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Working with Client's Trust Accounts

by
Constance V. Vecchione
First Assistant Bar Counsel

As we mark the second anniversary of the implementation of Disciplinary Rule 9-103 (the dishonored check rule requiring financial institutions to report bounced trust account checks to Bar Counsel), there is good news, good-and-bad news, and bad news for the Bar.

The good news is that the number of notices of dishonored checks received in the second year decreased about 11% from the first year. The good-and-bad news is that, thus far, the implementation of the rule has resulted in Bar Counsel's uncovering a few mid-level, but no major, thefts of client funds. We don't know why, exactly. Perhaps the rule is having a deterrent effect, or perhaps malefactors are simply avoiding bouncing checks or are using accounts other than trust accounts.

The bad news is that the implementation of the rule shows continuing confusion among lawyers concerning the use and management of IOLTA and other trust accounts. Further, minor discipline for problems with the management of trust accounts has increased as a result.

With these problems in mind, we offer some suggestions based on the most common problems we see:

1. Deposits. The only funds that can be deposited to an IOLTA or other trust account are client funds or other funds held in a fiduciary capacity, such as personal injury settlements or other settlements or judgments, collections, real estate conveyancing funds, and (most) retainers and advances for fees until actually earned. See DR 9-102 or Mass. R. Prof. C., Rule 1.15 (after January 1, 1998). Earned fees (meaning fees that are earned before the client pays) are not client funds and cannot be deposited to an IOLTA or other trust account.

2. Deposits (cont.). An account that it is purely a deposit for personal or business funds cannot be an IOLTA account and cannot be denominated as an IOLTA account, client account, or with any similar fiduciary designation. Lawyers who do not receive client or other fiduciary funds should not be using IOLTA or other trust accounts. We have seen too many attorneys in the last two years who thought that they were required to have an IOLTA account even though they receive no client funds and who, in their confusion, end up using the IOLTA account as an operating or personal account. For example, an attorney whose entire practice is criminal appointed-counsel work, and who accordingly is only paid for work already done, cannot deposit the fees earned on those cases to an IOLTA account. If that attorney nonetheless wishes to maintain an IOLTA account in the event he or she does come into possession of client funds, the account can be kept open with \$50 or \$100 of the lawyer's own funds--the deposit of a small sum necessary to maintain the account or to pay bank services charges is

not considered commingling under DR 9-102(B)(1) or Mass. R. Prof. C, Rule 1.15 (after Jan. 1, 1998)--but should not otherwise be used unless client funds are received.

3. Deposits (cont.). If the bank does levy charges (such as for new checks or for a wire transfer), the attorney must deposit his or her own funds to the account to cover these expenses. Otherwise, there will be an overdraft or the service charge will have been paid improperly with client funds. A surprising number of dishonored checks have resulted from lawyers' inadvertent failure to deposit their own funds to cover new check charges that the bank debits from the account. The charge initially is paid from client funds and, months later, when the account is at a point where the float is low, a check to a client will bounce. Monthly reconciliation (see below) would, of course, go a long way towards preventing this type of problem. Again, maintaining a small sum of personal funds in the trust account to cover charges of this nature is not considered commingling.

4. Deposits (cont.). We also are seeing too many attorneys who, because of personal financial problems, are intentionally using an IOLTA or other trust account as an operating account or personal account. They are depositing their earned fees or other personal funds to the account and using the account to pay office or personal expenses. Again, trust accounts, including IOLTA accounts, are only for trust funds and cannot be used in this manner.

5. Commingling. When the attorney and client agree that the attorney has a fee due from the IOLTA or trust account (a contingent fee on a personal injury settlement, for example, or a portion of a retainer that has been earned and billed), the attorney must promptly transfer the whole of the earned fee from the IOLTA or trust account to the attorney's operating or personal account. Fees that are earned cannot be disbursed piecemeal by the lawyer to himself or herself from the IOLTA or trust account and, worse, personal or business expenses cannot be paid directly from the IOLTA or trust account with earned fees remaining in the account. Either of these practices constitutes impermissible commingling. Both practices frequently result in the lawyer losing track of what funds in the account belong to clients and what funds belong to the lawyer. These practices have led to situations where client funds are negligently misused by the lawyer.

6. Commingling (cont.). A variation on this theme is the problem of the use of an ATM card with an IOLTA or trust account. While it may be useful to have an ATM card for deposits, the card should never be used for withdrawals. Given the absence of documentation of the purpose of the withdrawal, it is difficult, if not impossible, to keep the complete records of trust funds required by DR 9-102 if disbursements are made via ATM withdrawals. We have found too that lawyers who use ATM cards in this latter manner are withdrawing their fees piecemeal and invariably are keeping inadequate records of the balance remaining due them such that more is ultimately withdrawn than was owed.

7. IOLTA Accounts. It also is important to understand when to use an IOLTA account and when to use another type of trust account. Under DR 9-102 and Mass. R. Prof. C., Rule 1.15 (after Jan. 1, 1998), IOLTA accounts are pooled accounts for multiple clients to be used for trust funds that are held short-term or are nominal in amount. With a very narrow exception for certain limited types of noninterest-bearing conveyancing accounts (a complicated rule and outside the scope of this article), nominal sums or funds held short-term must be processed through an IOLTA account.

8. Individual Trust Accounts. Large sums or funds held longer term must be deposited to an individual trust account earning interest for the benefit of the client or other beneficiary. An estate account or (depending upon the dollar amount and the length of time it will be held) an escrow account for a substantial deposit on a sale of real estate are good examples of situations in which individual accounts should be used. Individual accounts can be maintained under the umbrella of a master account with subaccounts for individual matters, but attorneys must be very careful in those situations to follow the bank's requirements for deposit and disbursements. Banks often require all deposits first to be made to the master account and

then transferred to a subaccount, and then to be transferred back to the master account from the subaccount before a check can be written. Attorneys have found themselves bouncing checks because they have forgotten to transfer funds from the subaccount to the master account before remitting the check. Similarly, attorneys sometimes find themselves with undisbursed funds sitting in the master account not earning interest which should either have been transferred to a subaccount or disbursed.

9. Recordkeeping. The most critical aspect of trust accounting is to recognize that no trust account, even one with modest or little activity, can properly be maintained in the same manner as even a well-kept personal checking account. A simple check register is not sufficient. Additional recordkeeping is needed including a receipts and disbursements journal containing a chronological record of all deposits in, withdrawals from, and charges to that account, specifically identifying the date, source, and description of each item deposited as well as the date, payee, and purpose of each disbursement or charge; disbursement documentation (invoices, for example); bills and other billings records; fee agreements; accountings to clients; and most importantly, a subsidiary ledger (described in paragraph 10, below). These records can be kept either manually, with a one-write or similar system, or electronically, with any of several inexpensive software programs. A software program, properly employed, will greatly facilitate the maintenance of certain of the necessary records, such as the subsidiary ledgers.

10. Subsidiary ledger. The subsidiary ledger is a ledger containing a separate page or card for each client or other person for whom funds are held in trust, showing dates of receipts and disbursements, with up-to-date balances. A subsidiary ledger enables the attorney to know at a glance what funds are held for a given client and to provide the client with an accounting on request. It probably is impossible to adequately maintain an IOLTA or other trust account without keeping a detailed receipts and disbursement journal, described above, and without maintaining subsidiary ledgers.

11. Cash. If a client pays with cash (and aside from the federal reporting requirements for sums of \$10,000 or more), the lawyer should provide a receipt and retain a duplicate copy of the receipt. No trust account checks should be payable to CASH and no disbursement to a client should ever be made in cash. If the client does not have a personal checking account, he or she can cash the attorney's check at the attorney's bank. It is the lawyer who is responsible for having financial records if a dispute arises with a client or third party over receipts or disbursements.

12. Reconciliation A properly maintained trust account must be reconciled, preferably monthly and at least quarterly. Certain very active accounts, such as conveyancer's accounts, should perhaps be reconciled twice a month. A monthly trial balance of the subsidiary ledger should agree with the month end book balance of the client account. Reconciliation insures that any inadvertent errors--an arithmetic mistake, a deposit check mistakenly not deposited--will be found within a month and, with luck, before problems occur. Locating the source of a mistake obviously becomes more and more difficult the longer it goes undiscovered. Many of the problems we see arise from the fact that the attorney either does not do the addition and subtraction in the check register or does not reconcile the account or both. Lawyers explaining dishonored checks on occasion have told us that they had determined the balance in their trust accounts by calling the bank and making disbursements to themselves or others on that basis, thus overlooking outstanding checks that were presented--and bounced--months later.

13. Supervision. DR 9-102, or Mass. R. Prof. C., Rule 1.15 (after Jan. 1, 1998), is a strict liability rule. If the trust account is mismanaged in a manner that was preventable, the attorney will be found responsible even if a secretary or bookkeeper was actually doing the recordkeeping. A trust account cannot simply be delegated to a staff person untrained in trust account recordkeeping. Even with training, the lawyer is responsible to insure that the staff person is actually maintaining the records properly, that the receipts and disbursement

journal and subsidiary ledgers are being kept up to date, that the account is being reconciled monthly. For this same reason, it is preferable, too, that only attorneys be authorized signatories on the account.

14. Accounting To Clients. Lawyers should periodically apprise the client of the status of funds held for the client and certainly should prepare an accounting at the end of the case. If the funds in question are retainers, a detailed monthly billing is presumably adequate. In matters such as personal injury cases, the final accounting should show a complete summary of all receipts including PIP, med pay, and the liability settlement, and all disbursements, including fees, itemized costs and expenses, payments to third parties such as medical providers, and payments to the client. If the client objects to any disbursement, such as a payment of fees claimed to have been earned, then pursuant to DR 9-102, or Mass. R. Prof. C. Rule 1.15 (after Jan. 1, 1998), the disputed funds must remain in a trust account until the dispute is resolved.

The IOLTA Committee has prepared an enormously helpful booklet of guidelines for the management of client funds account. It is available free to any lawyer or law firm upon request. In addition, if there is sufficient interest, the IOLTA Committee is willing to do training for attorneys on the nuts-and-bolts of trust account recordkeeping, also free of charge. (Don't worry; Bar Counsel won't know who attends!) If you are interested in obtaining the booklet or attending a training session, contact the IOLTA Committee at (617) 723-9023 (telephone) or (617) 367-8815 (fax).

Please direct all questions to webmaster@massbbo.org.

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