
Guide for Effectively Managing Trust Safety Risk

With an estimated \$125 billion flowing through lawyers' trust accounts in Alberta in a twelve-month period, the legal profession must be ever vigilant to ensure that these trust funds remain safe. The legal profession is unique in that lawyers guarantee the safety of their client's trust property.

The Law Society of Alberta, as a regulator, is committed to providing continuing education and risk management tools to support lawyers in ensuring the safety of trust property.

New risks to the safety of trust property are constantly emerging. In order to maintain adequate accounting systems and procedures, lawyers must be wary of these risks and committed to continually assessing the safety and effectiveness of their accounting procedures.

This risk assessment guide will enable lawyers to develop and maintain internal accounting systems to better protect against those risks.

The main purposes of this guide are to:

1. Help lawyers to identify the key controls required to have adequate accounting systems and adequate accounting procedures that will meet the requirements of the Trust Safety Rules and offer assurance regarding the safety of trust property.
2. Give guidance on how the Responsible Lawyer can give sufficient oversight to the accounting systems and procedures to ensure their effectiveness – including some best practices that will provide assistance in this role.
3. Flag areas of other potential risk related to trust property.

Specific examples will also be provided of how law firms have experienced loss in the past due to becoming victims of client fraud or employee theft.

This guide will provide suggestions on practices that can protect a law firm from client fraud and a client's trust property from employee theft.

KEY CONTROLS REQUIRED TO HAVE ADEQUATE ACCOUNTING SYSTEMS

Use Approved Accounting Software and have the following Control Documents:

1. a pre-numbered receipt book for trust monies received and a duplicate pre-numbered receipt book for cash receipts;
2. deposit books for the law firm bank accounts or receipts printed from the law firm accounting software;
3. pre-numbered cheques for law firm bank accounts;
4. cheque requisition forms;

5. trust transfer authorizations.

Approved Accounting Software

A properly designed, and correctly used accounting system provides **most** of the controls that are required to ensure the safety of the trust funds that a lawyer receives.

Trust fund accounting is different than ordinary accounting and requires some special features that are contained only in accounting software designed for law firms.

Example:

Accounting software which has been designed for law firms has the capability of creating separate trust ledger accounts for each client matter and makes monthly reconciliation of the client trust listing (list of all the separate trust ledger accounts) to the trust bank accounts easier.

Several specialized law office accounting packages, designed specifically to incorporate trust accounting requirements, are available at often surprisingly reasonable cost. The Law Society has been working with the developers of several of these programs to incorporate the ability to electronically transmit trust accounting data to the Law Society [Subrule 119.30(5)] as an alternative to filing an annual Accountant's Report. This is called the Trust Safety Accounting Upload.

Due to a Rule change in September 2014, the Manager of Trust Safety can now require this Upload of all law firms for the annual financial filing. It will become mandatory for all law firms within the next few years.

Some of the main advantages of using approved accounting software to do trust accounting are:

1. The software is designed to properly deal with fund accounting (required to properly deal with trust funds) – which is a unique accounting process;
2. The software is designed to generate all the journals required by the Rules of the Law Society of Alberta;
3. A single input process can record information quickly and accurately in several of the required journals;
4. Timeliness and accuracy of accounting information is improved;
5. The software is designed with built in approvals and limits that are required by the Rules of the Law Society of Alberta; For example, the software is designed to issue a warning if payments from trust are being issued where there are not sufficient trust funds available related to that client's matter to cover the disbursement.
6. Trust accounting records can be better protected due to the ability to restrict access through user settings and passwords;
7. The software is designed with built in safety measures – like not allowing overpayments from trust ledgers; and

8. Ease of access to information – for instance, summary of all matters related to one client, etc.

There are a number of different approved accounting software programs that allow a law firm to complete the Upload. The software products currently available are:

- Clio
- PCLaw
- Esilaw

For practice management solution, the above as well as the following are available;

- Prolaw/Elite
- Acumen
- Aderant
- Elite
- EQX

Prolaw/Elite, Acumen, Aderant, EQX currently do not facilitate or support the data upload for trust account compliance purposes.

If the law firm uses the accounting software for as many processes as possible relating to trust monies (i.e. trust money receipts, payments from trust, and transferring trust monies in between trust ledger accounts) the trust accounting will be completed more accurately and on a more timely basis.

Example:

Processing cheques to pay monies out of the trust bank account using the approved accounting software records the disbursement from the trust bank account and posts it to the correct client trust ledger card in a one input process at the same time that the cheque is produced.

In a manual or “unapproved” accounting system, this process can often involve several different steps, some of which may be delayed for a period of time.

WARNING – Ensure software is used properly: A word of caution is in order with respect to using computerized accounting software. Unless the accounting software is used correctly, by trained staff, with the features designed to provide good controls activated and adhered to, it is not a safeguard of any kind.

Examples of risks:

- Many of the approved accounting software systems will produce a warning if the cheque is being issued from a client trust ledger that does not have sufficient funds to cover the payment.

This warning can protect the law firm from generating a trust shortage.

If this warning message is deactivated or it is customarily ignored or overridden by the accounting staff, the accounting system does not provide the protection against trust shortages.

- Many of the approved accounting software systems allow the cash receipts limits to be set in accordance with the Rules of The Law Society of Alberta. This will produce a warning message if cash has been received over the cash limit for any one client matter.

This warning can ensure that the law firm is in compliance with the cash Rules.

If this limit is set at an incorrectly high limit or the warning is customarily ignored or overridden by the accounting staff, the accounting system does not provide this protection.

Lawyers should exercise caution in considering inexpensive off-the-shelf accounting programs. These programs cannot be easily used for trust accounting because they do not integrate trust and general account processes. A separate trust accounting system will be required. Law Society auditors recommend against using spreadsheet programs for any law office accounting. Spreadsheet programs can be changed, on purpose or by accident, after items are posted. They do not allow the law firm to maintain the required permanent record of law firm financial transactions.

If a manual accounting system or accounting software that has not been approved by The Law Society of Alberta is chosen, there are many additional measures that must be taken to ensure Rule compliance and adequate procedures.

Other accounting systems (i.e. manual) are only appropriate if the law firm has minimal trust activity. These systems are only permitted if they fully comply with the Rules of the Law Society of Alberta.

If Approved Accounting Software is not used, the following additional measures should be adopted:

- the trust accounting system should be designed and monitored by a professional accountant who is familiar with the Rules of the Law Society of Alberta;
- additional oversight procedures to be performed by the Responsible Lawyer, will have to be developed and overseen, to ensure that the controls that are automatically put in place with a properly used Approved Accounting Software system, are in place and being adhered to.

Control Documents

Control documents, like those noted in the examples to follow, provide a means to control the use of the documents in the trust accounting system to prohibit misuse and ensure the completeness of the accounting records.

Control documents also provide the capability for the responsible lawyer, or their representative, to oversee some of the key accounting tasks through some simple review procedures. Some of these controls, such as the pre-numbering of accounting documents, are already incorporated into approved accounting software. The software automatically provides the sequential numbering.

Examples:

1. If:

- the receptionist prepares a receipt, from a **pre-numbered receipt book**, for each trust cheque received from a client; and
- a duplicate deposit slip is filled out for each deposit to the trust bank account in the **deposit book**;

then the bookkeeper can ensure that all trust cheques have been deposited and are properly recorded by comparing the receipt book to the deposits in the deposit book and trust bank statement.

Any missing or lost receipts can be promptly followed up.

Every receipt can be marked as “entered” when the bookkeeper records it in the accounting system.

2. If **pre-numbered cheques** are used in sequence to pay monies out of the trust bank account, the bookkeeper can ensure that all cheques have been recorded in the accounting system and review them to prevent misuse of trust cheques or misdirection of trust funds.

If there are cheques missing from the sequence, the bookkeeper can identify the missing cheque from the cheques returned from the bank and ensure that the cheque has not been misused.

3. If **cheque requisition forms**, authorized by a lawyer at the law firm, are required before trust monies are disbursed from the trust account, unauthorized disbursements from trust can be prohibited and quickly identified.

Accounting staff responsible for preparing and printing trust cheques should not proceed with a disbursement from trust without a cheque requisition form signed by a lawyer.

A lawyer should not sign a trust cheque without reviewing the accompanying signed cheque requisition form.

4. If **trust transfer authorizations**, authorized by a lawyer at the law firm, are required before trust monies are transferred to trust ledger card for a different client matter, unauthorized transfers within the trust account can be prohibited and quickly identified.

Accounting staff responsible for posting trust transfers should not proceed without a trust transfer authorization form signed by a lawyer.

Please see: **Every Lawyer – Duties and Obligations** for requirements regarding authorization of withdrawals and transfers from trust.

KEY CONTROLS REQUIRED TO HAVE ADEQUATE ACCOUNTING PROCEDURES

1. Segregation of duties amongst the administrative staff.
2. Timely recording of information and processing of trust accounting transactions.
3. Proper training and delegation to administrative staff.

Segregation of Duties

Adequate accounting procedures within the law firm require that for significant processes (i.e. dealing with trust receipts) the responsibilities and tasks are divided between different members of the law firm administrative staff.

If the law firm staff is not large enough to divide these duties among several individuals, additional monitoring controls will need to be put in place to secure the trust funds that the law firm receives. See: **Responsible Lawyer – Oversight Procedures**

Examples:

1. Trust Receipts: ensure that different individuals:
 - Open the mail – individual who opens the mail should immediately stamp each cheque received with a restrictive endorsement (i.e. *For deposit only*);
 - Take deposits to the bank;
 - Record the transaction in the law firm financial records;
 - Verify the numerical sequence of receipts and check to ensure that all funds receipted are also deposited in the bank and recorded in the accounting records; and
 - Perform the monthly bank reconciliations.
2. Trust Payments: ensure that different individuals:
 - Authorize the trust disbursement by signing the cheque requisition form (***must be a lawyer***);
 - Prepare and print the trust cheque;
 - Sign the trust cheque (***must be a lawyer***);

- Record the transaction in the law firm financial records;
- Verify the numerical sequence of cheques and check to ensure that all trust disbursements are legitimate and authorized, and recorded in the accounting records; and
- Perform the monthly bank reconciliations.

Additional segregation of duties is required when dealing with cash because cash is not a uniquely identifiable asset and is easily converted. In addition to the list above, a different individual should be responsible for the secure storage and regular reconciliation of any cash trust assets.

Timely Recording

The timely recording of information and processing of trust accounting transactions is necessary in order to be in compliance with the Rules and to ensure accurate and useful accounting information.

Examples:

1. Deposit trust receipts by the next banking day.

Ensure that the individual from the law firm administrative staff that is responsible for preparing the trust receipts for deposit to the bank attends at the bank the day that a trust receipt is received at the law firm, or the next banking day thereafter.

This will ensure that the law firm is in compliance with the Rules of The Law Society of Alberta regarding receiving trust money. Alternatively, have the deposit slips and trust receipts *that are not cash* couriered to the bank the day they are received at the law firm.

Any cash trust receipts should be taken to the bank by a member of the law firm the day that the trust receipt is received at the law firm, or the next banking day thereafter.

If receipts are not deposited the same banking day, ensure they are locked in a safe location until the next banking day.

Trust receipts paid to the law firm in cash, in particular, require additional security measures since cash is not uniquely identifiable and is easily converted.

Ensure that access to the cash receipts that cannot be deposited the same day is restricted and that the secure location for storing the receipts is not public knowledge.

2. Prompt recording of trust transactions in the trust journal and client trust ledger accounts.

In order to make decisions that execute the lawyer's fiduciary responsibilities regarding the disbursement of trust monies it is imperative that the trust accounting records are up to date on a continual basis.

If trust accounting records are not current, there is a risk of disbursing trust monies in excess of the amount that is held in trust for that client, and thereby creating a trust shortage.

Please see: **Every Lawyer – Duties and Obligations** for requirements regarding authorization of withdrawals and transfers from trust.

Every dollar in the law firm trust bank account is in “trust” and often has conditions attached. Consider if there are any trust conditions before every disbursement from trust.

WARNING: DON'T FALL BEHIND. The source of much of the regulatory review is falling behind in trust accounting. It is a major cause of sanctioning in the following areas:

- accounting rule violations;
- breach of trust conditions; and
- failing to serve the client.

3. Timely transfer of trust monies from trust bank account to general bank account for billings.

Once a Statement of Account has been rendered to a client for legal services, any trust monies that are to be used to pay for that account should be transferred from the law firm trust bank account to the law firm general bank account..

In order to be in compliance with the new Rule in this regard, this must occur within one month of the law firm becoming entitled to the monies.

PROPER TRAINING AND DELEGATION

Staff Trained in Accounting

Since a lawyer may not have an in-depth understanding of accounting principles and procedures, it is important that law firm accounting staff are well trained and competent in these areas.

The Code of Conduct, Rule 6.1 says that:

6.1-1 A lawyer has complete professional responsibility for all business entrusted to him or her and must directly supervise staff and assistants to whom the lawyer delegates particular tasks and functions.

See **Appendix A** for some questions to consider when choosing a bookkeeper or external accountant for the law firm.

Use of Approved Accounting Software

A properly designed, configured and correctly used accounting system provides **most** of the controls that are required to ensure the safety of the trust funds that the law firm receives.

A word of caution is in order with respect to using computerized accounting software. Unless the accounting software is used correctly, by trained staff, with the features designed to provide good controls activated and adhered to, it is not a safeguard of any kind.

Ensure accounting staff understand, and are trained to use, the approved accounting software and are aware of the features that can help to ensure the safety of the clients' trust monies.

The vendors of the accounting software that has been approved by the Law Society of Alberta provide classes and consulting, if required.

An important measure in ensuring the safety of client's trust funds is to control access to the law firm accounting software:

- Each staff member who is authorized to record trust accounting transactions should be issued their own user ID within the accounting software.
- Each user can be given authorization to access only the areas of the accounting software that they are responsible for or recording transactions in.
- Each user should have an individualized password/PIN that they use to sign on and access the accounting software.
- Each user should ensure that their password/PIN is securely maintained.
- Ensure that there are at least two people in the law firm who know how to operate the computer and accounting systems.
- Ensure that duties related to the various accounting functions of the computer system are segregated.
- Ensure computer systems and accounting software are password protected.
- Change passwords regularly.

It is also important to ensure the stability of the computer system and to take steps to protect the accounting data:

- Install adequate firewalls to prevent unauthorized access to the computer system through the internet.
- Ensure updates to the software are done.
- Scan for viruses regularly.
- Back-ups of computer accounting data should be made regularly and transported or transmitted to secure offsite storage, OR print hard copies of the law firm trust accounting records monthly and store them in a secure and fire-proof location.
- Have surge protectors for all computers and modems.
- Ensure that adequate service and support is available for the hardware and software.

Know the Rules of the Law Society of Alberta

Staff responsible for the accounting function of the law firm should be versant in the financial *Rules of the Law Society of Alberta (included in Part 5 – Duties of Law Firms)*.

Since every trust accounting transaction cannot be overseen, it is important for those that have the delegated responsibility for this function are aware of the Rules the Law Society has instituted to ensure the safety of clients' trust monies.

Please see: **Responsible Lawyer – Oversight Procedures** for guidance on how sufficient oversight can be given to the accounting systems and procedures to ensure their effectiveness.

RESPONSIBLE LAWYER – Oversight Procedures

The designated responsible lawyer for a law firm is accountable for the operation of the law firm bank accounts and accounting, as well as the related controls.

See the *Rules of the Law Society of Alberta, Rule 119.3*

Bank Reconciliation Review

Trust Bank Account Reconciliation

Carefully reviewing the trust reconciliation monthly is a key oversight procedure for the responsible lawyer.

If the responsible lawyer does a comprehensive and thoughtful review of the trust bank account reconciliation to the trust listing, they will potentially detect any trust accounting problems, errors or irregularities.

Examples:

1. *Outstanding deposits* – ensure that any outstanding deposits from the previous months trust reconciliation have been deposited to the trust bank account within the first few days of the month.

This will allow any trust bank account shortages are being hidden by fake deposits to be detected.

2. *Overdrawn trust ledger accounts* – ensure that none of the trust ledgers for individual client matters are “overdrawn” (in a negative balance).

This will allow any overpayments out of trust or misallocations in trust accounting to be detected.

Review trust reconciliations (comparison of trust bank accounts and client trust listings) to ensure:

- they are completed within 30 days of months end;
- all reconciling items are listed individually, clearly explained and traceable to the bank statements;

- deposit records confirm that any outstanding deposits listed on the reconciliations were deposited the next banking day;
- reconciling items from the prior month were cleared promptly and have not been carried forward;
- all outstanding cheques from the prior month that are still not cashed are followed up;
- for stale-dated cheques (6+ months old):
 - a stop payment is requested,
 - the cheque is reversed in the trust accounting record,
 - the client trust liability is reinstated in the client's trust ledger, and
 - a cheque is reissued to the payee, if appropriate.
- there are no trust shortages (overdrawn accounts) in the client trust ledger listings.
- for completed legal matters, billings have been rendered to clients and funds in trust have been either transferred to the law firm general account or returned to the client, as appropriate.
- all inactive client trust ledger accounts with balances (e.g. no activity for 12+ months) have been followed up;
- all funds held in trust are allocated to a client ledger account (i.e. there are no miscellaneous, suspense or firm accounts or accounts in law firm member's names in the trust ledger); and
- trust bank account balances are reasonable on an overall basis.

After the review is complete, DATE and SIGN the reconciliation.

General Bank Account Reconciliation

Law firm general accounts are required to be reconciled monthly.

See the ***Rules of the Law Society of Alberta, Rule 119.40***

Reviewing the general bank account reconciliations is a basic business management tool and, additionally, may highlight trust accounting errors or potential employee fraud issues.

Examples:

1. *Trust receipts incorrectly deposited into the general account* – look for reconciling items or unusual amounts that may indicate that trust receipts were deposited into the general bank account in error.
2. *Payments out of general* – a review of disbursements of general funds may identify irregular payment patterns, like a large number of expense reimbursements to one

employee who is inappropriately funneling firm monies to themselves. A quick and easy method to perform this review is to flip through all the returned cheques that accompany the bank statement.

Accounting Journals Review

There are numerous accounting journals that, according to the *Rules*, are required to be maintained by the law firm.

See the *Rules of the Law Society of Alberta, Rule 119.36*.

A review of these journals, on a monthly basis, for completeness and any unusual transactions is a good oversight procedure.

If an accountant that performs the monthly procedures, it may be appropriate to delegate this review to them and have them report to the Responsible Lawyer directly.

Examples:

1. Trust Account Reconciliation – see **Trust Bank Account Reconciliation**.
 - A thorough and thoughtful review of the monthly trust bank account reconciliation will provide oversight for the trust accounting transactions that are recorded in the trust journal (including trust receipts and withdrawals) and the trust transfer journal.
2. Billing Journal and Accounts Receivable ledger –
 - Review the accounts receivable ledger monthly to identify any credit balances that may indicate invoices/Statements of Account to clients have not been issued, sent to the client and/or entered into the client ledger account; and
 - Follow up on longstanding accounts receivable balances to identify possible instances where a client deposit has not been recorded or has been allocated to an incorrect account.

Review of Control Documents

See *Control Documents*.

The purpose of using control documents is to provide a means to control the use of the documents in the trust accounting system to prohibit misuse and ensure the completeness of the accounting records.

Some simple review procedures ensure that the control documents are providing the protection that they were intended to.

These procedures do not need to be performed by the Responsible Lawyer directly. However, if they are delegated, they should be performed by an individual that does not have direct responsibility for, control of or access to the control documents.

Examples:

1. *Pre-numbered control documents* – pre-numbered receipts and cheques should be reviewed to ensure that all documents are accounted for and have been properly entered into the accounting system.

The bank statements should also be reviewed to ensure that there are no cheques negotiated that are out-of-sequence, which may be an indication of a fraudulent cheque.

These procedures are easily incorporated into the monthly trust bank reconciliation process. They can be completed by the staff member who prepares the reconciliation or by the reviewing lawyer.

2. *Cheque requisition forms and trust transfer authorizations* – payments should not be issued without the appropriately used authorization form.

This procedure can be done by the individual preparing the cheques or by the lawyers responsible for signing the cheques.

Segregation of Duties – additional review procedures

If the law firm is not of sufficient size to allow for key accounting duties to be segregated, additional monitoring controls must be put in place to ensure the safety of client's trust monies.

See ***Adequate Accounting Procedures - Segregation of Duties***.

Analysis must be performed regarding each accounting system (i.e. trust receipts, trust payments, trust transfers, etc.) to determine if one staff member has sufficient access to all stages of the accounting cycle in order to jeopardize the safety of client's trust monies.

Example:

1. Trust Receipts: if one individual is responsible for all of the following:
 - Opening the mail;
 - Taking deposits to the bank;
 - Recording the transaction in the law firm financial records; and
 - Performing the monthly bank reconciliations;

then the trust receipts are vulnerable to employee theft.

Consideration should be given to instituting daily/weekly monitoring of the deposits and recording of trust receipts in the accounting system by an independent third-party.

Key Agreements Review

Review key agreements related to the law firm trust accounting. Trust bank accounts, for example, can be set up to prevent misuse and fraud.

Examples:

1. *Banking agreements* – ensure that:

- cheques issued on the law firm trust bank accounts and bank statements are clearly marked as relating to a *trust* bank account;
- signatories on the law firm trust bank account are lawyers of the firm *only*;
- bank charges for the law firm trust accounts will be taken from the law firm general account;
- any bank cards issued on law firm trust bank accounts are *deposit only* – not allowing any withdrawals; and
- interest earned on the trust bank account is remitted directly to the *Alberta Law Foundation* at least semi-annually, in accordance with the *Rules*.

See the ***Rules of the Law Society of Alberta, Rule 119.16 and 119.22.***

File Monitoring

The responsible lawyer is accountable to ensure that the controls put in place at the law firm are functioning properly.

Consider a periodic review of client files to ensure:

- client ID verification rules are being followed - see ***Client Identity Verification***;
- there has been a proper accounting to clients for their trust monies (i.e. *Statement of Receipts and Disbursements* given to clients upon the completion of their matter agrees with the client's trust ledger card in the law firm trust accounting records);

Trust Property Audit

The responsible lawyer is also accountable for the security of client's trust property that is not money.

Periodically check the physical existence and security of trust property that is not cash.

See the ***Rules of the Law Society of Alberta, Rule 119.28.***

EVERY LAWYER – DUTIES AND BEST PRACTICES

Duties under the Rules of the Law Society of Alberta

Client Identity Verification

Know your client. Asking a few pertinent questions about the clients and verifying their identity can help protect the law firm from many of the common client frauds:

- fraudulent cheques from clients;
- payments from trust to fictitious or fraudulent payees;
- money laundering – conveying proceeds of crime through a law firm trust account;
- mortgage fraud;
- fraudulent investment scheme.

Identification requirements apply whenever a lawyer is retained to provide legal services of any nature to a client. The lawyer must obtain basic identification information about individual or organizational clients in every retainer. The lawyer must obtain the following information:

- Client's full name;
- Client's business address and phone number;
- If client is individual:
 - home address and phone number;
 - occupation;
- If client is organization:
 - incorporation or business number, place of issue of its number;
 - general nature of the type of business or activities engaged in by the client;
 - name, position and contact information for the individuals authorized to give instructions with respect to the legal matter;
- if client is acting for third-party – obtain the above information about the third-party.

Verification requirements arise when a lawyer, who has been retained by a client to provide legal services, engages in or gives instructions in respect of the receipt, payment or transfer of funds, subject to certain exceptions. By definition, "funds" include shares and negotiable instruments. Verification requires the lawyer to make reasonable efforts to obtain and retain copies of information which may be used to confirm that the client is who or what they say they are.

See the ***Rules of the Law Society of Alberta, Rule 118.2 to 118.6. and the Law Society Client Identification and Verification Flowchart***

Withdrawals and Transfers of Trust Funds

Each lawyer is responsible to ensure that funds are properly disbursed from the trust monies that their clients entrust to them.

Before signing any cheque issued from trust or trust transfer authorization, a lawyer must:

- Ensure that trust accounting records are up to date;

- Review client's trust ledger card to ensure that it contains sufficient funds to make the disbursement;
- Ensure that the disbursement is required for the legal matter for which the lawyer was retained;
- Ensure that the client's authorization has been given to make the disbursement;
- The money is not subject to any trust conditions that would prohibit the disbursement;
- Ensure that the trust bank account has sufficient funds to permit the withdrawal;
- Review disbursement to ensure it looks reasonable;
- Review the supporting documentation – (i.e. ensure that service was provided, disbursement is proper, etc.);
- Ensure the cheque is labeled with a client name or reference; and
- Ensure that any cheques payable to financial institutions include details of the transaction (i.e. mortgage number).

It is a best practice to ensure that a signed authorization from the client is on file for all withdrawals and transfers from trust.

See the ***Rules of the Law Society of Alberta, Rule 119.21: Certification of Funds Prior to Signing Trust Withdrawals and Transfers.***

Common Compliance Errors

There are a few Rules that some may not be aware of:

1. Duplicate Receipt Book for Cash

A book of duplicate receipts must be maintained which evidences the receipt of cash trust money.

See the ***Rules of the Law Society of Alberta, Rule 119.39(1).***

Tip: This duplicate receipt book for cash can be used for both trust bank and general bank cash receipts, but must be dedicated only to cash receipts

This can be done using the law firm accounting software as well. Just ensure that three copies of the receipt are printed in conjunction with the actual receipt of the cash, and get the signatures from both parties, as required by the Rules, on all copies. Maintain one copy, as usual with the law firm accounting records and keep another file/binder with all the cash receipts.

2. Trust Shortage Reporting

If a shortage in the law firm trust account is discovered (i.e. the bank deducted cheque printing charges) or on a trust ledger card for an individual client matter (i.e. a client has been overpaid when returning any remaining trust funds at the close of a matter), the money must be replaced in the trust account immediately.

All shortages must be rectified immediately and disclosed to the Executive Director in compliance with Subrule 119.24(2) and 119.24(3):

- if the deficiency was not corrected within 7 days, or
- if the deficiency is greater than \$2,500, regardless of when it was corrected.

The *Trust Account and Client Ledger Shortages* form that must be remitted to the Trust Safety department can be found on the Law Society website.

3. Trust Account Signing Authority in case of the absence of the Responsible Lawyer

Rule 119.21 says that all withdrawals and transfers from a law firm trust account must be signed by a lawyer of the law firm.

If a sole proprietorship is being operated and/or there are occasions when all of the lawyers of the firm will be absent and payments must be made from the trust account during that absence, a written request must be made of the Manager of Trust Safety to authorize another lawyer to sign any cheques or transfers on the law firm trust account for that time.

Requests can be made by sending an email to the Trust Safety email mailbox:
Trust.Safety@lawsociety.ab.ca

4. Representative Capacity Undertaking

Ensure lawyers disclose when they are acting as executor, estate trustee or exercising power of attorney on matters that are not reflected in the firm's books and records.

If a lawyer is acting in a representative capacity, the Manager of Trust Safety must be notified and an undertaking must be given that the accounting records will be made available for review if requested.

The *Representative Capacity Annual Undertaking* form that must be remitted to the Trust Safety department can be found on the Law Society website.

See the ***Rules of the Law Society of Alberta, Rule 119.26***.

5. General Retainers

All retainers should be deposited into the trust account, unless the Client signs a general retainer acknowledgment that:

1. money is non-refundable and belongs to the law firm immediately upon receipt;
2. law firm is not obliged either to account for the money or render any services with respect to the money; and

3. services may never be rendered in respect of the money.

See the ***Rules of the Law Society of Alberta, Rule 119.41***.

EXAMPLES

Employee theft

1. Forged trust and general cheques requisitions

Employee theft occurred in a large law firm (>50 lawyers). The legal assistant defrauded the law firm of over \$500,000 over a period of 8 years using the following methods:

- a. she requisitioned cheques payable to her company or the Canada Revenue Agency on files that had dormant trust funds;
- b. she requisitioned cheques payable to her company or the Canada Revenue Agency from director's fees payable to the firm that the firm held in trust; and
- c. she requisitioned or prepared general cheques payable to her company or the Canada Revenue Agency, supported by false invoices;

Most of the cheques were for small amounts. The legal assistant forged trust requisitions or procured lawyers' signatures on the false trust cheque requisitions through:

- a. misrepresentation to the lawyers; or
- b. failure on the part of the lawyers to properly determine that legitimacy of the payment.

The legal assistant removed the copies of the trust requisitions from the law firm files to hide her theft. The fraud was enabled by a lack of oversight by the lawyer on the file to verify the trust transactions. This theft could likely have been prevented.

Refer to the following sections of this guide:

- ***Control Documents***
- ***Segregation of Duties***
- ***Withdrawals and Transfers of Trust Funds***
- ***Trust Bank Account Reconciliation***

2. Forged trust cheques requisitions

Employee theft occurred in a large law firm (>50 lawyers). The legal assistant defrauded the law firm of over \$800,000 over a period of 3 years. She procured forged trust requisitions payable to a financial institution or to her personal creditors, one being the Canada Revenue Agency.

The funds were stolen from clients' estates held in trust in the following ways:

- a. high net worth trusts held outside the firm. In this instance, the legal assistant forged the lawyers signature on the cheques and altered the bank statements to remove the fraudulent disbursements;
- b. trust funds held within the firm trust account. The legal assistant forged the trust cheque requisitions.

The legal assistant was the recipient of the bank statements for the trust funds held outside the firm. However, a lawyer would have been responsible for reviewing the trust reconciliation and signing off on it. The fraud was enabled by a lack of oversight by the lawyer on the file to verify the trust transactions. This theft could likely have been prevented.

Refer to the following sections of this guide:

- ***Control Documents***
- ***Segregation of Duties***
- ***Withdrawals and Transfers of Trust Funds***
- ***Trust Bank Account Reconciliation***

3. Legal assistant steals \$138,000 from law firm general account

Employee theft occurred in a small one-lawyer office. The legal assistant wrote cheques to her benefit out of the firm's general account. The theft of \$138,000 occurred over a period of 4 years.

It is unclear if:

- the lawyer signed the cheques as prepared by the legal assistant – this is unlikely, however, since the information available indicated that the legal assistant hid or destroyed the cheques once returned from the bank with the monthly bank statement;
- the lawyer pre-signed the cheques;
- the legal assistant had signing authority on the general account; or
- the legal assistant forged the lawyer's signature on the cheques.

“A former legal assistant for a Calgary real estate lawyer has pleaded guilty to stealing \$138,736 from her employer over four years.

In an agreed statement of facts filed with the court, Annie Mae Cummer, 52, who worked for Bruce D. Blumell, admits she wrote 227 cheques on her boss's general account to herself, her husband, her company and other family members.

She also paid her bills, including credit cards, by writing cheques from the law firm account, and covered up her crime by hiding or destroying the cheques when they were returned by the bank, according to the documents.

The theft occurred between January 2002, a year after she started working for Blumell, and July 2006, when she was fired.

Cummer's theft was noticed by Blumell's accountant, Cheryl Marshall, who brought a number of discrepancies to her boss's attention when she filled in for Cummer when she was on vacation in July 2006.

A review of records initially indicated the women had been double paid for her June 2006 paycheque, and prompted a criminal investigation."¹

This theft could likely have been prevented.

Refer to the following sections of this guide:

- **Segregation of Duties**
- **General Bank Account Reconciliation**

4. Employee conducts improper transactions through trust account that result in a \$1 million trust shortage

Employee theft occurred in a small law firm with four practicing lawyers. The legal assistant, a long-term and trusted employee misused the trust account in the following ways:

- a. She misappropriated trust funds for her own benefit;
- b. She misappropriated trust funds for the benefit of a third-party;
- c. She made loans of trust monies to a third-party; and
- d. She disbursed funds to clients from trust prior to the law firm receiving the trust monies into the trust account.

Trust shortages in excess of \$1 million occurred over a period of just over 2 years. All disbursements from the trust account were signed by lawyers from the law firm. The legal assistant frequently got a lawyer that was not directly responsible for the file to sign the trust cheques.

The legal assistant was responsible for initiating and entering transactions directly into the trust accounting system.

The legal assistant covered up the misappropriations using *lapping*. Lapping is where trust funds are moved from client ledger to client ledger to hide a trust shortage. The trust monies from other matters, that are not currently "due", can be used to cover the trust shortage in the matter that is required to be paid out currently. Detection of the shortage can be avoided.

The legal assistant also:

¹ Calgary Herald, October 29, 2008, "Legal assistant admits \$138,000 theft".

- a. Falsified accounting posting sources like cheque stubs to prohibit detection of the fraud by the bookkeeper;
- b. Deposited trust monies received from clients into the trust bank account without opening a client trust ledger account for that matter;
- c. Forged supporting documentation, such as letters and courier slips, to make it appear that payments had been made; and
- d. Concealed correspondence and other communications from clients from the lawyers.

An overdraft of \$80,000 was detected by the lawyer early in the fraud, however, the legal assistant stated it was a mistake. The lawyer did not report the trust shortage to the Law Society.

A year later another trust shortage of nearly \$200,000 was detected by the lawyer, who repaid that shortfall from his own resources. The legal assistant indicated that the trust shortage was as the result of posting errors due to the late receipt of mortgage funds. The lawyer did not report the trust shortage to the Law Society.

The lawyer detected several other shortages and rectified them himself, repaying more than a \$1 million into trust, before instigating an investigation into the matter and ultimately, firing the employee.

This theft could likely have been prevented.

Refer to the following sections of this guide:

- ***Control Documents***
- ***Segregation of Duties***
- ***Withdrawals and Transfers of Trust Funds***
- ***Trust Bank Account Reconciliation***
- ***Use of Approved Accounting Software – re: Access Controls***

Client Fraud

1. Fraudulent cheque received

There are a variety of scams circulating constantly in which clients attempt to give the law firm a fraudulent cheque to deposit to trust. The matter does not proceed and they ask for a quick refund of the monies.

Common schemes:

- Debt collection;
- Divorce settlement collection;

- Real estate purchase transaction;
- Workers' injury settlement collection;
- Inheritance.

Some recent schemes have become more sophisticated, including fake websites and fake law firms. These are some of the common characteristics:

- Client resides overseas and therefore, cannot meet in person;
- Do not communicate by phone or fax – just email;
- Require quick action;
- Evade questions regarding their contact information or a legal representative in their jurisdiction.

It is good practice to certify cheques at the client's bank that are received from clients on matters that require a quick turn-around time. Alternatively, ensure that trust deposits have cleared the bank before disbursing any of the trust funds. Keep in mind that foreign cheques take much longer to clear the banking system.

Refer to the following sections of this guide:

- ***Client Identity Verification***

2. Fraudulent investment scheme

The fraud involved a movie investment opportunity that provided both a tax write-off for the investor in the short term and then a good return on investment in the long term. The fraudster recruited investors through investment seminars and word-of-mouth.

The fraudster engaged the lawyer to prepare the investment documents, receive the executed agreements along with the investment monies from the investors, and then pay the monies out according to the directions of the fraudster. The fraudster had the investors make out the cheques to the law firm in trust.

The fraudster involved the lawyer in this scheme for two purposes:

- to protect the details of the scheme through solicitor-client privilege; and
- to give an air of legitimacy to the scheme and false sense of security to the investors by having the funds flow through the lawyer's trust account.

Law firm involvement in this fraud could have been prevented. Do not negotiate monies through the law firm trust account where legal services are not provided directly related to those funds (i.e. do not be a "banker" for a fraudster).

See the Rules of the Law Society of Alberta, Rule 119.17.

Refer to the following sections of this guide:

- ***Client Identity Verification***

External Fraud

1. Fraudulent law firm cheque clears the law firm bank account

In 2014, several law firms have been contacted by their banks to inform them that fraudulent law firm cheques have been negotiated through the law firm bank account each month. In each instance, the law firm cheque was a fake – often very closely resembling the actual law firm cheque and signatures of the signatories on the account.

These fraudulent cheques have historically been small in value, but in recent years have been for 10s of thousands or 100s of thousands of dollars. They are frequently deposited in banks in other towns or cities, or in the United States of America.

These fraudulent cheques are often detected because the cheque number is out of sequence with the other law firm cheques.

Refer to the following sections of this guide:

- ***Control Documents***

Appendix A – Trained Accounting Staff

Since a lawyer may not have an in-depth understanding of accounting principles and procedures, it is important that law firm accounting staff are well trained and competent in these areas.

Bookkeeper

Some questions to ask a potential bookkeeper:

1. Do they have any other law firms as clients?
2. Are they familiar with trust accounting?
3. Are they familiar with the Rules of the Law Society of Alberta?
4. Are they familiar with the law firm accounting software that the law firm is using?
5. Know how often they would be required to attend at the law firm offices to ensure compliance with the Rules. Can they accommodate the law firm needs?
 - a) are they going to be completing the day-to-day recording of transactions for the law firm or is a paralegal/administrative person employed at the law firm who can do some of the day to day work?
 - b) will they be preparing the fee billings (Statements of Account)?
 - c) do they need to follow up overdue receivables?

- d) will they prepare the payroll?
 - e) what government remittances would they be required to prepare and file? payroll – due once a month? GST – due quarterly?
 - f) will they prepare financial statements? monthly? annually?
6. Do they understand how to prepare trust reconciliations? (*See the Appendix on preparing a trust bank reconciliation.*) Ask some specific questions like:
- a) what does a client trust listing consist of?
 - b) what are the main things that should “balance” on a trust reconciliation?
 - c) what would they look for is a bank reconciliation did not balance?
7. Discuss confidentiality. Explain solicitor-client privilege and consider a confidentiality agreement.

Consider what internal controls need to be in place to supervise the work of the bookkeeper and compliance with the duties of Responsible Lawyer.

Check with your colleagues. Get references – preferably from other law firms.

External Accountant

Some questions to ask the potential external accountant:

1. Rule 119(1) (a): are they a Public accounting firm as defined in the *Regulated Accounting Profession Act*? (i.e. Chartered Professional Accountant, Chartered Accountant, Certified General Accountant, Certified Management Accountant)
2. Do they have any other law firms as clients?
3. Are they familiar with trust accounting?
4. Are they familiar with the Rules of the Law Society of Alberta?
5. Have they completed the Accountant’s Report or Start Up Report before?

(These filings are different than typical assurance reports accountant’s issue, like Review Engagements to review financial statements. These are prescribed forms available on the Law Society website and they involve testing compliance with a regulatory regime.)
6. Be aware of filing deadlines. Ask if they have sufficient capacity to ensure the filings gets submitted on time.

(Many law firms have December 31 year ends. That makes the filing deadline for Accountant’s Reports April 30 – which coincides with the personal tax filing deadline.)

Talk to colleagues about their external accountants:

1. Has their accountant filed on a timely basis?

2. Do they seem to understand the needs and requirements of accounting in a law firm?
3. How much do they pay for the preparation of the Accountant's Report or Start Up Report?

This paper was originally presented at the LESA Business of Law seminar in April 2015 by Jocelyn Frazer and Loreen Austin.