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ABOUT US

FOR LAWYERS

BAR PROGRAMS

LAWYER DISCIPLINE

NEWS AND PUBLICATIONS

FOR THE PUBLIC

Home [For Lawyers](#) [Trust Accounting](#)

TRUST ACCOUNTING

THE NORTH CAROLINA STATE BAR'S
TRUST ACCOUNT HANDBOOK**Introduction**

On a daily basis, a lawyer in private practice receives, holds and disburses money that belongs to the lawyer's clients and to third parties in conjunction with the representation of clients. Millions of dollars flow through the hands of lawyers while serving clients, making the handling of client funds one of the most significant fiduciary obligations of lawyers to their clients. To reduce the possibility of theft, misappropriation or mishandling of client funds, the North Carolina State Bar established trust accounting standards in Rules 1.15-1, 1.15-2, and 1.15-3 of the Rules of Professional Conduct and implemented a program of random audits of lawyers' trust accounts. This handbook explains the requirements for segregating, safekeeping, and record keeping for client funds, and how the random audit program works. The purpose of the handbook is to answer questions about establishing a trust account, deposits and disbursements from a trust account, record keeping for a trust account, and what to expect when you are selected for audit by the State Bar auditor. If the handbook fails to answer your specific question, please contact the State Bar for further assistance.

Lawyer's Trust Account Handbook (revised December 2014)

Please note: The Lawyer's Trust Account Handbook is being revised to reflect the amendments to Rule 1.15, which were approved by the North Carolina Supreme Court on June 9, 2016. The revisions should be completed in August 2016. For information about the new rules and how to stay in compliance, you can [read an article](#) on page 10 of the Summer 2016 *Journal*.

Reconciliation - Read [Bruno's Top Tips for Tip Top Trust Accounting](#) on reconciliation (from the Fall 2010 *Journal*)

FOR LAWYERS

- ▶ Governing Rules of the State Bar
- ▶ Ethics/Rules of Professional Conduct
- ▶ Continuing Legal Education (CLE)
- ▶ Directories
- ▶ FAQs
- ▶ Forms
- ▶ Professional Organizations
- ▶ [Trust Accounting](#)
- ▶ Helpful Links

ADDITIONAL
RESOURCES

- ▶ Trust Account Handbook
- ▶ Trust Account Reconciliation Sheet
- ▶ Monthly Trust Account Report
- ▶ Quarterly Trust Account Review Report

POPULAR FORMS

- ▶ Attorney Name Change Form

Coming to Terms (and into Compliance) with the Pending Trust Accounting Rule Amendments

BY PETER BOLAC

This past October, the State Bar Council adopted the amendments

on pages 14 to 17 to Rule 1.15 of the Rules of Professional Conduct.

These amendments are now pending before the North Carolina

Supreme Court. If and when the amendments are approved, lawyers must act to ensure their compliance with new requirements. To that end,

notice of any action taken by the Court will be emailed to the membership and posted immediately on the State Bar's website.

After a brief background of the procedural history of the amendment process, this article will explain each rule change, give guidance on how to come into compliance with the new rules, and provide links to sample forms and examples to help lawyers and firms comply with the new rules. Although the rules would become effective immediately upon the Supreme Court's approval, the State Bar understands that becoming 100% compliant with the new rules may take some time.

Background

On October 23, 2015, the council adopted

the proposed amendments to Rule 1.15 of the Rules of Professional Conduct of the North Carolina State Bar. The amendments were the result of a rules review process that began in April 2014 at the behest of then State Bar Vice-President Margaret Hunt. Hunt, as chair of The North Carolina State Bar's Issues Committee, formed a subcommittee in early 2014 to study Rule 1.15 of the Rules of Professional Conduct and determine if any changes should be made to facilitate prevention and early detection of internal theft, and to add clarity to the existing requirements. In addition to examining the existing rules, the

Subcommittee on Trust Account Management was also tasked with developing a procedure whereby a firm with two or more lawyers might designate a firm partner to oversee the firm's general trust accounts. The subcommittee drafted the proposed amendments, the Issues and Executive Committees approved the amendments, and the full council approved the amendments for publication in the *Journal*. The first set of proposed rule amendments was published in the Spring 2015 edition of the State Bar *Journal*. In response to comments received after publication, the council published additional changes



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in the Summer 2015 *Journal*. Based on comments received after the second publication, additional changes were approved and the rules were published a third and final time in the Fall 2015 *Journal*. No adverse comment was received after that publication and the amendments were adopted by the council.

Explanation of Amendments to Rule 1.15

(Items in bold marked with *** would require action in order to remain compliant)

Rule 1.15-1 Definitions

Rule 1.15-1(a): Adds credit unions to the definition of “bank.” This change allows lawyers and law firms to maintain trust accounts at credit unions. Credit unions were removed from the definition in 2008 due to concerns about whether deposit insurance applied to individual clients in a trust account maintained at a credit union in the same way FDIC insurance applied to trust accounts maintained at banks. The deposit insurance concern was addressed, and credit unions are now eligible to offer IOLTA accounts to North Carolina lawyers.

Rule 1.15-1(k): Adds language excluding “professional fiduciary services” from the def-

inition of “legal services.” The converse of this exclusion already exists in Rule 1.15-1(l). Lawyers who provide “legal services” have different requirements than lawyers who only provide “professional fiduciary services,” so a clear distinction is important.

Rule 1.15-2 General Rules

Rule 1.15-2(f): This rule change clarifies that lawyers may not hold funds for third parties in the trust account unless they were received in connection with legal services or professional fiduciary services.

Rule 1.15-2(g): This one-word change of “may” to “shall” clarifies that a lawyer must promptly remove funds to which the lawyer is or becomes entitled.

Rule 1.15-2(h): This amendment clarifies any confusion caused by the old language, but does not change the substance of the rule. Any item drawn on the trust account must identify (by name, file number, or other information) the client from whose balance the item is drawn. The identification must be made on the item itself, not on a stub or other document.

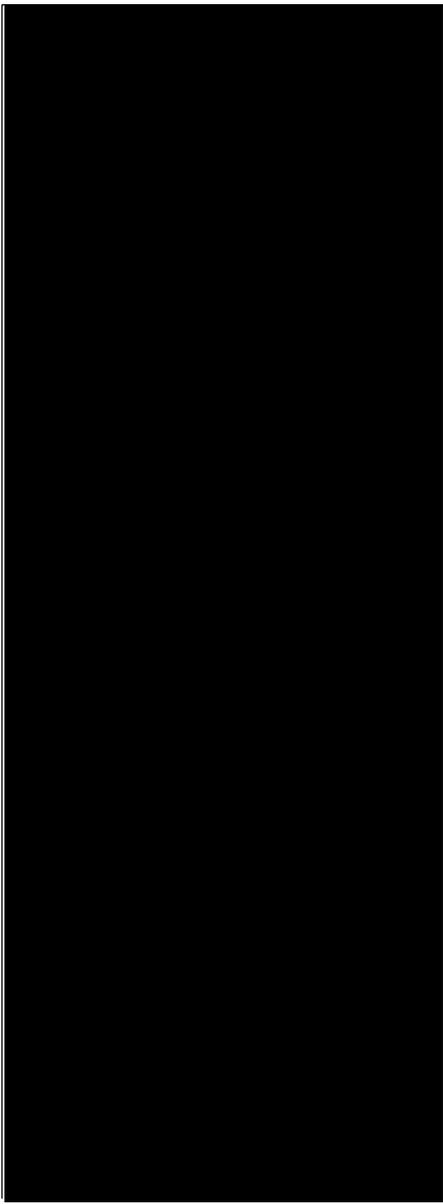
Rule 1.15-2(i): The amendment prohibits cash withdrawals by any means, not just debit cards.

Rule 1.15-2(j): The amendment moves the debit card prohibition from the end of Rule 1.15-2(i) to a standalone paragraph.

(All subsequent paragraphs in Rule 1.15-2 are relettered)

Rule 1.15-2(k): An amendment to the title of the rule clarifies that entrusted funds should not be used or pledged for the personal benefit of the lawyer or a third party.

Rule 1.15-2(p): This is a substantive amendment to the lawyer’s duty to report misappropriation or misapplication of entrusted property. While confirming that intentional theft or fraud must be reported immediately, this amendment removes the reporting requirement for unintentional and inadvertent misapplications of entrusted funds *if* the misapplication is discovered and rectified on or before the lawyer’s next quarterly reconciliation. The amendment also clarifies that to satisfy the lawyer’s duty to self-report, the lawyer may reveal confidential information otherwise protected by Rule 1.6. Comment [26] further explains the lawyer’s duty to report misappropriation or misapplication of entrusted funds, and a comment to **Rule 8.3, *Reporting Professional Misconduct***, clarifies that a



lawyer has a duty to report misappropriation or misapplication of trust funds regardless of whether the lawyer is reporting the lawyer's own conduct or that of another person.

*****Rule 1.15-2(s)** – This amendment requires that checks drawn on a trust account must be signed by a lawyer, or by an employee who is not responsible for reconciling the trust account and who is supervised by a lawyer. Further, any lawyer or employee who exercises signature authority must take a one-hour trust account management CLE course before exercising such authority. The rule also prohibits the use of signature stamps, preprinted signature lines, or electronic signatures on trust account checks. As Comment [24] explains, “[d]ividing the check signing and reconciliation

responsibilities makes it more difficult for one employee to hide fraudulent transactions. Similarly, signature stamps, preprinted signature lines on checks, and electronic signatures are prohibited to prevent their use for fraudulent purposes.” ***

(Note: To ease the burden of the CLE requirement, the State Bar has partnered with the North Carolina Bar Association to produce an online trust accounting training CLE series that will be available for free to all North Carolina lawyers. More information on the CLE program will be provided as it becomes available.)

Rule 1.15-3 Records and Accountings

Rule 1.15-3(b) and (c): Lawyers can now electronically maintain images of cancelled checks and other items instead of hard copies because new Rule 1.15-3(j) allows lawyers to maintain records electronically provided certain requirements are met. Rule 1.15-3(b) also amends language to mirror the clarification in Rule 1.15-2(h).

*****Rule 1.15-3(d)**: Explains how a quarterly reconciliation should be performed and adds the requirement that a lawyer must review, sign, and date a copy of all monthly and quarterly trust account reconciliations. ***

*****Rule 1.15-3(i)**: The new rule requires the lawyer to 1) review bank statements and cancelled checks for each trust account and fiduciary account on a monthly basis, 2) at least quarterly, review a random sample of a minimum of three transactions (statement of costs and receipts, client ledger, and cancelled checks) to ensure that disbursements were properly made, 3) resolve any discrepancies discovered during the reviews within ten days, and 4) sign, date, and retain a copy of a report documenting the monthly and quarterly review process, including a description of the review, the transactions sampled, and any remedial action taken. ***

The monthly review will disclose: a) forged signatures, b) improper payees or checks to cash, and c) unexplained gaps in check numbers indicating checks may have gone missing. The lawyer can verify that checks from the general trust account properly identify on the face of the check the client from whose balance the check is drawn. The lawyer can also examine the back of cleared checks to ensure proper endorsements were made.

Random review of ledgers and settlement statements helps to ensure that the ledgers

and statements accurately reflect the transaction. This type of review can uncover improper disbursements, incorrect deposits, and substituted or unissued checks. While the random review requirement may not uncover any improper activity, it will most definitely act as a deterrent to employee malfeasance.

Rule 1.15-3(j): The new rule provides for the retention of records in electronic format provided 1) records otherwise comply with Rule 1.15-3, including any signature requirements, 2) records can be printed on-demand, and 3) records are regularly backed up by an appropriate storage device.

Rule 1.15-4 Alternative Trust Account Management Procedure for Multi-Member Firm

This new rule permits, but does not require, a law firm to designate a trust account oversight officer (TAOO) to oversee the administration of the firm's general trust accounts. This is an optional rule; firms are **not required** to designate a TAOO. However, if the firm would like to designate a TAOO, it must follow the following guidelines.

Rule 1.15-4(a): permits a firm to designate a partner as the firm's TAOO. A partner is defined as a member of a partnership, a shareholder in a law firm organized as a professional corporation, or a member of an association authorized to practice law. The designation must be in writing, and signed by the TAOO and the managing lawyers of the firm. A law firm may designate more than one partner as a TAOO. Comment [27] explains the supervisory requirements for delegation under Rule 5.1, and states that “delegation consistent with the requirements of Rule 1.15-4 is evidence of a lawyer's good faith effort to comply with Rule 5.1.”

Rule 1.15-4(b): Lawyers remain individually responsible for the oversight of any dedicated trust account and fiduciary account associated with a legal matter for which the lawyer is primary legal counsel, and must continue to review disbursements, ledgers, and balances for any such account. Comments [28] and [29] further explain the limitations on delegation.

Rule 1.15-4(c): Explains the initial and annual training requirements of a TAOO. Comment [29] further explains this requirement.

Rule 1.15-4(d): Sets forth what must be included in the written agreement designating a lawyer as a TAOO.

Rule 1.15-4(e): Requires any firm that designates a TAOO to have a written policy detailing the firm's trust account management procedures.

Coming into Compliance

While most of the proposed amendments are stylistic and nonsubstantive, lawyers will need to become compliant with the procedural changes and additional review requirements. The following checklist and sample forms, which can be found online at ncbar.gov/for-lawyers/forms, should ensure compliance with the new requirements if they are approved by the Supreme Court.

Compliance Checklist

___ 1. All trust account checks are signed by a lawyer, or by an employee who is not responsible for reconciling the trust account and who is supervised by a lawyer.

___ 2. Any person with signatory authority on the trust account has taken a one-hour trust account management CLE (within the last three years).

NOTE: Proof of completion of the CLE requirement will not need to be sent to the

State Bar, but should be retained and will be checked during a random audit.

___ 3. No trust account checks are signed using signature stamps, pre-printed signature lines, or electronic signatures.

___ 4. All reconciliations are reviewed, signed, and dated by a lawyer.

___ 5. A lawyer reviews the bank statements and cancelled checks for all trust and fiduciary accounts on a monthly basis and a report is created documenting the review.

___ 6. At least quarterly, a lawyer reviews a random sample of at least three transactions (selected by the lawyer) to ensure that disbursements were properly made by reviewing the statement of costs and receipts, client ledgers, and cancelled checks for each transaction. Transactions should include multiple disbursements where available. A report is created documenting the lawyer's review.

___ 7. All reports are signed and dated by a lawyer.

___ 8. Any discrepancy discovered during reconciliations or reviews is investigated and resolved within 10 days.

The State Bar has created forms for

lawyers and law firms to conduct the required monthly and quarterly trust account reviews and reconciliations. Although recommended, lawyers will not be required to use the State Bar forms if they have an alternate method of ensuring compliance. Proper completion of the State Bar's forms should ensure a lawyer's compliance with all of the monthly and quarterly reconciliation and review requirements.

Conclusion

The proposed amendments to the trust account rules are the product of a two-year effort that involved public comment and multiple revisions. While the proposed review requirements may seem onerous, the minimal extra work involved should help deter and prevent costly mistakes and thefts that could jeopardize a lawyer's practice and pocketbook. For questions about the proposed amendments or any other trust account questions, please contact Peter Bolac at PBolac@ncbar.gov or (919) 828-4620. ■

Peter Bolac is the trust account compliance counsel for the North Carolina State Bar.

AMENDMENTS TO THE RULES OF PROFESSIONAL CONDUCT OF THE NORTH CAROLINA STATE BAR

The following amendments to the Rules and Regulations and the Certificate of Organization of the North Carolina State Bar were duly adopted by the council of the North Carolina State Bar at its quarterly meeting on October 23, 2015.

BE IT RESOLVED by the Council of the North Carolina State Bar that the Rules of Professional Conduct of the North Carolina State Bar, as particularly set forth in 27 N.C.A.C. 2, be amended as follows (additions are underlined, deletions are interlined except where noted):

27 N.C.A.C. 2, North Carolina Rules of Professional Conduct

Rule 1.15 Safekeeping Property

This rule has ~~three~~ four subparts: Rule 1.15-1, Definitions; Rule 1.15-2, General Rules; ~~and~~ Rule 1.15-3, Records and Accountings; and Rule 1.15-4, Trust Account Management in Multiple-Lawyer Firm. The subparts set forth the requirements for preserving client property, including the requirements for preserving client property in a lawyer's trust account. The comment for all ~~three~~ four subparts as well as the annotations appear after the text for Rule ~~1.15-3~~ 1.15-4.

Rule 1.15-1 Definitions

For purposes of this Rule 1.15, the following definitions apply:

(a) "Bank" denotes a bank, ~~or~~ savings and loan association, or credit union chartered under North Carolina or federal law.

(b) ...

(k) "Legal services" denotes services (other than professional fiduciary services) rendered by a lawyer in a client-lawyer relationship.

Rule 1.15-2 General Rules

(a) Entrusted Property.

...

(f) Segregation of Lawyer's Funds. Funds in Accounts. A trust or fiduciary account may only hold entrusted property. Third party funds that are not received by or placed under the control of the lawyer in connection with the performance of legal services or professional fiduciary services may not be deposited or maintained in a trust or fiduciary account. Additionally, ~~No~~ no funds belonging to a ~~the~~

lawyer shall be deposited or maintained in a trust account or fiduciary account of the lawyer except:

(1) funds sufficient to open or maintain an account, pay any bank service charges, or pay any tax levied on the account; or

(2) funds belonging in part to a client or other third party and in part currently or conditionally to the lawyer.

(g) Mixed Funds Deposited Intact. When funds belonging to the lawyer are received in combination with funds belonging to the client or other persons, all of the funds shall be deposited intact. The amounts currently or conditionally belonging to the lawyer shall be identified on the deposit slip or other record. After the deposit has been finally credited to the account, the lawyer ~~may~~ shall withdraw the amounts to which the lawyer is or becomes entitled. If the lawyer's entitlement is disputed, the disputed amounts shall remain in the trust account or fiduciary account until the dispute is resolved.

(h) Items Payable to Lawyer. Any item drawn on a trust account or fiduciary account for the payment of the lawyer's fees or expenses shall be made payable to the lawyer and shall indicate on the item by client name, file number, or other identifying information the client from whose balance ~~on which~~ the item is drawn. Any item that does not include ~~exp~~ sure this information may not be used to withdraw funds from a trust account or a fiduciary account for payment of the lawyer's fees or expenses.

(i) No Bearer Items. No item shall be drawn on a trust account or fiduciary account made payable to cash or bearer and no cash shall be withdrawn from a trust account or fiduciary account by any means ~~of a debit card~~.

(j) Debit Cards Prohibited. Use of a debit card to withdraw funds from a general or dedicated trust account or a fiduciary account is prohibited.

(~~k~~) (k) No Personal Benefit to Lawyer or Third Party. A lawyer shall not use or pledge any entrusted property to obtain credit or other personal benefit for the lawyer or any person other than the legal or beneficial owner of that property.

(~~l~~) (l) Bank Directive.

...

[Relettering intervening paragraphs.]

(~~p~~) (p) Duty to Report Misappropriation. A lawyer who discovers or reasonably believes that entrusted property has been misappropriated or misapplied shall promptly inform the

trust account compliance counsel (TACC) in the North Carolina State Bar Office of Counsel. Discovery of intentional theft or fraud must be reported to the TACC immediately. When an accounting or bank error results in an unintentional and inadvertent use of one client's trust funds to pay the obligations of another client, the event must be reported unless the misapplication is discovered and rectified on or before the next quarterly reconciliation required by Rule 1.15-3(d)(1). This rule requires disclosure of information otherwise protected by Rule 1.6 if necessary to report the misappropriation or misapplication.

(~~q~~) (q) Interest on Deposited Funds.

...

(~~r~~) (r) Abandoned Property.

(s) Signature on Trust Checks.

(1) Checks drawn on a trust account must be signed by a lawyer, or by an employee who is not responsible for performing monthly or quarterly reconciliations and who is supervised by a lawyer. Prior to exercising signature authority, a lawyer or supervised employee shall take a one-hour trust account management continuing legal education (CLE) course approved by the State Bar for this purpose. The CLE course must be taken at least once for every law firm at which the lawyer or the supervised employee is given signature authority.

(2) Trust account checks may not be signed using signature stamps, preprinted signature lines on checks, or electronic signatures.

Rule 1.15-3 Records and Accountings

(a) Check Format...

(b) Minimum Records for Accounts at Banks. The minimum records required for general trust accounts, dedicated trust accounts, and fiduciary accounts maintained at a bank shall consist of the following:

(1) ...;

(2) all cancelled checks or other items drawn on the account, or ~~printed~~ digital images thereof furnished by the bank, showing the amount, date, and recipient of the disbursement, and, in the case of a general trust account, the client name, file number, or other identifying information of the client from whose ~~client~~ balance ~~against which~~ each item is drawn, provided, that:...

(c) Minimum Records for Accounts at

Other Financial Institutions.

(1)...;

(2) a copy of all checks or other items drawn on the account, or ~~printed~~ digital images thereof furnished by the depository, showing the amount, date, and recipient of the disbursement, provided, that the images satisfy the requirements set forth in Rule 1.15-3(b)(2);

(d) Reconciliations of General Trust Accounts.

(1) Quarterly Reconciliations. ~~At least quarterly, the individual client balances shown on the ledger of a general trust account must be totaled and reconciled with the current bank statement balance for the trust account as a whole. For each general trust account, a reconciliation report shall be prepared at least quarterly. Each reconciliation report shall show all of the following balances and verify that they are identical:~~

(A) The balance that appears in the general ledger as of the reporting date;

(B) The total of all subsidiary ledger balances in the general trust account, determined by listing and totaling the positive balances in the individual client ledgers and the administrative ledger maintained for servicing the account, as of the reporting date; and

(C) The adjusted bank balance, determined by adding outstanding deposits and other credits to the ending balance in the monthly bank statement and subtracting outstanding checks and other deductions from the balance in the monthly statement.

(2) Monthly Reconciliations.

...

(3) The lawyer shall review, sign, date, and retain a record copy of the reconciliations of the general trust account for a period of six years in accordance with Rule 1.15-3(g).

(e) Accountings for Trust Funds.

...

(i) Reviews.

(1) Each month, for each general trust account, dedicated trust account, and fiduciary account, the lawyer shall review the bank statement and cancelled checks for the month covered by the bank statement.

(2) Each quarter, for each general trust account, dedicated trust account, and fiduciary account, the lawyer shall review the statement of costs and receipts, client

ledger, and cancelled checks of a random sample of representative transactions completed during the quarter to verify that the disbursements were properly made. The transactions reviewed must involve multiple disbursements unless no such transactions are processed through the account, in which case a single disbursement is considered a transaction for the purpose of this paragraph. A sample of three representative transactions shall satisfy this requirement, but a larger sample may be advisable.

(3) The lawyer shall take the necessary steps to investigate, identify, and resolve within ten days any discrepancies discovered during the monthly and quarterly reviews.

(4) A report of each monthly and quarterly review, including a description of the review, the transactions sampled, and any remedial action taken, shall be prepared. The lawyer shall sign, date, and retain a copy of the report and associated documentation for a period of six years in accordance with Rule 1.15-3(g).

(j) Retention of Records in Electronic Format.

Records required by Rule 1.15-3 may be created, updated, and maintained electronically, provided

(1) the records otherwise comply with Rule 1.15-3, to wit: electronically created reconciliations and reviews that are not printed must be reviewed by the lawyer and electronically signed using a "digital signature" as defined in 21 CFR 11.3(b)(5);

(2) printed and electronic copies of the records in industry-standard formats can be made on demand; and

(3) the records are regularly backed up by an appropriate storage device.

Rule 1.15-4, Alternative Trust Account Management Procedure for Multi-Member Firm [NEW RULE: bold, underlined font is not used]

(a) Trust Account Oversight Officer (TAOO).

Lawyers in a law firm of two or more lawyers may designate a partner in the firm to serve as the trust account oversight officer (TAOO) for any general trust account into which more than one firm lawyer deposits trust funds. The TAOO and the partners of the firm, or those with comparable managerial

authority (managing lawyers), shall agree in writing that the TAOO will oversee the administration of any such trust account in conformity with the requirements of Rule 1.15, including, specifically, the requirements of this Rule 1.15-4. More than one partner may be designated as a TAOO for a law firm.

(b) Limitations on Delegation.

Designation of a TAOO does not relieve any lawyer in the law firm of responsibility for the following:

(1) oversight of the administration of any dedicated trust account or fiduciary account that is associated with a legal matter for which the lawyer is primary legal counsel or with the lawyer's performance of professional fiduciary services; and

(2) review of the disbursement sheets or statements of costs and receipts, client ledgers, and trust account balances for those legal matters for which the lawyer is primary legal counsel.

(c) Training of the TAOO.

(1) Within the six months prior to beginning service as a TAOO, a lawyer shall,

(A) read all subparts and comments to Rule 1.15, all formal ethics opinions of the North Carolina State Bar interpreting Rule 1.15, and the North Carolina State Bar *Trust Account Handbook*;

(B) complete one hour of accredited continuing legal education (CLE) on trust account management approved by the State Bar for the purpose of training a lawyer to serve as a TAOO;

(C) complete two hours of training (live, online, or self-guided) presented by a qualified educational provider on one or more of the following topics: (i) financial fraud, (ii) safeguarding funds from embezzlement, (iii) risk assessment and management for bank accounts, (iv) information security and online banking, or (v) accounting basics; and

(D) become familiar with the law firm's

accounting system for trust accounts.

(2) During each year of service as a TAOO, the designated lawyer shall attend one hour of accredited continuing legal education (CLE) on trust account management approved by the State Bar for the purpose of training a TAOO or one hour of training, presented by a qualified educational provider, on one or more of the subjects listed in paragraph (c)(1)(C).

(d) Designation and Annual Certification.

The written agreement designating a lawyer as the TAOO described in paragraph (a) shall contain the following:

(1) A statement by the TAOO that the TAOO agrees to oversee the operation of the firm's general trust accounts in compliance with the requirements of all subparts of Rule 1.15, specifically including the mandatory oversight measures in paragraph (e) of this rule;

(2) Identification of the trust accounts that the TAOO will oversee;

(3) An acknowledgement that the TAOO has completed the training described in paragraph (c)(1) and a description of that training;

(4) A statement certifying that the TAOO understands the law firm's accounting system for trust accounts; and

(5) An acknowledgement that the lawyers in the firm remain professionally responsible for the operation of the firm's trust accounts in compliance with Rule 1.15.

Each year on the anniversary of the execution of the agreement, the TAOO and the managing lawyers shall execute a statement confirming the continuing designation of the lawyer as the TAOO, certifying compliance with the requirements of this rule, describing the training undertaken by the TAOO as required by paragraph (c)(2), and reciting the statements required by subparagraphs (d)(1), (2), (4), and (5). During the lawyer's tenure as TAOO and for six years thereafter, the agreement and all subsequent annual statements shall be maintained with the trust account records (*see* Rule 1.15-3(g)).

(e) Mandatory Oversight Measures.

In addition to any other record keeping or accounting requirement set forth in Rule 1.15-2 and Rule 1.15-3, the firm shall adopt a written policy detailing the firm's trust account management procedures which shall annually be reviewed, updated, and signed by the TAOO and the managing lawyers. Each version of the policy shall be retained for the min-

imum record keeping period set forth in Rule 1.15-3(g).

Comment [to follow Rule 1.15-4]

[1]...

Responsibility for Records and Accountings [16]...

[17] The rules permit the retention of records in electronic form. A storage device is appropriate for backing up electronic records if it reasonably assures that the records will be recoverable despite the failure or destruction of the original storage device on which the records are stored. For a discussion of storage methods not solely under the control of the lawyer, see 2011 FEO 6.

~~[17]~~[18] Many businesses....

[Renumbering the following paragraphs.]

Fraud Prevention Measures

[23] The mandatory monthly and quarterly reviews and oversight measures in Rule 1.15-3(i) facilitate early detection of internal theft and early detection and correction of errors. They are minimum fraud prevention measures necessary for the protection of funds on deposit in a firm trust or fiduciary account from theft by any person with access to the account. Internal theft from trust accounts by insiders at a law firm can only be timely detected if the records of the firm's trust accounts are routinely reviewed. For this reason, Rule 1.15-3(i)(1) requires monthly reviews of the bank statements and cancelled checks for all general, dedicated, and fiduciary accounts. In addition, Rule 1.15-3(i)(2) requires quarterly reviews of a random sample of three transactions for each trust account, dedicated trust account, and fiduciary account including examination of the statement of costs and receipts, client ledger, and cancelled checks for the transactions. Review of these documents will enable the lawyer to verify that the disbursements were made properly. Although not required by the rule, a larger sample than three transactions is advisable to increase the likelihood that internal theft will be detected.

[24] Another internal control to prevent fraud is found in Rule 1.15-2(s), which addresses the signature authority for trust account checks. The provision prohibits an employee who is responsible for performing the monthly or quarterly reconciliations for a trust account from being a signatory on a check for that account. Dividing the check signing and reconciliation responsibilities makes it more difficult for one

employee to hide fraudulent transactions. Similarly, signature stamps, preprinted signature lines on checks, and electronic signatures are prohibited to prevent their use for fraudulent purposes.

[25] In addition to the recommendations in the North Carolina State Bar Trust Account Handbook (see the chapter on Safeguarding Funds from Embezzlement), the following fraud prevention measures are recommended:

(1) Enrolling the trust account in an automated fraud detection program;

(2) Implementation of security measures to prevent fraudulent wire transfers of funds;

(3) Actively maintaining end-user security at the law firm through safety practices such as strong password policies and procedures, the use of encryption and security software, and periodic consultation with an information technology security professional to advise firm employees; and

(4) Insuring that all staff members who assist with the management of the trust account receive training on and abide by the security measures adopted by the firm.

Lawyers should frequently evaluate whether additional fraud control measures are necessary and appropriate.

Duty to Report Misappropriation or Misapplication

[26] A lawyer is required by Rule 1.15-2(p) to report to the trust account compliance counsel of the North Carolina State Bar Office of Counsel if the lawyer knows or reasonably believes that entrusted property, including trust funds, has been misappropriated or misapplied. The rule requires the reporting of an unintentional misapplication of trust funds, such as the inadvertent use of one client's funds on deposit in a general trust account to pay the obligations of another client, unless the lawyer discovers and rectifies the error on or before the next scheduled quarterly reconciliation. A lawyer is required to report the conduct of lawyers and nonlawyers as well as the lawyer's own conduct. A report is required regardless of whether information leading to the discovery of the misappropriation or misapplication would otherwise be protected by Rule 1.6. If disclosure of confidential client information is necessary to comply with this rule, the lawyer's disclosure should

be limited to the information that is necessary to enable the State Bar to investigate. *See* Rule 1.6, cmt. [15].

Designation of a Trust Account Oversight Officer

[27] In a firm with two or more lawyers, personal oversight of all of the activities in the general trust accounts by all of the lawyers in the firm is often impractical. Nevertheless, any lawyer in the firm who deposits into a general trust account funds entrusted to the lawyer by or on behalf of a client is professionally responsible for the administration of the trust account in compliance with Rule 1.15 regardless of whether the lawyer directly participates in the administration of the trust account. Moreover, Rule 5.1 requires all lawyers with managerial or supervisory authority over the other lawyers in a firm to make reasonable efforts to ensure that the other lawyers conform to the Rules of Professional Conduct. Rule 1.15-4 provides a procedure for delegation of the oversight of the routine administration of a general trust account to a firm partner, shareholder, or member (*see* Rule 1.0(h)) in a manner that is professionally responsible. By identifying, training, and documenting the appointment of a trust account oversight officer (TAOO) for the law firm, the lawyers in a multiple-lawyer firm may responsibly delegate the routine administration of the firm's general trust accounts to a qualified lawyer. Delegation consistent with the requirements of Rule 1.15-4 is evidence of a lawyer's good faith effort to comply with Rule 5.1.

[28] Nevertheless, designation of a TAOO does not insulate from professional discipline a lawyer who personally engaged in dishonest or fraudulent conduct. Moreover, a lawyer having actual or constructive knowledge of dishonest or fraudulent conduct or the mismanagement of a trust account in violation of the Rules of Professional Conduct by any firm lawyer or employee remains subject to professional discipline if the lawyer fails to promptly take reasonable remedial action to avoid the consequences of such conduct including reporting the conduct as required by Rule 1.15-2(p) or Rule 8.3. *See also* Rule 5.1 and Rule 5.3.

Limitations on Delegation to TAOO

[29] Despite the designation of a TAOO pursuant to Rule 1.15-4, each lawyer in the firm remains professionally responsible for the trust account activity associated with the legal matters for which the lawyer provides

representation. Therefore, for each legal matter for which the lawyer is primary counsel, the lawyer must review and approve any disbursement sheet or settlement statement, trust account entry in the client ledger, and trust account balance associated with the matter. Similarly, a lawyer who establishes a dedicated trust account or fiduciary account in connection with the representation of a client is professionally responsible for the administration of the dedicated trust account or fiduciary account in compliance with Rule 1.15.

Training for Service as a TAOO

[30] A qualified provider of the educational training programs for a TAOO described in Rule 1.15-4(c)(1)(C) need not be an accredited sponsor of continuing legal education programs (*see* 27 NCAC 1D, Rule .1520), but must be knowledgeable and reputable in the specific field and must offer educational materials as part of its usual course of business. Training may be completed via live presentations, online courses, or self-guided study. Self-guided study may consist of reading articles, presentation materials, or websites that have been created for the purpose of education in the areas of financial fraud, safeguarding funds from embezzlement, risk management for bank accounts, information security and online banking, or basic accounting.

Rule 8.3 Reporting Professional Misconduct

(a) A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the North Carolina State Bar or the court having jurisdiction over the matter.

(b) ...

(c) This Rule does not require disclosure of information otherwise protected by Rule 1.6.

(d) ...

(e) ...

Comment

[1] Self-regulation of the legal profession requires that members of the profession initiate disciplinary investigation when they know of a violation of the Rules of Professional Conduct. Lawyers have a similar obligation with respect to judicial misconduct. An apparently isolated violation may indicate a pattern of misconduct that only a disciplinary investigation can

uncover. Reporting a violation is especially important where the victim is unlikely to discover the offense. A lawyer is not generally required by this rule to report the lawyer's own professional misconduct; however, to advance the goals of self-regulation, lawyers are encouraged to report their own misconduct to the North Carolina State Bar or to a court if the misconduct would otherwise be reportable under this rule. Nevertheless, Rule 1.15-2(p) requires a lawyer to report the misappropriation or misapplication of entrusted property, including trust funds, to the North Carolina State Bar regardless of whether the lawyer is reporting the lawyer's own conduct or that of another person.

[2]... ■