Anatomy of a Law Practice Audit

By Sharon D. Nelson, Esq. and John W. Simek

Few visitors to a law office are less welcome than law practice auditors. They are generally there because a lawyer is in trouble with the state bar. The lawyer has usually entered into an Agreed Disposition with Terms (there are of course different names in different states) and may have received a private or public reprimand, perhaps even had his or her law license suspended.

The lawyer is commanded by the terms of the Agreement to engage the services of a law practice auditor, pay for those services, open all the computer and paper records of the law firm to the auditor, and to comply with all of the auditor's recommendations. Generally, the auditor will make a follow-up visit to ensure compliance.

The authors serve as law practice auditors in the state of Virginia. When we went to research law practice audits for this article, we were shocked at the dearth of results. There was some material on financial audits of law firms (to ensure profitability and efficiencies), but almost nothing relating to a true law practice management audit. It appears there is a void to fill!

The first step for the auditor is to review the complaint(s) filed against the attorney. Generally, there is the sense that one is seeing only the tip of the iceberg and that there is a massive block of ice just under the waters, which usually proves to be true. The auditor will then review the Agreed Disposition with Terms and will calendar all of the due dates within the document, generally including a date by which the attorney must sign a contract, the date when the first report is due and the date when the follow-up report checking for compliance is due. Sometimes, the attorney may choose from a list of approved auditors and sometimes an auditor is specified. The exact nature of auditing practices varies widely from state to state, so be mindful that this article, while hopefully very illustrative, is Virginia-centric.

There are auditors and auditors. Some auditors essentially conduct an interview with the attorney and then take a brief look at the files and the physical organization of the office. In our judgment, this is a pretty useless exercise. To really audit a law practice takes time and the approach of a detective, ferreting out facts and following leads.

Once the contract has been signed and the retainer received, the auditor makes an appointment. The first step at the meeting is to sit down and interview the attorney. This is always an interesting experience. In general, the attorney will rationalize, dissemble and sometimes tell bald-faced lies. It simply seems to go against human nature to say, "I did what I was charged with, the fault is mine, and there is no excuse for what I did."

These interviews have their comical moments. In one case, a lawyer had a severe nervous tick in his right arm when he lied – very reminiscent of Peter Sellers in Dr. Strangelove. He finally became aware of this giveaway and planted his hand in pocket, but the pocket continued to jerk when he prevaricated. It was pretty hard to keep straight faces!

More often, auditors look for signs of deceit, much as a detective would. There are those who cannot meet your eyes, look skyward for inspiration, blink rapidly, change stories in mid-stream, contradict themselves, stammer, fidget, have rapid changes in voice tone or pitch, excessively clear their throat or touch their face, grow wide-eyed, pale or red (especially if you strike a nerve), use a defensive tone, or become inappropriately humorous or sarcastic. If particular questions elicit this sort of behavior, it helps to identify something the auditor may want to follow up on.

As an example, if you get this sort of behavior when asking if clients other than those who made a bar complaint have also complained about, for instance, a failure to return phone calls, you know you need to check the phone message slips in the files (we still find most solo/small firm lawyers use these). If you ask whether clients are apprised of the lawyer's transfer of trust account funds to the operating account and get an evasive answer or some of the signs listed above, then it's time to zero into a comparison between those transfers and the monthly invoices.

It is wise to open with things that set the lawyer at ease. For instance, the auditor may gather information about staff, law school, year of graduation, the number of years at the current address, whether they rent or own and other non-controversial inquiries. This gives a behaviorial baseline against which to compare when more sensitive questions are asked.

The auditor will then ask the lawyer to explain what happened in the complaint(s) at issue in the Agreed Disposition. This is where it gets really interesting. The lawyer has already been found guilty of committing an ethical violation and yet there is almost always an anguished and tortured attempt to explain, to lessen the degree of fault, to blame other circumstances in their lives, etc. It makes for fascinating listening. No two cases are ever alike, but the answers to this question tend to give quick insight into the attorney's character. In some cases, the attorney has already been found guilty of not cooperating with the disciplinary process by failing to provide the requested documents – and in some cases, they fail to show up for disciplinary hearings.

Follow-up questions about other similar (or different) complaints from clients always evoke a wide array of responses. Some will deny other complaints, hopeful that the auditor will find no evidence of them. Others, guessing that the auditor is going to pore through electronic and paper files, want to admit to other complaints, while generally soft-pedaling the number and the seriousness of the complaints.

Depending on the ethical rules in the state, the auditor will ask how fees are handled, how often the trust account in reconciled, whether engagement letters are used, whether e-mail communications are used with clients, if e-mail communications are addressed in engagement letters, whether there are closing letters, how time is kept, how billing is accomplished, what tickler systems are used, what law office functions are done by software programs, how the return of phone calls and answers to letters and e-mails are monitored, whether the attorney receives or pays any referral fees, etc.

After interviewing the lawyer, it is instructive to interview the lawyer's assistant. This tends to go one of two ways: The assistant is protective of the lawyer and clearly doesn't want to divulge anything – or the assistant is cognizant that the auditor is there on behalf of the Bar and wants to make sure they are telling the truth, whether or not it is to the lawyer's detriment. Even if the assistant wants to protect the lawyer, as they were not in the room during the lawyer interview,

the auditor will usually hear a tale that is somewhat different from the tale the lawyer told, which again points to avenues of possible investigation.

It is important these to investigate computers, including everything from time-keeping to billing to document management – and more. The auditor will specifically look for information involving the cases that gave rise to the complaint(s) and other cases that the attorney may have mentioned during the interview.

Amazingly critical are the paper files, which still rule in most solo and small firms. One of the first things to check is the time-keeping mechanism, usually a book that the lawyer carries about each day. Signs of trouble here? Repeated entries that are meaningless, such as "Researched case" "Reviewed documents" etc. Frequently, there are time entries that are suspicious because they are all in hour or half hour segments. When questioned, almost invariably the attorney will say that he or she made their "best guess" as to time, often because it wasn't recorded contemporaneously. Quite often, the entries are so vague that the client cannot reasonably be expected to understand what the charges are for.

Looking through paper files in a troubled practice, it usually isn't long until you see signs of discontent. There may be threatening telephone messages which the legal assistant has dutifully recorded on pink slips. There may be letters of complaint or threatening legal action, documenting what the writer believes was done wrong in the case. Most frequently, the complaints involve failure to return phone calls or answer letters, excessive fees that the client wasn't expecting, missed filing dates, the failure to show up in court and even showing up in court with incorrect paperwork.

While engagement letters may not be required under the rules, they are certainly desirable as a way of clarifying the scope of work and financial arrangements. If they do not exist, auditors always recommend their use. Likewise, closing letters are helpful in ensuring that the client gets a final understanding that their case has been closed and a financial reconciliation as well – the use of closing letters is always a best practice.

A comic aside: We rarely find any sign of complaints in criminal files. After some discussion, we concluded between ourselves that bad things happen to criminals all the time – getting a rotten lawyer is just one of a long string of misfortunes. On the other hand, complaints in family law cases are legion in number and a fruitful source of possible ethical violations.

It is also useful to look at the files that gave rise to the bar complaints – there are frequently notes and documents that the bar never saw. Also, if the attorney has admitted to other cases where clients were unhappy or where the attorney was sued, those files tend to document attorney misdeeds.

In many cases, just looking around the office can give clues as to why the lawyer's practice is a disaster. Though you would think lawyers in trouble with the bar would tidy up before a law practice management audit, not all of them do. In one notable case, the built-in bookcases were covered with papers and books stacked every which way in great disarray. The attorney's desk was a mess, as were his drawers. Things were simply crammed haphazardly everywhere. The filing cabinet behind his desk held unpaid bills stacked so high that some of them had fallen to the floor. Upon closer inspection, a good many of the bills had not been opened – no good news

to be gleaned from them apparently. Of those that were opened, they were all overdue and some were threatening collection action.

Very often, it is clear that the lawyer's business and personal life are completely intertwined in the credit cards. Payments for guns, home furnishings, vacations, and other clearly non-business expenses are common. And a look at the business tax return and the personal tax return will often make it clear that personal expenses were charged against the business and never adjusted to show up as income on the personal tax return. The CPAs who prepare the returns are often as disingenuous as the attorneys in their tangled explanations of why the returns don't appear to reflect the truth.

In many cases, it is clear that the lawyer simply has no head for business – and in fact, that is often admitted by the lawyer. They are unable to get themselves organized, to establish duplicate tickler systems, to enter time promptly – one lawyer even had trouble getting bills out, sometimes sending them as infrequently as once a quarter. It was no wonder that he had cash flow problems. Another lawyer sent out no bills at all, so his flat fee clients had no way of knowing what they were being charged and when monies were being transferred to from the trust account to the operating account.

In fact, many of these lawyers seem not to known that they are financially drowning. They are unable to determine whether their business is profitable. The financial pressures often make it more tempting to cut corners or to commit overtly unethical acts.

A number of these lawyers were putting unearned monies directly in the operational account rather than the trust account, sometimes in the belief that if they had a document saying that a flat fee was earned upon receipt, they would be ok. Obviously not so – as almost all state rules make very clear. Other simply put monies in the operational account, seemingly oblivious to ethics rules, or perhaps so desperate to make payroll and pay bills that they felt no choice and simply hoped that their acts would go undiscovered.

Reconciliation of trust accounts is pretty rare among these attorneys. Some honestly do not know how to reconcile the accounts and must be taught. Others seem to regard it as a chore and they avoid it. A lot of time is spent simply explaining the clear meaning of the ethics rules and how to comply with them.

Raiding trust accounts, unfortunately, is not uncommon. It is imperative in doing a law practice audit to review all trust accounts. Generally, where an account is being raided, you will see large withdrawals over a fairly short period of time and a look at the invoices (if they exist) will not seem to justify the withdrawals. In many instances, the invoices will not indicate the withdrawals, so the client is completely unaware that funds have been disbursed.

In some cases, long after a case has closed, the client has monies left in their account, but the lawyer stops sending out notices of the credit balance and simply coverts the funds to his or her own usage..

A great deal of evidence is on the computer, increasingly so as time goes on. In almost all cases, the technology environment is not secure, perhaps virus/malware protection has lapsed, perhaps there is no anti-phishing or spyware protection, or perhaps every piece of technology in the often has been left at default settings, well know to those who wish to steal identities or data. In some

cases, lawyers are using software so old that it is effectively obsolete and will not allow them to perform their work competently. Some lawyers even have bootleg (pirated) software, or student versions. Not only is this unethical but the Business Software Alliance has gone after a number of lawyers and law firms in Virginia, with major settlements. Consider that the cost of a single illegal program, under copyright law, can cost the lawyer $150,000. If there is more than one (and there usually is) the potential financial risk is astronomical. Yet, surprisingly, even when told that their software is illegal, the reaction is "So what? Everybody does it." Then the auditor must recite chapter and verse of the ethical rules. They eventually get the message that they are going to have "get legal" or remain in trouble with the bar, but the cavalier attitude to copyright law is disturbing.

Commonly, computer backups are haphazardly made, if at all. Often, they are not encrypted. It is not uncommon to find clients' credit card data, unencrypted, on the computers – worse yet, on paper notes stuck in files. Some attorneys are so dependant on their IT support person that they have no idea how to get into their own routers.

It is impossible to generalize overmuch, as each case is different. Auditors find themselves essentially being detective. Each personality is different and the auditors must get a sense of the person and when they are being led down a garden path. They must note what questions evoke a reaction and make note to checks records relating to the question. What they find in electronic records may lead them to paper records or vice versa. It is challenging work, and almost always multiple ethical violations not contemplated by the original complaint appear as the audit continues.

The approximate onsite audit time is 4-6 hours for the first visit and 2-4 hours for the follow-up audit. Once in a while, a third audit is required. The bulk of the work is studying the electronic and paper records that are brought back to the office and then compiling a detailed report of the results. It is not uncommon for the reports to be 15-20 pages and to contain dozens of recommendations.

The general price range tends to run from $6000-$10,000, which strikes many of these audited attorneys as unfair. Mind you, they are hardly likely to be receptive to auditors no matter what the cost, but as this article notes, there is extensive work that the audit requires - and (in almost every case), the attorney has paid more for his or her counsel – and by a considerable amount.

Most of these attorneys are "salvageable." Poor business practices mean they spend a lot of time scurrying to cover up errors or have to refund monies. In spite of their unethical conduct, many of these attorneys are cheating themselves because they charge flat fees and have no idea how many hours they are working to earn that flat fee. Post-audit, most attorneys report that they are now making money and that their practices are ethically "clean as a whistle." This is of course the desired result.

On the other side of the coin, there are some lawyers who simply need to be in another business because they cannot be trusted to meet the high ethical standards required by the legal profession. Even there, law practice audits are invaluable because they ferret out these lawyers, amassing a body of evidence of their misdeeds upon which Bar Counsel can then act.

We have often said lawyers in lectures that a self-audit is a good thing. Many practitioners are aware of some ethical problems in their practice or in their law firm. Shutting one's eyes to the problems does not resolve them. One thing we salute is the willingness of the Virginia State Bar and its sister bars to assist lawyers who find themselves in trouble – the bar doesn't cavalierly suspend or revoke law licenses. The process is lengthy and serious and every effort is made to allow the lawyer to come into ethical compliance while at the same time protecting the public. It's a delicate balance, but our experience is that the process, while it can always be improved, works pretty doggone well.

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