

Memo

To: Committee on Special Discipline Case Audit

From: Richard Schauffler

Date: 9/21/2021

Re: Client Trust Account Audit Programs

This memo will serve to update the Committee on issues and questions raised regarding proactive management of client trust accounts during the Committee's September 9, 2021, meeting.

1. Benchmarking with large states: We have confirmed that the other states with the largest state bars—Florida, New York, and Texas—do *not* have random audit programs for client trust accounts (CTAs). Texas offers CLE courses on CTA management; New York requires a statement on its biennial registration form indicating awareness of and compliance with CTA rules; Florida requires annual certification of awareness of and compliance with CTA rules and further requires under Rule 5.1-2(c)(1):

Every law firm with more than 1 lawyer must have a written plan in place for supervision and compliance with this rule for each of the firm's trust account(s), which plan must be disseminated to each lawyer in the firm. The written plan must include the name(s) of the signatories for the law firm's trust accounts, the name(s) of the lawyer(s) who are responsible for reconciliation of the law firm's trust account(s) monthly and annually and the name(s) of the lawyer(s) who are responsible for answering any questions that lawyers in the firm may have about the firm's trust account(s). This written plan must be updated and re-issued to each lawyer in the firm whenever there are material changes to the plan, such as a change in the trust account signatories and/or lawyer(s) responsible for reconciliation of the firm's trust account(s).

2. Escrow Accounts: Non-real estate escrow accounts are regulated in California by the Department of Financial Protection and Innovation. Annual audits are required under California Code of Regulations 1741.5(a). These are detailed, financial audits performed by an independent accountant at the expense of the holder of the escrow account.
3. Audit Program Features:
 - A. *Profiles of High-Risk Attorneys/Red Flags*: No bar regulatory body in the United States uses risk-based auditing; all use random selection auditing. (Victoria, Australia and British Columbia and Ontario utilize risk-based regulation, based on prior audit findings and complaints). That said, state bar staff in other states all agree that the locus of the problem with client trust account

management is with solo practitioners and small firms (<6 lawyers) and particularly with older attorneys in those offices. Other “red flags” noted by state bar staff in Connecticut, Delaware, and Washington include:

Pre-Audit:

- If attorney has received 3 or more bank overdraft notices in a 6-18 month period
- If attorney has received a prior warning for bank overdraft(s) and receives subsequent bank overdraft notice

During On-site Audit:

- Cash withdrawals
- Settlements being paid out in a series of amounts <\$10,000 to avoid bank reporting of transactions over \$10,000
- Commingling of client and attorney funds
- Checks made payable to anyone with same last name as attorney
- Withdrawals for expenses that seem unrelated to the client’s matter
- Transfers to other accounts (that is, using funds from one account to cover deficit in another)
- Missing records
- Reconciliations not being performed on regular basis
- Personal Injury law practices: if using settlement statements in lieu of actual ledger accounting (usually means they are using client funds for multiple purposes, with no real records of whose money is paying for what, just lump sum payouts)

Post On-site Audit in Follow Up With Attorneys and/or Clients

- If responses to queries are overly detailed or verbose; this usually indicates a smokescreen covering up error
- If attorneys are rude/irritable, and/or if bullying/berating clients into silence

B. *Partnership with Certified Public Accountant Profession:* These collaborations are designed to educate CPAs with the standards to be used in auditing a client trust account on behalf of the state bar; they are not formal certifications of CPAs. CPAs are licensed and regulated as a profession by a state board of accountancy, and are held to accounting standards that are not identical to those required by the state bars for client trust accounts.

- North Carolina Partnered with statewide CPA association to develop the “Agreed Upon Procedures for CPA Examination of Lawyers’ Trust Accounts,” which are used when CPAs examine these accounts (Note: CPAs do this when a law firm opts to engage a CPA; if the audit is successful, the law firm gains a 15-month exemption from audit by the state bar.) Otherwise, attorneys are subject to random selection within their judicial district and the audit is performed by a state bar auditor.)
- Delaware: Partners with its statewide CPA association to make 2-hour presentations for CPAs.

C. *Program Support for Attorneys:* All programs contacted emphasize education and correcting inadvertent error. Many client trust account program managers and program rules (e.g., British

Columbia practice reviews for lawyers moving from large firm to solo practice) indicate that solo practitioners and small firms (<6 lawyers) do not know requirements, methods, or the terminology required to do CTA accounting correctly and are responsible for a high percentage of the errors in client trust accounting. While several states provide CLE on client trust account management, none appear to have made it mandatory.

- Connecticut:
 - Produces podcasts that are posted on its web site to provide tips/best practices
 - CLE is provided by state bar staff on CTA management.
- Delaware:
 - State Bar collaborates with statewide CPA association and together they do 2-hour presentations to CPAs on State Bar requirements for CTA management.
 - Presentations also provided for attorneys in local bars upon request
 - No CLE requirement specific to CTA management
- North Carolina:
 - Offers CLE courses on CTA management
 - Trust account maintenance workshops are conducted in judicial districts selected for random audit upon request of the local district bar president.
 - The state bar auditor, time permitting, will also conduct workshops upon request from other groups affiliated with the practice of law
- Washington:
 - Offers 60-90 minute CLE courses specifically on CTA management
 - Makes presentations to law associations and local bars, law school ethics classes, and law firms upon request
 - Has produced a number of resources, including a manual on how to use Quickbooks for CTA reporting

D. Do State Bars Restrict Attorneys after Negative Audit Findings?

- North Carolina: May refer attorneys to Trust Account Compliance program as a type of rehab program, for attorneys whose audits reveal “significant” compliance issues. Grievance Committee defers imposition of sanction; if program completed (may be up to 2 years) then it may waive sanction altogether. Attorneys suspected of fraud, deceit, misappropriation, etc. are not eligible.
- Washington: May refer attorneys to Probation, in which case they are required to submit monthly CTA reconciliation forms on all accounts (usually for 2 years). May offer “rehabilitation letter” giving attorneys 2 months to fix specific problems discovered during audit in order to avoid formal discipline.
- Delaware: If an attorney is sanctioned, they must retain a CPA to re-certify their CTA accounts within 90 days.