A rogue in your midst (Pt 2)

In a second in a series of articles, Frank Maher advises upon how to discover rogue partners & employees

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This is the second of three articles on practical problems caused by rogue partners and employees, and looks at how you might discover them.

First however, there is an interesting postscript to the first article, which looked at types of rogue behaviour (see "A rogue in your midst (Pt 1)", *NLJ*, 28 October 2016, p 21). Readers will recall that many of these are far removed from the cases of theft from client or office account: they may encompass many types of misbehaviour where someone puts the firm at risk by failing to comply with the systems and controls which have been put in place to protect it.

Minor to major

We finished by looking at the American case of John Gellene, and Professor Mitt Regan's conclusion that Gellene was prone to engaging in petty transgressions which, as his moral compass began to lose direction, led incrementally to more serious breaches. Each small step took him closer to his final crime, of dishonesty.

Before the (metaphorical) ink had dried on that article, an academic paper was published by Neil Garrett and others from University College London. Their research confirmed that this was indeed the case more widely: many dishonest acts can be traced back to a sequence of smaller transgressions that gradually escalated. Minor dishonest decisions snowball into significant ones over time.

This is therefore a warning sign on the road to finding a rogue: firms must learn to be intolerant of rule-breakers. That applies, even though the rule-breakers are often also the rainmakers. Firms may be reluctant to bite the bullet, but they ignore such transgressions at their peril.

Vigilance & reaction

The second way the activities of rogues may be uncovered is by keeping one's eyes and ears open and reacting to information. So often, when they have been exposed, and the writer has been investigating on behalf of either the firm or its insurers, someone has said to the writer that they had been thinking there was something wrong, something which did not stack up. So follow your nose. If it does not seem right, investigate. There is a lot you can do without making direct allegations at the outset. But be cautious of creating a documentary trail at this stage.

The writer had one case where a rogue (senior) partner had been borrowing money from the firm's bank and applying it to support a favoured client's business (quite why is anyone's guess). The other partners paid insufficient attention to the accounts. After the rogue was found out, one of the partners commented that he had been puzzled as to why the firm always seemed to be short of money, when profits were supposedly increasing. Had he followed his instincts, he might have discovered the cause and saved a lot of money in the process. The rogue partner's behaviour cost approximately £3m.

In a number of other cases, a partner has enjoyed high living which would not be supported by the partner's profit share. This creates danger for the remaining partners, because if there is fraud resulting in client losses, insurers may try to decline indemnity for the uninvolved partners on the ground that they turned a blind eye and condoned the fraud.

Supervision

The third way you can discover rogues is through effective supervision. As a matter of conduct, you are not generally under a regulatory duty to supervise equity partners, but that is not a reason for letting people go completely off on their own, and this is even more so with lateral hires. It has been said that lateral hires are people whose faults you have not yet discovered.

Internal audit

Fourth, and most importantly, there is the role of internal audit. The PwC Law Firm Survey 2015 commented that "internal audit remains an area of underinvestment, particularly when benchmarked against corporate businesses of equivalent size, complexity and geographic reach". However, their 2016 Survey reported that firms with an internal audit function had increased from 40% in 2015 to 56% in 2016.

As PwC's report observed, this shows a growing appreciation that internal audit is fundamental to a strong internal control environment. However, it is not only an opportunity to discover roguish behaviour, it helps discover those early, small transgressions which may morph into more serious misdemeanours, as explained earlier. Even more importantly, it may act as a deterrent.

However, the report also noted that the focus of law firms' internal audit functions was on financial and compliance risk, a more restricted approach than would typically be expected in corporate businesses. It should not be confined to file review. There are other important areas of risk to address too, including procurement and accounts. In the accounts context, many firms have had severe problems with the SRA in recent times from breaches of r 14.5 of the SRA Accounts Rules 2011, which prohibits using client account as a banking facility.

The final article in this series will look at what you need to do if you find a rogue, and some points to consider in advance (albeit hoping that you never have the misfortune). **NLJ**

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