trust records

Trust accounts are an essential part of the practice of law. When dealing with trust accounts and trust records consider the following suggestions:

- Monthly reconciliations and adjustments are reviewed and signed by someone other than the individual who prepared the reconciliation.
- Reviewer of the reconciliation ensures that:
 - reconciliations are prepared on time;
 - reconciled items are cleared promptly;
 - all unusual items are questioned and an adequate explanation is given for the unusual nature of the item and noted in the firm records and client file.
 - a list of trust balances is periodically reviewed for closed or completed matters including trust balances that have not changed in the past twelve months.
- Trust transfer requisitions are prepared to transfer funds from one client's trust ledger account to another trust ledger account; and:
 - written authorization from the client to transfer funds to another trust ledger is always obtained prior to the trust transfer;
 - the trust transfer requisition is signed by the responsible lawyer and an explanation is provided; and
 - the accounting department, or personnel responsible for accounting, has been instructed to process trust transfer requisitions only if the criteria for signatures and explanations has been met;
- A senior partner or office manager periodically reviews the client's trust ledger accounts for unusual items.
- Blank trust cheques should be kept in a secure manner.

Staffing policies and procedures

Law firm staff are an essential part of getting all work done in a law office. The following are some suggested staffing policies that can operate as internal controls:

- The firm has a policy respecting an individual's need to take regular holidays.
- The firm conducts periodic reviews of lawyers' work.
- Periodic reviews of client files are conducted by a senior partner or office manager to ensure:
 - the client receives an accounting for trust receipts and disbursements;
 - the details of the accounting to the client match with the trust ledger; and
 - the file is maintained in an orderly fashion.
- Lawyers are required to consider whether their outside interests may put them in a conflict of interest situation.

The firm should also be aware of indicators of potential problems which may result in inappropriate activities or conduct, including:

- a lawyer who is consistently too busy to take holidays;
- a lawyer who appears to be living beyond his or her means;
- sudden and significant increases in advances for entertainment expenditures;
- large increases in unbilled disbursements;
- a lawyer whose production has fallen off for no apparent reason;
- a lawyer who appears withdrawn or nervous;
- a lawyer who continually makes last-minute requests for funds.

Segregation of duties

Lawyers should segregate firm duties so that the same individual does not have complete control over the management of funds. Consider the following suggestions:

- The individual who opens the mail is different from the individual responsible for preparing a listing of all cash and cheques received.
- All cheques received are stamped "deposit only."
- The firm issues receipts for all cash or cheques received to:
 - provide client with proof of payment;
 - help prevent funds from being redirected to another client's account; and
- The numerical sequence of receipts is checked to ensure that all funds receipted are also recorded in accounting records and deposited into the bank.

¹ This section is based in part on the Financial Management Guideline prepared by the Law Society of Upper Canada (www.lsuc.on.ca/services/pmg_summary.jsp).