



Activity Review

North Carolina State Board of Certified Public Accountant Examiners

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State Bar Amends Procedures for Exemption from Random Audit of Trust Accounts

Since 1985, the North Carolina State Bar (State Bar) has allowed lawyers to obtain an exemption from the random audit of trust accounts by having their trust accounts preemptively examined and reported on by a CPA.

Although the policy remains in effect, it was recently revised based in part on concerns raised by CPAs and the State Board of CPA Examiners (the Board).

[A licensee expressed concern to the Board staff that the report required by the State Bar for exemption from the random audit of trust accounts was not in accordance with the standards for agreed-upon procedures engagements as set forth in the Statements on Standards for Attestation Engagements.]

After expressing those concerns to the State Bar staff and learning that the State Bar itself was concerned about the effectiveness of the examinations, the Board staff worked with the State Bar to create an agreed-upon procedures report that follows the standards, as well as an engagement letter to be used when auditing trust accounts.

In addition to developing a report that is in accordance with

standards, the State Bar included in the agreed-upon procedures report the requirement for the CPA to report all specific findings where the lawyer client failed to comply with the State Bar's rules governing trust accounts.

Adding that requirement provides the State Bar with more detail about trust account rule violations and allows the State Bar, not the CPA, to determine the severity of the violations and whether further action is warranted.

The State Bar will only accept agreed-upon procedures reports and no longer accepts opinion-type audit reports in conjunction with engagements performed on trust accounts when a lawyer is attempting to obtain an exemption from the Bar's random audit requirements.

A copy of the NC State Bar *Journal* article, "North Carolina State Bar Amends Procedures for Exemption from Random Audit of Trust Accounts," which explains the amended procedure in more detail, is posted on the Board's website, www.nccpaboard.gov.

Also available are copies of the required engagement letter, the required agreed-upon procedures

to be performed, and the required lawyer's representation form for agreed-upon procedure engagements involving the lawyer's trust accounts.

Sample agreed-upon procedures reports are available on the forms page of the NC State Bar website, www.ncbar.gov/PDFs/11a.pdf.

Please contact Peter Bolac, the State Bar's Trust Account Compliance Counsel, at (919) 828-4620 or pbolac@ncbar.gov with questions regarding the revised procedure and forms.

Please contact the Board's Deputy Director, J. Michael Barham, CPA, at (919) 733-4215 or mbarham@nccpaboard.gov with questions about the Statements on Standards for Attestation Engagements as they apply to agreed-upon procedures engagements involving lawyer trust accounts.

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Journal Article

North Carolina State Bar Amends Procedures for Exemption from Random Audit of Trust Accounts

BE IT RESOLVED: Henceforth, it will be the policy of the North Carolina State Bar Council that a lawyer may seek exemption from the random audit of trust accounts authorized by 27 NCAC 1B, Rule .0128(b), by having a CPA or CPA firm perform an examination of his/her trust account pursuant to procedures approved by the council and by having the CPA or CPA firm send a report showing compliance to the North Carolina State Bar. The required period covered by the CPA examination is 12 months. Exemptions are good for 15 months from the date the CPA examination was concluded. A lawyer is prohibited from seeking exemption from the random audit of his/her trust accounts during the quarter in which the lawyer's judicial district bar has been selected for review.

Since the creation of the State Bar's Random Audit Program in 1985, lawyers have, as a matter of policy, been permitted to obtain exemption from selection for random audit by preemptively submitting their trust accounts for examination by certified public accountants. The impetus behind this policy was to allow lawyers to subject their trust accounts to an examination similar to a random audit and thus preclude selection by the Random Audit Program. In theory, this policy would be a win-win for both the State Bar and the lawyer, as it would allow the State Bar auditor to examine other lawyers and let the lawyer have his account examined on his own schedule and by a CPA of his choice. This policy remains in effect; however, the method for seeking and being granted an exemption has been revised.

Previously, a certified public accountant examined the lawyer's trust account and certified that the trust account was in compliance with Rule 1.15 of the Rules of Professional Conduct. The CPA was not required to provide any specific findings, explain the process by which the examination was conducted, or show that any remedial measures were taken to bring the trust account into compliance. When the State Bar received a completed form that showed compliance with Rule 1.15, the lawyer or law firm was exempted from random audit for 15 months. The State Bar received, on average, 35-40 exemption forms a year from law firms of all sizes, including solo practitioners.

Not surprisingly, the reports the State Bar received from the accountants almost always certified that the lawyer's trust account was spotless and had no deficiencies. From our experience with the Random Audit Program and the high percentage of non-compliant trust accounts, we were suspicious that the examinations were either not thorough or not conducted at all.

Additionally, the Board of CPA Examiners expressed reservations with the format and language of our exemption form, and asked us to revise the form to provide more specific requirements for the CPA examination. Given our concerns with the effectiveness of the exemption process and the request from the Board of CPA Examiners, we undertook to revise our forms and procedures for seeking and obtaining an exemption from the Random Audit Program. Descriptions of the new forms are below.

- The Lawyer's Representation Form will require the lawyer to certify to the State Bar that he/she is in compliance with certain trust accounting rules. The form requires the lawyer or law firm to list all of their trust accounts and all of the lawyers covered by the requested exemption. The representation form must be provided to the CPA/CPA firm prior to commencement of the examination and must be attached to the CPA report sent to the North Carolina State Bar.
- The Agreed Upon Procedures Form specifies what records the CPA must examine for the State Bar, how they are to examine the records, and what we want CPAs to report to us. It will make the CPA trust account examination more equivalent to the random audit procedure, and will give the State Bar a more detailed look into the lawyer's compliance with trust accounting rules.
- The Agreed Upon Procedures Engagement Letter is the contract between the lawyer and the CPA that clearly states what the CPA will be examining and how information will be reported to the State Bar.

Finally, the CPA will provide the lawyer and the State Bar with a report detailing the results of the examination pursuant to the agreed upon procedures.

These documents are available in the "Forms" section of the State Bar website, under "Trust Accounting." They are also available in the *Lawyer's Trust Account Handbook*, available online at ncbar.gov/PDFs/TrustAccountHandbook.pdf.

Please note that a lawyer is *prohibited* from seeking exemption from the random audit of his/her trust account(s) during the quarter in which the lawyer's judicial district bar has been selected for review.

The revisions to the procedures regarding exemption from random audit balance the need to advance the State Bar's mission of protecting the public with the desire to allow lawyers to have their accounts audited in a more convenient and less stressful environment. If you have any questions about the new procedure and forms, please contact Peter Bolac, trust account compliance counsel, at (919) 828-4620 or PBolac@ncbar.gov.

Lawyer's Representations Pursuant to CPA Examination of Lawyer's Trust Account(s)
(Lawyer's Representation Form)

Pursuant to the policy of the North Carolina State Bar Council, a lawyer or law firm may seek exemption from the random audit of trust accounts authorized by 27 NCAC 1B, Rule .0128(b) by having a CPA or CPA firm perform an examination pursuant to the *Agreed Upon Procedures for CPA Examination of Lawyers' Trust Accounts* ("Agreed Upon Procedures") to provide information to the lawyer and the North Carolina State Bar regarding the management of the lawyer's trust account(s). As a condition of the exemption, the lawyer must make certain representations regarding the management of client and/or fiduciary funds held in trust. **This representation form and any attachments must be provided to the CPA/CPA firm prior to commencement of the examination and must be attached to the CPA report sent to the North Carolina State Bar.**

_____, hereafter "Lawyer", must attach a list of all bank accounts into which Lawyer has deposited client or other fiduciary funds, including all general, dedicated, and fiduciary trust accounts (Attachment 1), and list all lawyers affiliated with Lawyer's firm to which the exemption would apply (Attachment 2).

Lawyer's Representations

I hereby certify personally and on behalf of any lawyers affiliated with this firm, whose names are listed in Attachment 2, that the account(s) listed in Attachment 1 is/are the only trust account(s) to which such lawyer(s) has had access during the past year, that the records and documents provided to _____, hereafter CPA, are the full and accurate records of the trust accounts and, further, with respect to transactions occurring during the past year, that the following statements are true:

- 1) The lawyer/firm does not maintain any trust accounts outside the state of North Carolina.
- 2) The lawyer/firm is aware of his/her duty to report trust/fiduciary account misappropriation.
- 3) The lawyer/firm retains required trust account records for at least the six (6) year period immediately preceding the lawyer's most recent fiscal year end.
- 4) The lawyer/firm has not used or pledged any entrusted property to obtain credit or other personal financial benefit for the lawyer or any other person other than the legal or beneficial owner of that property.
- 5) Entrusted properties belonging to a client received by the lawyer are promptly identified and labeled as the property of the client.
- 6) Entrusted property not deposited in a trust account or fiduciary account when received by lawyer/firm is placed in a place of safe keeping as soon as practical. Specifically, it is placed in:
 N/A Safe Deposit Box Office Safe Other _____
- 7) The lawyer/firm promptly notifies client of the receipt of any funds, securities or property belonging in whole or in part to client.

8) Where the funds received are a mix of trust funds and non-trust funds, the deposit is made to the trust account intact and the non-trust portion is withdrawn when the bank credits the account upon final settlement or payment of the instrument.

9) Written accountings are provided to client at completion of disbursement or at least annually if funds are held more than twelve (12) months.

10) If the lawyer/ firm holds any property or titles to property as security for the payment of any fees or other obligations owed to the lawyer other than for fees presently owed, the lawyer has indicated that the property or titles to property are held in trust as security for the obligation and not as a completed transfer of ownership to the lawyer.

11) The lawyer/firm has not earned interest on the trust account or fiduciary account which was not distributed to client or to IOLTA.

This the _____ day of _____, 20____.

Lawyer/Firm [print]

By _____
[Signature]

Sworn to and subscribed to before me this the _____ day of _____, 20____

Notary Public

CPA Engagement Letter to Perform Agreed Upon Procedures For Lawyer

{Date}

{CPA/CPA firm name and address}

Dear _____ {Lawyer Name}:

This letter is to explain our understanding of the arrangements for, and the nature and limitations of, the services we are to perform pursuant to the *Agreed Upon Procedures for CPA Examination of Lawyers' Trust Accounts* ("Agreed Upon Procedures") relative to your exemption from the random audit of lawyer trust accounts authorized by 27 NCAC 1B, Rule .0128(b). **Unless specifically indicated in the Agreed Upon Procedures, a reference to a lawyer's trust account(s) includes all general trusts, dedicated trusts, and fiduciary accounts in which the lawyer holds funds for others.** You are solely responsible for compliance with the State Bar's rules regarding lawyers' trust accounts. The Agreed Upon Procedures are included as Attachment A to this letter. A copy of this letter and Attachment A will be sent to the North Carolina State Bar along with our report and your representation form.

Engagement Services

Our engagement will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Because the Agreed Upon Procedures included in Attachment A do not constitute an audit made in accordance with generally accepted auditing standards, we will not express an opinion on any of the specific elements, accounts, or items referred to in our report.

At the conclusion of our engagement, we will submit a report in letter form outlining the procedures performed and our findings resulting from the procedures performed. It is our understanding that any and all exceptions noted will be reported as a finding and that materiality will not be considered by _____ (hereafter "CPA/CPA firm").

Our report will contain a statement that it is intended solely for the use of _____ (hereafter "lawyer/law firm") and the North Carolina State Bar and should not be used for any other purpose.

The procedures that we will perform are not designed and cannot be relied upon to disclose fraud or illegal acts should any exist. However, we will inform the {lawyer/law firm} and the State Bar of any fraud or illegal acts that come to our attention.

Furthermore, the services are not designed to provide assurance on internal control or to identify significant deficiencies or material weaknesses. However, we will communicate to {lawyer/law firm} and the State Bar any significant deficiencies or material weaknesses that become known to us during the course of the engagement.

Conditions and {Lawyer/Law Firm} Responsibilities

The sufficiency of these procedures is solely the responsibility of {lawyer/law firm} and the State Bar. We make no representation regarding the sufficiency of the procedures described above either for the purpose for which these services have been requested or for any other purpose.

If circumstances arise relating to the condition of {lawyer/law firm} records, the availability of appropriate evidence, indications of a significant risk of fraudulent transactions, or misappropriation of assets, which in our professional judgment prevent us from completing the engagement, we retain the unilateral right to take any course of action permitted by professional standards including declining to issue a report, or withdrawal from the engagement.

The assistance to be supplied by your personnel (if any) will be discussed and coordinated with {lawyer/law firm}. The timeliness and accuracy of this assistance is an essential condition to the completion of our services and issuance of our report. We understand that the final agreed upon procedures report is required to be issued no later than _____.

Fees, Costs, and Access to Documentation

Our fees are based on the time required by the individuals assigned to the engagement, plus direct expenses. We anticipate that the total fees will not exceed \$_____. Billings are due upon submission.

In the event we are requested or authorized by {lawyer/law firm} or are required by government regulation, subpoena, or other legal process to produce our documents or our personnel as witnesses with respect to our engagement, {lawyer/law firm} will, so long as we are not a party to the proceeding in which the information is sought, reimburse us for our professional time and expenses as well as the fees and expenses of our counsel incurred in responding to such requests.

This letter constitutes the complete and exclusive statement of agreement between {CPA/CPA firm} and {lawyer/law firm} superseding all proposals, oral or written, and all other communications with respect to the terms of the engagement between the parties.

If this letter defines the engagement as {lawyer/law firm} understands it, please sign and date the enclosed copy and return it to us.

Sincerely,

{Print name, CPA/CPA firm}

Signature

Enclosures

CC: Trust Account Compliance Counsel, NC State Bar

This letter defines the engagement as _____ (Lawyer/law firm) understands it.

(Signature)

(Date)

Agreed Upon Procedures for CPA Examination of Lawyers' Trust Accounts
("Agreed Upon Procedures")

The CPA/CPA firm agrees to perform the following tasks:

- Obtain an executed Lawyer's Representation Form required for exemption from random audit and be alert for any inconsistencies between the representations in the form and the results of the engagement (see next-to-last procedure to report such inconsistencies).
- Review a sample of bank statements, deposit slips, and checks for all trust account(s) to determine that they are labeled as a trust account(s) or fiduciary account(s).
- Review bank statements for the trust account(s) to determine whether the lawyer is using business-sized checks containing an Auxiliary-On-Us field in the MICR line which correlates to the check number.
- Test a sample of original trust account(s) deposit slips to determine if the client name is identified and the source of funds is indicated if source is other than the client (e.g., 3rd party payee).
- Test a sample of amounts received (deposits) to determine if client ledgers are being maintained for each person or entity from whom or for whom trust money is received.
- Test a sample of wire/electronic transfers into or out of the trust account(s) to determine if the client/beneficiary is identified.
- Test a sample of trust account disbursements to determine that the clients (from whose ledgers the funds are drawn) are identified on the checks.
- Review a sample of disbursements to determine that payees are specific persons or entities and that checks are not to "cash" or "bearer."
- In the course of our work, be alert for and report any transactions that do not appear relevant to typical trust receipts and disbursements.
- Review trust account bank statements to determine if check images are legible copies of the front and back and no smaller than 3 x 1 3/16 inches in dimension.
- Review trust account records to confirm that the lawyer has maintained cancelled checks, bank statements, and any other documents, including NSF notices, received from the bank regarding the account for a period of at least 6 years immediately preceding lawyer's most recent fiscal year end.
- Review the trust account(s) to determine that bank charges are paid from the lawyer's operating account or, if not, that the lawyer has deposited a reasonable amount of funds to the trust account specifically to pay for future bank service charges and that a trust account ledger is maintained to account for these funds.

- Examine individual client ledgers (or a computerized report showing all client ledger balances) to determine if any have been overdrawn (i.e. have negative balances).
- Review monthly trust account bank statement reconciliations to confirm that they are being performed.
- Review quarterly reconciliations of the general trust account(s) with the client ledgers pursuant to Rule 1.15-3(d) of the Rules of Professional Conduct.
- Determine whether the lawyer sent the bank a written directive requiring the bank to report to the Bar when an item drawn on the lawyer's trust account(s) is presented for payment against insufficient funds pursuant to Rule 1.15-2(k) of the Rules of Professional Conduct.
- Test a sample of lawyer's accountings required to be sent annually to clients for whom funds have been held for more than one year and for all clients whose funds have been fully disbursed (zero balance ledgers).
- Report on any inconsistencies noted between the Lawyer's Representation Form and the results of the foregoing procedures.
- Utilize the report format provided by the NC State Board of CPA Examiners to describe the work performed and to note any findings.