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LEGAL ETHICS

Oh, No! The Random Audit

Why honest lawyers need not worry

By Marc Garfinkle

The most common phobia in America is the fear of public speaking; supposedly more prevalent than claustrophobia and fear of heights, combined. These fears may worry lay people, but we lawyers have other bugaboos. For example, the specter of an ethics grievance can paralyze a lawyer. Even attorneys with no reason to anticipate discipline are often shaken by the process and may suffer anxiety, panic attacks, depression, sleeplessness and nausea.

A distance behind our fear of the grievance is our fear of today's topic: the random ethics audit. This is the Sword of Damocles that comes free with a seat at the bar. Many readers will have already experienced one, or even several, random audits during their careers. This article may help attorneys better understand them, so they may approach their own more comfortably and be better able to advise an anxious colleague.

Random audits are distinguished from disciplinary audits, where troubling evidence (such as a grievance or a bounced trust check) requires the Bar to review a lawyer's accounts. The focus, then, will be on tracking funds, locating discrepancies, connecting the dots, and determining the existence and extent of wrongdoing. While the auditors in a disciplinary case will not overlook a lawyer's technical noncompliance, their priority is the serious offense.

In contrast, a random audit for compliance is truly random, despite mumblings you may have heard to the contrary. (The Bar does not need a pretext to review our books and records.) Fortunately, the auditors are more concerned with compliance than with punishment. Attorneys with sloppy books who are confident that there was no comingling or appropriation of client funds should not fear the audit. No matter how bad your books are, the auditor has seen worse. The best strategy is usually to produce the requested records as quickly and completely as you can, subject, of course, to the unique facts of your case, and notwithstanding the advice of your counsel.

Two important facts are operative here. First, cooperation with the auditors or investigators will always be mentioned later as a factor in your favor, but lack of cooperation may result in a separate complaint. Second, the special rules pertaining to ethics proceedings make it a violation for an attorney to file a pleading that is less than fully responsive and complete, or one that is interposed for the purpose of buying time.

The fundamental rule of attorney bookkeeping is that our accounting records be maintained in accordance with "generally accepted accounting practice." This means that, as to deposits, all revenue must be recorded and must be deposited along with a deposit slip. That deposit slip must contain the date and must identify the client or matter by name or file number. A running balance must be kept in the checkbook or on the stub.

When disbursing funds, each check must identify the client or matter by name or file number. The check and stub or checkbook should also indicate the check number and, ideally, the purpose of the check. At the same time, the amount of each check should be deducted, and a running balance entered on the check stub or checkbook.

In the case of an attorney trust account transaction, the deposit or disbursement should be entered on the individual trust ledger sheet or card. The running balances on the ledger cards should "zero out" for each matter when completed, and the total of all client sub-account balances must equal the balance in trust. An allowance is made for money we keep in that account to protect against bank charges which otherwise might cause the inadvertent invasion of client funds. Attorneys are sometimes surprised to learn that this financial "cushion" may be *no more than* $250. An account that does not "zero out" will likely result in a violation.

This bookkeeping process allows us to demonstrate what is called "three-way reconciliation" of our trust accounts. This is the heart of most random audits. Much of the "audit anxiety" affecting *honest* lawyers stems from the production of reconciliations. In solo and smaller practices, reconcili-

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ations are often not current or, for a host of flimsy reasons, have never been done. This is silly. For accountants and bookkeepers, the task of preparing three-way reconciliations is usually easy.

For some reason, perhaps parsimony, many solos and small firms prefer to do these reconciliations themselves. This is often a mistake and frequently more expensive than the preventive measure would have been. The standard attorney bookkeeping software is fine, but if your practice is characterized by many trust transactions, then the need for an accountant should be apparent. If your trust account is not busy, then the cost of an accountant won't be burdensome. If you decide to outsource that function, confirm that your accountant or bookkeeper has experience with the New Jersey rules, or provide him/her with a copy of the audit committee's outline, referred to below.

Much of the "audit anxiety" for honest lawyers can be relieved by knowing that we are not prohibited from having our messed-up books straightened out before the audit. There is every reason to do this. You should keep a copy of the records as they originally were, messed-up and all, as the auditors may wish to review those, too, and then (preferably with a professional) you should prepare whatever records you need to comply. Even if you've never set up separate subaccounts for your clients, you may create them at any time in order to comply. Advise the auditor of what you are doing. You might even be afforded a short extension of time to do this.

Another source of "audit anxiety" is the result of misinformation. Many of us hold retainers or "flat fees" in trust until they have been earned. Then, we bill the trust account and pay ourselves. The fear is that the audit will reveal that the attorney never put the money in trust or deposited such funds into the business account before they had been earned. Holding the money in trust is the procedure mandated by the Model Rules of Professional Conduct. It is also the law in most states and the preferred system at many law firms. New Jersey, however, does not follow the model rule. Our bar only insists that all fees for services be deposited into an attorney account, trust or otherwise, and that the attorney return to the client the unearned part of any fee.

A better-grounded cause of "audit anxiety" exists when a lawyer believes that the accounting records may contain suggestions of misappropriation or comingling or drawing on funds that have not cleared. The lawyer's criminal exposure may far exceed the disciplinary measures available to the bar. In such a case, expect that a thorough investigation, including an expansion of the inquiry, will follow. Be aware, however, that any attempt to retroactively "correct" the record may be met with additional serious charges. Seeking the advice of counsel would be wise.

Despite the fact that honest lawyers have little to fear from a random audit, very few audits conclude without the need for some action by the attorney, usually regarding banking or bookkeeping details. For example, we must produce copies of all checks. Most banks no longer want to return these to us. Moreover, when the bank provides the copies, the bar has set a maximum of two checks per page, front and back. Most banks prefer the five-per-page model, as it is more economical.

There has been some tension with IOLTA-approved banks in this regard. While lawyers and the bankers alike have considered the bar's insistence on two-per-page copies as capricious on the part of the bar, the logic behind it is compelling. In the event of a problem with an attorney account, the bar will want the attorney to produce full-sized copies of the check. At one or two checks per page, the copies are usually full-size. Allowing banks to provide five checks per page of copies would be cumbersome and difficult for later use in bar-related proceedings. Many attorneys have had to change banks in order to insure compliance.

Where there is noncompliance of a technical nature, such as poor record-keeping or nonconforming records from the bank, the bar has a host of remedies available to help attorneys. In most cases, attorneys are given instructions and suggestions to make their record-keeping easy and current. In more extreme cases, a third party may be required to monitor or supervise the record keeping. In all cases, the instructions will be followed up to ensure compliance.

Like nothing else, the random audit makes us consider how we deal with the money we earn and the money with which we are entrusted. Fortunately, everything we need to know is in a letter-sized outline prepared by the Supreme Court's Random Audits Compliance Program. It contains all of the record-keeping requirements under RPC 1.15 and R.1:21–6. Auditors will provide a copy to the attorney at some point, often at the audit. You need not wait. If you don't already have a copy, you may contact the program at (609) 530-5208 and request one.

Colleagues, if you have been scrupulously honest and largely compliant with your books, you have little to fear from the random audit. If not, please look for my ad elsewhere in this paper.■