

**To:** Committee on Special Discipline Case Audit  
**From:** Richard Schauffler  
**Date:** 10/6/2021  
**Re:** Published Results of Client Trust Account Audit Programs

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The following summarizes the published results from client trust account audit programs, indicating the extent of deficiencies discovered through audit.

<b>Delaware State Bar, 2018 Annual Report</b>	<b>60 random audits</b>
No deficiencies	6%
Minor Deficiencies	46%
“More than minor” deficiencies, most of which were “non-material”	48%
<b>North Jersey State Bar, 2020 Annual Report</b>	<b>454 random audits</b>
Minor or no deficiencies in books and records	97%
Discipline (reprimand, censure, admonition, suspension, disbarment)	3%

<b>Law Society of Ontario, Canada, 2020 Annual Report</b>	<b>1,309 risk-based audits</b>
Minor or no deficiencies in books and records	54%
Deficiencies “readily remediated”	32%
Serious deficiencies in books and records	14%
<b>Law Society of British Columbia, Canada, 2021 Annual Report</b>	<b>636 periodic audits</b>
Minor or no deficiencies in books and records	80%
Deficiencies requiring follow up (site visit, reaudit, documentation)	10%
Serious deficiencies in books and records	10%
<b>Victorian Legal Services Board and Commissioner, Australia 2020 Annual Report</b>	<b>1,572 risk-based audits</b>
No deficiencies	81.5%
Minor deficiencies	9%
Moderate deficiencies with follow-up (site visit, education, remedial action)	9%
Investigation into serious deficiencies/discipline	.5%

# Discussion Document

**To:** Committee on Special Discipline Case Audit

**From:** Richard Schauffler

**cc:** Leah Wilson

**Date:** 10/8/2021

**Re:** Design Options for a California Client Trust Account Management Program

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This memo provides to the Committee two options for a proposed integrated client trust account (CTA) management program. These options are designed to provide the benefits of education and support for attorneys responsible for client trust accounts to ensure the protection of client assets, as well as serving the functions of deterrence and detection of actual misconduct. The distinctions between the two options are reflected in section **3. Client Trust Account Compliance Review and Audit** below and relate to reach and type of intervention: compliance review versus audit. See the **Terminology** section at the end of this document for an overview of the differences between these two activities.

## 1. Registration of Client Trust Accounts

**Annual registration** by every attorney of client trust accounts as part of State Bar license renewal process. Requires attorneys to report whether or not they are responsible for client trust accounts (CTAs) under the provisions of California Rule of Professional Conduct 1.15<sup>1</sup>. If responsible, the attorney must also register the client trust accounts for which they are responsible, by account number and financial institution.

*Rationale:* The State Bar needs to collect this information to have a complete picture of the number of licensed attorneys who manage client trust accounts and the corresponding account information. This provides the universe of attorneys and accounts from which a random sample can be drawn for audit purposes (see below).

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<sup>1</sup> Rule 1.15, entitled Safekeeping Funds and Property of Clients and Other Persons, governs oversight of client trust accounts. [https://www.calbar.ca.gov/portals/0/documents/rules/rrc2014/final\\_rules/rrc2-1.15\\_\[4-100\]-all.pdf](https://www.calbar.ca.gov/portals/0/documents/rules/rrc2014/final_rules/rrc2-1.15_[4-100]-all.pdf)

## 2. Certification of Compliance

**Annual certification:** Every year, every attorney licensed by the State Bar who is responsible for client trust accounts should certify in writing as part of the license renewal process that they are knowledgeable about and compliant with the provisions of California Rule of Professional Conduct 1.15.

*Rationale:* Every licensed attorney should be aware of Rule 1.15 and know whether and how it applies to their practice of law. Certification means that the attorney or their firm received funds and/or property from clients or third parties in connection with the representation of a client, has a client trust account, and followed all the client trust account and safekeeping property rules. Requiring certification raises awareness of this requirement and serves as notice that the State Bar is actively engaged in protecting the public through compliance with this rule.

## 3. Client Trust Account Compliance Review and Audit

Two models are presented below for client trust account compliance review and audit design and implementation.<sup>2</sup> There are two key distinctions between these models: 1) scope: Option 1 contemplates a limited scope, covering a random sample of attorneys annually. Option 2 covers all attorneys annually; and 2) review vs. audit: Option 1 includes a compliance review while Option 2 includes both compliance reviews and audits.

**Option 1: Annual Random Compliance Review.** The State Bar will oversee annual random compliance reviews of client trust accounts by CPAs, based on a sampling strategy designed to select a meaningful sample of attorneys.

**A. Self-assessment report:** If selected for a random compliance review, an attorney will have to complete a CTA management self-assessment report.

*Rationale:* Self-assessments are a low-impact yet meaningful way to promote awareness and self-reflection regarding CTA management practices.

**B. Compliance reviews conducted by a CPA:** If selected for a random compliance review, attorneys will hire, at their expense, a CPA to conduct the compliance review and report the results to the State Bar. The State Bar will work with the Certified Public Accountant (CPA) community to develop agreed-upon procedures and forms for the CTA compliance reviews. These compliance reviews are designed to ensure that client trust accounts are being managed and documented properly.

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<sup>2</sup> Note that in addition to either of these random audit options, the State Bar will continue to conduct focused audits as part of investigations in formal disciplinary matters.

*Rationale:* CPAs are professionally qualified to conduct compliance reviews and are regulated by the California Board of Accountancy. Requirements for client trust accounts are more stringent than for accounts typically found in other professions, thus standards for client trust account compliance reviews need to be defined and understood for these reviews to serve the purposes of Rule 1.15.

**Option 2: Annual Universal Compliance Review with Audit.** All attorneys who acknowledge responsibility for CTAs will be required to complete an annual self-assessment and secure a CPA to conduct a compliance review. Subsequently, a random sample of these attorneys will be selected by the State Bar for audit.

- A. Self-assessment report:** All attorneys who acknowledge responsibility for CTAs in the Registration process will have to complete a CTA management self-assessment report.

*Rationale:* Self-assessments are a low-impact yet meaningful way to promote awareness and self-reflection regarding CTA management practices.

- B. All attorneys required to complete compliance review:** All attorneys who acknowledge responsibility for CTAs in the Registration process will hire, at their expense, a CPA to conduct the compliance review and report the results to the State Bar. The State Bar will work with the Certified Public Accountant (CPA) community to develop agreed-upon procedures and forms for the annual, random compliance reviews of client trust accounts. These compliance reviews are designed to ensure that client trust accounts are being managed and documented properly.

*Rationale:* Extending this requirement to all attorneys will maximize the benefits of the State Bar's CTA compliance program for California consumers. CPAs are professionally qualified to conduct compliance reviews and are regulated by the California Board of Accountancy. Requirements for client trust accounts are more stringent than for accounts typically found in other professions, thus standards for client trust account compliance reviews need to be defined and understood for these reviews to serve the purposes of Rule 1.15.

- C. Audits of the client trust accounts of randomly selected attorneys, based on compliance reviews:** The State Bar will oversee an audit program designed to examine in detail a randomly selected set of client trust accounts.

- a. **Variant 1:** Audits are conducted by State Bar audit staff.
- b. **Variant 2:** Audits are conducted by external auditors.

*Rationale:* Formal audits, as opposed to the type of review performed by a CPA, will provide greater protection against harmful mismanagement of client trust accounts by the randomly selected attorneys. The audits will also serve to gauge the effectiveness of compliance reviews in highlighting deficiencies in client trust account management.

As the State Bar accumulates data about the frequency and types of errors discovered in the audit process, it may move to incorporate audits based on risk, using the data to develop an assessment of the probability of client trust account mismanagement and degree of harm.<sup>3</sup>

### **3. Analysis and Action Based on Review and Audit Findings**

**A. State Bar review of compliance review and audit findings:** State Bar staff will review the results of compliance reviews and audits conducted by CPAs hired by the attorney. The purpose of these reviews is to determine the appropriate follow-up for the attorney based on audit findings. In addition, the cumulative audit findings will permit the identification of patterns, both of individual attorneys/firms and statewide across all attorneys/firms audited, to determine risk as well as training/education needs.

#### **B. Compliance review and audit outcomes and graduated corrections**

1. File closed: If no deficiencies or minor deficiencies noted and corrected during compliance review or audit.
2. Written statement of minor deficiencies to be corrected within a 45-day deadline; subsequent submission of documentation by the attorney that errors have been corrected; upon receipt of acceptable response, file is closed.
3. Referral for administrative supervision of the client trust account, e.g., requiring frequent, detailed monthly reporting for up to 2 years and/or re-enrolling in client trust account CLE).
4. Written statement of more serious deficiencies, accompanied by requirement to re-audit within 3 months to ensure that the deficiencies reported by the audit have been corrected; upon receipt of acceptable audit findings, file is closed.
5. Referral for investigation and possibly disciplinary action, for cases that uncover more serious misconduct .

*Rationale:* Only the State Bar has the authority to enforce the provisions of Rule 1.15. Based on the experiences of other jurisdictions, it is anticipated that the overwhelming majority of findings will result in error correction that does not rise to the level of formal discipline. But when it does, the State Bar will utilize the existing disciplinary system to investigate individual cases.

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<sup>3</sup> The issues related to possible State Bar use of risk-based regulation are discussed in detail in the July 2020 [Governance in the Public Interest Task Force Report](#).

#### 4. Support for Attorneys Managing CTAs

**A. Enhanced State Bar education, collaboration, and professional development:** The State Bar will invest in increased support for attorneys responsible for client trust accounts, providing support through a variety of channels, for example:

- i. **A mandatory CLE course** specific to Client Trust Accounts for attorneys who indicate that they have responsibility for CTA management.<sup>4</sup>
- ii. **Presentations** to local bar associations, law schools, accountants re CTA account management.
- iii. **Use of multiple channels** (e.g., video, podcast, newsletter, website, print, social media) to disseminate tips and highlight issues.
- iv. **Self-assessment tools** (e.g., checklists) to allow attorneys to review their practices.
- v. **Remedial programs** to mentor, educate, oversee attorneys.

Rationale: Attorneys, especially those in smaller law offices, need support to ensure they are managing client trust accounts correctly. Other jurisdictions report that most error is inadvertent error not based on fraudulent intent. Increasing the availability and formats of content related to the State Bar's [\*Handbook on Client Trust Accounting for California Attorneys\*](#) as well as developing new tools for improvement are required.

#### 5. Support for Clients

**Public Education:** The State Bar will develop informational resources utilizing a variety of channels to inform the public as well as clients of their rights with respect to a client trust account opened on their behalf and of the responsibility of their attorney to communicate timely, report on changes in funds, and account in a timely manner for client trust funds. This information should be distributed by the State Bar. In addition, attorneys opening a client trust account should be required to distribute a State Bar information resource on CTAs to clients at the time the account is established.

*Rationale:* Clients cannot assert their rights unless they know what those rights are.

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<sup>4</sup> The *Plan for Preventative Education for Attorneys* presented by the Office of Professional Competence to the Board of Trustees at the July 2021 meeting includes a proposed non-mandatory CLE course on Client Trust Accounts (see page 5). The course is to be designed consistent with the self-assessment checklist being developed by the same Office on this topic. See Item 703 here <https://board.calbar.ca.gov/Agenda.aspx?id=16294&tid=0&show=100030118&s=true#10037720>

**Terminology**

As used here, the concepts of compliance review and audit are both designed to identify key issues in client trust account management. The two approaches are complementary, but differ in several respects.

**Compliance review:** a method of examining records in a client trust account to ascertain whether key processes are being conducted and documented as required. A compliance review may be reported as a series of Yes/No questions, short narrative explanations, or checklists. For example, a compliance review might examine whether or not client trust accounts and their checks and deposit slips are labeled correctly; whether separate client ledgers have been established for each client trust account; or whether monthly three-way reconciliations have been conducted and documented correctly. Compliance reviews can also illuminate the effectiveness of rules and requirements, and lead to changes in rules or improved training designed to raise the level of overall compliance for all.

**Audit:** a more formal method of examining accounts to determine whether financial transactions are appropriate and whether the accounting for accounts and transactions is accurate. Audits are typically conducted by independent, outside examiners who provide unbiased findings.