

Ten Commandments of Good Trust Accounts

New lawyers, without any business courses or training, are expected to manage trust accounts with no experience, necessitating this minimal coverage in this chapter.

Trust account violations are the fast track to disbarment. Most trust account violations are the result of poor management rather than evil intent, but will still be punished.

I have written the book *The ABA Guide to Lawyer Trust Accounts*, which is available from the American Bar Association's Law Practice Management Section. You may have used the book in your law school class on Professional Responsibility or used it in a CLE ethics course. There is also a videotape based on the book entitled "Dos and Don'ts of Lawyer Trust Accounting." I highly recommend reviewing both the book and the videotape as being well worth the time. You should have copies of the book and the videotape or DVD in your current library for new lawyers and office manager education. A complimentary copy of the videotape can also be obtained from me.

The book and tape are practical, not theoretical. They present real-life trust account situations faced by real-life clients with real-life problems.

In this book, I have excerpted and modified two parts of the book, entitled "Ten Rules of Good Trust Account Procedures" and "Ten Steps to Good Trust Account Records."

The book contains many forms and form letters you will find helpful.

576

Ten Rules of Good Trust Account Procedures

These ten rules are generic. They will apply anywhere in the United States. It is also important to know your local rules and where to get help locally. Get a copy of your local trust account rules. Learn where they can be found on the Internet. Learn the telephone number of the ethics hot line maintained by your state and local bar associations. Learn the name and phone number and e-mail address of the chair of the bar association ethics committee. Don't be afraid to call as many people as you can when you have a trust account question. There are no foolish or stupid questions when it comes to trust accounts.

If you follow the general rules set forth in this section, you'll go a long way toward staying out of trouble.

Rule 1

Have a trust account.

You can't properly use what you don't have. Be sure it is clearly identified as "Client Trust Account" or use some other language that makes it clear that the account is a trust account. At the very least, you should have a checking client trust account, a client trust safe deposit box, and, when appropriate, a savings client trust account. You should have these even though you have no immediate need for them. When you do need them, you'll be ready to go. The account should be in a federally insured institution within the geographic boundaries of your state.

Rule 2

Never let anyone else sign your trust account.

Never allow another person to sign trust account checks. Do not use mechanical or rubberstamp signatures. Do not allow your bookkeeper or secretary or paralegal or spouse to sign on the account. If the trusted secretary or bookkeeper of many years opts for early retirement down in Brazil some Friday afternoon using the latest trust account deposit as the funding for retirement, you will have civil and disciplinary responsibility, including possible loss of license, if you don't cover the defalcation. An intervening defalcation won't relieve you of responsibility.

Rule 3

Obtain and understand your IOLTA (Interest On Lawyers' Trust Account) rules.

Almost every state, if not every state, requires that lawyers put trust account funds into special accounts where the interest on the account goes to fund some activity such as legal aid or a client trust account protection fund. Your state will have such a mandatory system, your bank will have an agreement with the bar organization, and you will have no option but to use the IOLTA account in most situations. Most IOLTA banks are obligated to notify the bar disciplinary authorities if one of your checks is presented against insufficient funds, even if it doesn't bounce. The bar may send out auditors to investigate your trust account. They may investigate your account for many years, looking for mistakes. They might not limit their investigation to the single transaction that caused the bank to notify the disciplinary authorities.

If the amount of interest is likely to be significant because of the amount of money or the length of time, you should not use an IOLTA account, but rather you should open another special trust account for that one client, giving the interest to the client.

The technical issues of whether the interest does or does not exist and whether or not it has been "taken" and who took it has been up and down before the U.S. Supreme Court at least twice and is beyond the scope of this book.

Rule 4

Immediately notify the client every time something is added to the client's account balance and every time something is taken from the account balance.

For your purposes, assume that the interest does or will exist and must go to IOLTA or to your client, and that your client is entitled to accountings even if they are not entitled to the interest.

Rule 5

Unearned fees and unexpended costs belong in the trust account until earned or spent.

Calling the fees a "retainer" or "deposit" or "advanced funds" doesn't change anything. A nonrefundable or minimum or retainer

fee can only go to your general account and be spent by you if expressly permitted under your local rules; otherwise, it must go to the trust account. When the fee is earned, you must withdraw the earned fee, notifying the client of the withdrawal and the remaining balance in the account. You do not have to wait for client permission to withdraw the funds, but if the client complains about the fee taken, you must immediately return the funds to the account until the disagreement is resolved. In some cases, the disputed fee need not be entirely returned to the trust account if your fee contract is properly written. Costs expended in accordance with your written fee agreement normally need not be returned to the account if the client complains.

Rule 6

Do not commingle your funds with the client funds in the trust account.

Your funds must be removed immediately upon being earned. You probably may leave a "nominal amount" of your funds in the account to cover check printing and miscellaneous charges to the account. Ask your ethics hot line how much you may keep in the account. Typically, the amount allowed, if any, is \$50 to \$200.

The IRS will be especially interested in whether you left earned fees in the account on December 31 in order to defer fees into the next taxable year.

Do not pay personal or office expenses from the trust account even if earned. Transfer the earned fees to the general account and spend from there. If you are going to be writing both business and personal checks from the same account, it is better practice to pay your personal bills from a "personal account."

Rule 7

Be sure you understand the exact nature of the item deposited or credited to the trust account.

Do not write checks against the deposit or make advances out of the account until you are positive the deposit is good. If the deposit bounces or is not honored, checks that clear will be cleared against the funds of other clients and you will have compounded the rules violation and created new rules violations.

Rule 8

Reconcile the bank trust account monthly.

If your CPA or office manager does the reconciliation, be sure you have personally examined the reconciliation and are satisfied that your records and the bank statement reconcile to each other. Trust account responsibility cannot be delegated to anyone else. You and your license to practice are personally responsible for others' mistakes.

Rule 9

Reconcile and examine the individual client trust account balances monthly, and do not delay giving the clients their money.

Trust accounts should liquidate in a month or two in most cases. If the funds are in the account more than ninety days, there should be a good reason. By notifying the clients monthly of the balance in their account, the clients will normally inquire as to when they will get their money.

Rule 10

Be alert to third-party claims.

In some states, failure to honor a third-party lien on trust accounts is an ethics violation. In other states, only trust account disputes between the client and the lawyer are covered by ethics rules. If there is an unresolved dispute between third parties or between you and third parties over funds in the trust account, get an ethics opinion and consider inrerpleading the money into court.

Following these ten rules will help you avoid some of the most common trust account problems.

Ten Steps to Good Trust Account Records

This is a short summary of longer chapters in *The ABA Guide to Lawyer Trust Accounts* describing mandatory trust account records and documents. Use this list for a quick review of how to maintain good trust account records.

1. Get a copy of your current local rules and read them.
2. Give a copy of the rules to your CPA along with a copy of this book and *The ABA Guide to Lawyer Trust Accounts*, so the CPA can set up a "no brainer" system for your office.

3. Be sure you reconcile everything at least monthly.

4. It's all right to use a computer to write checks, record bank deposits, maintain balances, do reconciliations, etc., but be sure you make a hard-copy printout once a month for easy examination at a later time.

5. Maintain a journal. The journal can be the client trust account checkbook. The starting point and main focal point in your system should be the trust account checkbook. A simple, ordinary handwritten checkbook is adequate if you record all deposits, checks, dates, and amounts and explain each item. This will be the source document for all subsequently prepared required records.

6. Keep a client ledger. This is a trust account term, not an accounting term. It is the statutory name (in many states) for a simple running balance by client with all checks, disbursements, dates, amounts explanations, etc., on the card with a running balance calculated after each transaction.

7. Track client balances. This is simply a list of every client trust account balance as of month's end by client name and amount. The total of this list should equal the total of all the individual ledger cards.

8. Do regular bank reconciliations. This is nothing more than the old-fashioned bank reconciliation found on the back of most bank statements on which you reconcile cash per checkbook to cash per bank statement.

9. Do regular triple reconciliations. To be in perfect balance, the reconciled bank balance must reconcile to the client balances total, which must reconcile to the total of all the ledger cards.

10. Keep your financial statements separate. Do not combine or include client trust account cash with other cash balances on the financial statements you give to creditors. It's not yours.

If you follow these ten steps, you should have no difficulty in producing most, if not all, of the required documents and reports when needed.