Help! I'm Being Audited by the Bar



BY LAINIE PATTERSON

our day starts out like any other. Coffee, checking e-mail, sorting through correspondence. And then you see it. The envelope from the Bar marked "CONFI-DENTIAL." Your heart pounds as you discover you have been randomly selected for an examination of the client trust account (IOLTA). If you are part of a large firm, you immediately call the Accounting Department and pass this off like a hot potato. If you are a small firm or solo practitioner, you tell yourself, "Everything is in order. I shouldn't have anything to worry about." But worried you are. What will they find?

This article addresses the three most common violations found, regardless of the firm's size. It provides information regarding the applicable Rules of Professional Conduct (RPC), as well as the preferred remedy. The first, inactive client accounts and aged outstanding checks, you will recognize immediately, but may not know how to fix. The second, failure to reconcile client ledgers, you may not know how to do.

The third, processing overpayments, you may not like, but it's the rule. The ultimate goal is an exam with no reportable findings.

Inactive Client Accounts and Outstanding Checks

Inactive client account balances in the trust account and outstanding checks from the trust are closely related. They both fall under RPC 1.15A(f),1 which addresses a lawyer's duty to promptly pay or deliver client funds to the client or third person. This rule is further clarified by Comment [6],² which charges the lawyer with a duty to take reasonable steps to locate clients for whom the lawyer is holding funds. However, if the client cannot be located, the Unclaimed Property Statute may be the best solution to disbursing these funds. That statute indicates three years is the magic number for declaring property unclaimed.

During an exam, we look for client matters with no activity during the last 12 months, and focus on accounts with no activity in more than three years. Obviously some practice areas, such as probate, have matters go on for years with no activity occurring in the trust. If

the matter is ongoing, or the client has specifically requested the funds remain in trust, it would not be a noted violation. However, if the matter has been inactive more than three years and the client cannot be located with reasonable efforts, Unclaimed Property procedures should be used to disburse the client's funds. The Washington State Department of Revenue website (http://dor.wa.gov) has the forms and instructions to complete this process.

The same is true for aged, outstanding checks in the trust account. During your next bank reconciliation, look for checks dated more than a year in the past, contact the client, and request he cash the check. If it has been lost, stop payment and reissue a new check. (Don't forget to put sufficient funds in the trust account to cover the stop-payment fee.) If you cannot locate the client, use the Unclaimed Property procedures discussed above.

Failure to Reconcile Client

The Rules require trust account records to be reconciled as often as bank statements are received.3 Each month when the bank statement comes, you must reconcile the bank statement to the trust account check register. However, do not stop here. After reconciling the bank statement, add up the individual client balances that are supposed to be in the trust account as of the date of the bank statement, and make sure the total agrees with the check register on that date. For example:

Check register balance

as of 1/31/10	\$500.00
Client A balance on 1/31/10	\$100.00
Client B balance on 1/31/10	\$150.00
Client C balance on 1/31/10	\$250.00
Total	\$500.00

Check register and client totals agree.

If there is a discrepancy, verify that all deposits and withdrawals are noted on the client ledgers. If there is more money in the trust account than the total of client balances, perhaps a deduction for earned fees is on the client ledger, but not yet withdrawn from the account. If there is less money in the bank than the client totals, perhaps a payment was made on behalf of a client but not noted on the client's ledger, or worse, funds were used that had not been deposited.

If you follow these steps and still cannot get the balances to reconcile, contact the WSBA at 206-733-5949 or 800-945-9722, ext. 5949 for additional information on locating the discrepancy. Finally, make sure you keep a copy of this reconciliation with the bank statement.

Processing Overpayments

This is a sore point when found during an exam, so let's deal with it up front. The Rules require overpayments to be deposited into the trust account, with the earned portion withdrawn once the check has cleared.4 However, RPC 1.15A(h)(3) prohibits withdrawing earned fees before the client has been billed through an invoice or statement and has had an opportunity to dispute the bill.5 If the client has not been billed for the work and a reasonable amount of time passed for the client to dispute the bill, the money needs to be in the trust account.

If a client overpays or double-pays, the entire amount must be deposited into trust. Yes, even if the overpayment is only a penny. Yes, even if there is work in progress for that month exceeding the overpayment amount. Yes, even if the client states it is acceptable to keep the balance as a credit. Deposit all



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Tel: 425-452-1600 Fax: 425-452-5570 overpayments into the trust account, and once the deposit has cleared, the earned portion that has already been billed can be withdrawn. Alternatively, the check containing the overpayment can be returned to the client with a request for a new check in the correct amount.

These are the most common violations found during an examination, regardless of the firm's size. Other violations occur, but with less frequency. Clearing these up before the examination happens will go a long way toward having no reportable findings. Remember, auditors are here to help with trust account questions even if you have not been selected for an examination. And calling us with a question will not get you onto the random exam selection list. So have your coffee, check your e-mail, and don't panic if the inevitable letter for an examination shows up one day. The auditors are here to help. If you have additional questions, contact Lainie Patterson at 206-733-5949.

Lainie Patterson is a WSBA auditor and can be reached at lainiep@wsba.org.

NOTES

- RPC 1.15A(f) states: "Except as stated in this Rule, a lawyer must promptly pay or deliver to the client or third person the property which the client or third person is entitled to receive."
- 2. Comment [6] states: "A lawyer has a duty to take reasonable steps to locate a client or third person for whom the lawyer is holding funds or property. If after taking reasonable steps, the lawyer is still unable to locate the client or third person, the lawyer should treat the funds as unclaimed property under the Uniform Unclaimed Property Act, RCW 63.29."
- 3. RPC 1.15A(h)(6) states: "Trust account records must be reconciled as often as bank statements are generated or at least quarterly. The lawyer must reconcile the check register balance to the bank statement balance and reconcile the check register balance to the combined total of all client ledger records." (emphasis added).
- 4. RPC 1.15A(h)(1)(ii) states: "Funds belonging in part to a client or third person and in part presently or potentially to the lawyer must be deposited and retained in a trust account, but any portion belonging to the lawyer must be withdrawn at the earliest reasonable time."
- 5. RPC 1.15A(h)(3), states in part: "The lawyer may withdraw earned fees only after giving reasonable notice to the client of the intent to do so, through a billing statement or other document."