

Trust Accounting Questions and Answers

A complete Trust Accounting Handbook is available online at www.ncbar.gov.
Select "Programs" from the website's main menu.

Trust Accounts - Help Is Available

The State Bar's Trust Account Handbook, which provides greater detail on managing a trust account, can be purchased from the Bar or accessed on the State Bar's website, www.ncbar.gov/programs/trust_gu.asp. Members of the State Bar staff are also available to answer questions about maintaining a trust account. Call the State Bar at 919/828-4620. If you need ethics advice, ask for a lawyer who works in the ethics program. If you need technical support, ask for Bruno DeMolli, staff auditor.

Trust Accounts - What Are They and How Many Do You Need?

(Questions 1-6)

1. What is a trust account?

A trust account is a bank account maintained incident to a lawyer's law practice in which the lawyer holds funds received in a fiduciary capacity on behalf of or belonging to a client. Rule 1.15-1(1).

2. Who must have a trust account?

Any lawyer who receives funds in a fiduciary capacity in the context of his or her law practice must have access to or maintain a trust account. The lawyer must have access to or establish a trust account before receiving such funds. Rule 1.15-2(a), (b), and (c). Lawyers who do not receive funds belonging to or on behalf of clients do not have to have a trust account.

3. Are there restrictions concerning the kinds of institutions where trust accounts may be maintained?

Yes. Trust accounts may only be maintained at federally or North Carolina chartered banks, savings and loan associations, or credit unions located in North Carolina or with branch offices in North Carolina. Rule 1.15-2(e) and Rule 1.15-1(a). Unless the client specifically provides written direction to the contrary, the bank at which a trust account is maintained must be in North Carolina. With the written consent of the client, a trust account dedicated to one client's funds (*see* Rule 1.15-1(c)) may be maintained at a bank outside of North Carolina or at a financial institution other than a bank inside or outside of North Carolina. Rule 1.15-2(e).

A law firm with offices in North Carolina and another state may send a North Carolina client's funds to a firm office in another state for centralized processing without client consent provided the funds are promptly deposited in a trust account in North Carolina with a qualified bank. Rule 1.15-3, Comment [4].

4. How many trust accounts does a lawyer need?

Generally speaking, a lawyer needs only one trust account to handle monies received in trust which are either nominal in amount or held for a short period of time. Within this common account—called a "general trust account"—the funds of many clients may be commingled so long as adequate records are kept to identify the funds of each client. Rule 1.15-1(h) and Rule 1.15-2. A lawyer may have multiple trust accounts if desired for administrative purposes. For example, lawyers often have trust accounts for real estate transactions that are distinct from the trust accounts used for other client matters.

5. Does each lawyer in a firm need a separate trust account?

No. Each lawyer in a firm may ethically use the firm's general trust

account so long as adequate records of the funds of each client are maintained. However, multiple accounts are permissible. A lawyer may personally maintain several trust accounts if he or she desires. Rule 1.15-2.

6. Is a lawyer ever required to establish a trust account for one client, one transaction, or a series of integrated transactions?

Yes, if, because of the size of the deposit or the length of time the deposited funds are to be held a prudent person acting in a fiduciary capacity would be expected to invest the funds on behalf of the beneficiary, a lawyer receiving funds under such circumstances would have a corresponding obligation to deposit the funds in a separate interest-bearing or "dedicated trust account." Rule 1.15-1(c). Comment [3] following Rule 1.15-3 contains a list of factors to be considered when determining whether there is a duty to deposit funds into a separate interest-bearing dedicated trust account. Any interest generated would be the property of the client. Rule 1.15-2(p).

Who is Responsible for the Management of a Trust Account?

(Questions 7-8)

7. May the responsibility for managing a firm's trust accounts be delegated to one lawyer in a firm?

Yes, however, all managing lawyers in the firm may be professionally responsible for violations of the trust accounting rules that result from failure to have in effect measures giving reasonable assurance that the rules will be followed. Rule 5.1.

8. May a lawyer delegate the management of a trust account, including check signing authority, to a staff member who is not a lawyer?

Yes, however, the lawyer is professionally responsible for the supervision of the non-lawyer. Rule 5.3 and Rule 8.4(a). A lawyer may be subject to professional discipline for violations of the trust accounting rules that result from the inadequate supervision of a staff member.

Must a Trust Account Bear Interest?

(Questions 9-10)

9. What sort of bank account must be maintained?

Since a lawyer has an ethical obligation to pay or deliver client funds promptly as instructed by the client, trust accounts are generally demand accounts with check writing privileges. Pursuant to an order of the North Carolina Supreme Court, beginning January 1, 2008, every general trust account must be an interest-bearing account and the establishment of any such general trust account must be reported to the North Carolina Interest on Lawyers Trust Accounts program (NC IOLTA) for inclusion in NC IOLTA. Rule 1.15-2(b) and 27 NCAC 1D, Section .1300. The interest earned on such accounts is remitted by the depository bank directly to the IOLTA Board of Trustees which subsequently distributes the funds in the form of grants to persons or entities for various public purposes in accordance with the rules of NC IOLTA.

10. What sort of account should a lawyer serving as a personal representative maintain?

A lawyer who is serving as trustee, guardian, attorney in fact, or personal representative should usually maintain a separate, specially denominated

account called a "fiduciary account." Rule 1.15-1(e). Generally speaking, a fiduciary account should be interest-bearing since the deposited funds are generally held in trust for significant periods of time. Rule 1.15-2(c), (p). Any interest generated would be the property of the trust, estate, principal, or other beneficiary. Rule 1.15-2(p).

How Do You Label a Trust Account?

(Question 11)

11. How should a trust account be identified?

A trust account must be clearly labeled and designated as a "trust account," and all checks drawn on the account must be so identified. For instance, an appropriate title for a general trust account might be "The Trust Account of John Smith, Attorney" or "Smith, Jones & Williams Trust Account." An example of a properly labeled general trust account check is found in Appendix Item E. Each account in which funds are held by a lawyer pursuant to the lawyer's service as a trustee, guardian, personal representative, attorney in fact, or escrow agent must be appropriately labeled as a fiduciary account unless such funds are held in a general trust account. Rule 1.15-1(c), (e), (h), (l). For example, an appropriate title for a fiduciary account might be "Trust Account for the Estate of John Doe." Similarly, a dedicated trust account that holds the funds of one client must be properly labeled as a trust account (e.g., "Trust Account for the Benefit of Jane Smith").

What Goes in the Trust Account?

(Questions 12-15)

12. How does a lawyer know what funds should be deposited in the trust account?

The general rule is that every receipt of money from a client or for a client which will be used or delivered on the client's behalf should be placed in the trust account or a fiduciary account if the funds are received by a lawyer while serving as a lawyer or other professional fiduciary. This includes funds received by the lawyer as an escrow agent. Rule 1.15-2(b) and (c), and Comment following Rule 1.15-3.

13. What about funds received by the lawyer as a fiduciary outside the context of his or her law practice?

The trust account rules are not applicable when the lawyer handles money for a business, religious, civic, or charitable organization as an officer, employee, or other official of that organization. The lawyer's only professional obligation regarding such funds is to deal honestly. Rule 8.4 (c). Such funds should not be deposited in the lawyer's general trust account. Rule 1.15-1(d) and (m); Rule 1.15-2(c); Comment following Rule 1.15-3.

14. What about funds received by a lawyer acting as a court-appointed fiduciary or pursuant to appointment in some specific trust instrument?

Such funds should not be deposited in the lawyer's general trust account. A lawyer serving in such a fiduciary role must segregate fiduciary property from his or her personal property, deposit such funds in a designated fiduciary account, maintain the minimum financial records required for a fiduciary account, and instruct any financial institution in which fiduciary property is held to notify the North Carolina State Bar of any negotiable instruments drawn on the account which are presented for payment against insufficient funds. Rules 1.15-1(e) and (f); Rule 1.15-2(c),(e),(f),(k); Rule 1.15-3.

15. Is it appropriate to deposit items other than cash or cash equivalents in the trust account?

Generally speaking, any negotiable instrument may be deposited in a trust account whether or not it represents collected funds. Unless specifically permitted by law, the Rules of Professional Conduct or definitive interpretations thereof, no withdrawal should be made with respect to any deposited item until the funds represented by that item are collected. Rules 1.15-1(i) and 1.15-2(g); *see also*, RPC 191, 01 FEO 3, and 06 FEO 8.

What Does Not Go in the Trust Account?

(Questions 16-17)

16. May a lawyer deposit his or her own funds in a trust account?

No funds belonging to the lawyer may be deposited in the trust account except such funds as are necessary to open or maintain the account, or pay service charges, or funds belonging in part to a client and in part presently or potentially to the lawyer, such as where a deposited item includes both the client's recovery and the lawyer's fee. In such a case, the portion of the funds belonging to the lawyer must be withdrawn from the trust account as soon as the lawyer becomes entitled to the funds unless the right of the lawyer to receive that portion is disputed by the client, in which event the disputed portion must remain in the trust account until the dispute is resolved. Rule 1.15-2(f).

17. Should retainers be deposited in the trust account?

Strictly speaking, no. A retainer, preferably referred to as a "general retainer," in its truest sense is money paid to the lawyer to reserve the exclusive use of the lawyer's services for a particular time or in regard to a particular matter. *See* 08 FEO 10. Since a general retainer is deemed earned when paid, it immediately becomes the property of the lawyer and as such must not be deposited in the trust account. General retainers must be distinguished from fees paid in advance which are intended to be held by the lawyer as security deposits against work which is yet to be performed. Since a lawyer has an ethical obligation to refund the unearned portion of any fee paid in advance upon discharge or withdrawal, such funds are not considered property of the lawyer and must be held in the trust account until they are earned. Rule 1.15-2(a); Comment following Rule 1.15-3; and Rule 1.16(d). *See* 08 FEO 10 for a complete overview of the different types of fees and where they should be deposited.

What Records Are Required?

(Questions 18-24)

18. Is there a required format for trust account and fiduciary account checks?

Yes, all general trust accounts, dedicated trust accounts, and fiduciary accounts must use business-sized checks (longer than six inches) that contain a field called an "Auxiliary On-U's" field in the MICR (magnetic ink character recognition) line of the check. Rule 1.15-3(a). Business-sized checks which contain the Auxiliary On-U's field are at least six inches long. The special check format prevents conversion of a check into an electronic transaction through the automated clearinghouse network for converting checks drawn on consumer accounts to which most financial institutions belong. If a check is converted, the paper check is destroyed, thereby possibly eliminating a lawyer's record of the transaction. *See* Appendix Items E and M for additional information.

19. What are the minimum record keeping requirements for trust and fiduciary accounts maintained at a bank?

A lawyer maintaining a trust account or a fiduciary account at a bank must keep the following records:

1. A record of receipts. This can be a journal, file of receipts (including wire and electronic transfer confirmations), file of deposit slips, or a collection of checkbook stubs. The record of receipts must list the source, client, and date of the receipt of all deposited funds. Rule 1.15-3(b)(1). Examples of properly composed deposit slips are appended as Appendix Items A and B.
2. All canceled items drawn on the account or printed digital images thereof. Rule 1.15-3(b)(2).
3. All instructions or authorizations to transfer, disburse, or withdraw funds from the account (including electronic transfers or debits) or a written or electronic record of any such transfer, disbursement or withdrawal. The record must show the amount, date, recipient of the transfer or disbursement, and the client to whom the funds belonged. Rule 1.15-2(b)(3).
4. All bank statements or documents received from the bank regarding the account. Rule 1.15-3(b)(4).
5. For a general trust account, a ledger containing a record for each person or entity from whom or for whom funds were received and showing the current balance of funds held for that person or entity. Rule 1.15-3(b)(5). *See* Appendix Items C and D.

6. All records pertaining to the quarterly and monthly reconciliations of the general trust account with the statements provided by the bank. Rule 1.15-3(d).
7. All records required by law. Rule 1.15-3(b)(6).

20. What are the minimum record keeping requirements for a dedicated trust account or a fiduciary account maintained at a financial institution other than a bank?

1. A record of all depository receipts, deposit slips, and wire and electronic transfer confirmations for the account listing the source and date of receipt. Rule 1.15-3(c)(1).
2. A copy of all cancelled items drawn on the account or printed digital images of such items. Rule 1.15-3(c)(2).
3. All instructions or authorizations to transfer, disburse, or withdraw funds from the account (including electronic transfers or debits) or a written or electronic record of any such transfer, disbursement or withdrawal. The record must show the amount, date, and recipient of the transfer or disbursement. Rule 1.15-3(c)(3).
4. All statements or documents received from the financial institution regarding the account. Rule 1.15-3(c)(4).
5. All records required by law. Rule 1.15-3(c)(5).

21. How does this work in practice?

It can be very simple. For a trust account maintained at a bank, all that is really required is a checkbook, a ledger card for each client, and a file for correspondence from the bank. When properly maintained, all the information required for deposits and disbursements can be recorded on the checkbook stub. The only other record that must be generated by the lawyer is a ledger card for each client describing each transaction involving the client's funds and carrying a running balance. Rule 1.15-3(b).

22. How long must these records be kept?

A lawyer must retain trust account and fiduciary account records for the six-year period immediately preceding the lawyer's most recent fiscal year end. Rule 1.15-3(g).

23. May trust account and fiduciary account records be kept on computer?

Yes, if the records are retrievable in hard copy or in digital form for the required six-year period. Rule 1.15-3(g).

24. How often must the records for a general trust account be reconciled?

Each month, the balance of the trust account as shown on the lawyer's records must be reconciled with the current bank statement balance for the trust account. In addition, at least once a quarter, the individual client balances as shown on the client ledgers of a general trust account must be totaled and reconciled with the current bank statement balance for the trust account. At a minimum this is intended to ensure that the running balances kept for each client equal the total funds on deposit, exclusive of funds belonging to the lawyer, which have been properly deposited in the account. Rule 1.15-3(d). All records pertaining to the monthly and quarterly reconciliations must be retained for a period of six years. Rule 1.15-3(d). Examples of quarterly trust account reconciliations formats are attached as Appendix Items F and G.

What Disbursements Are Appropriate?

(Questions 25-30)

25. May a lawyer unilaterally decide to use funds held in trust to pay his or her legal fees or the claims of other creditors?

As the client's agent and fiduciary, the lawyer has an obligation to pay or deliver the funds in accordance with the client's most recent instructions. Unless the lawyer is authorized by the client to pay a particular charge or claim, the lawyer may not disburse trust funds for those purposes. Rule 1.15-2(m).

26. What if the lawyer has an interest in funds received in settlement of a claim or in satisfaction of a judgment?

All receipts of trust funds must be deposited into the trust account intact. If an instrument represents funds belonging in part to the client and in part to the lawyer,

the portion belonging to the lawyer must be withdrawn when the lawyer becomes entitled to the funds unless the right of the lawyer to receive the portion of the funds is disputed by the client. In that case the disputed portion must remain in the trust account until the dispute is resolved. Rules 1.15-2(f)(2) and (g).

27. What happens if a client directs a lawyer not to pay medical bills incident to the settlement of a tort claim?

Generally, the lawyer must follow the client's most recent directions. Unless the health care provider in question has perfected a statutory lien against the funds in the hands of the lawyer, the lawyer must handle the settlement proceeds as directed by the client. RPC 75. *But see* 01 FEO 11.

28. Is it ever proper for a lawyer to make disbursements from the trust account with respect to funds represented by a deposited instrument which has not yet been collected?

Prior to the adoption of RPC 191 in October 1995, a lawyer was permitted to issue trust account checks against funds which, although uncollected, were provisionally credited to the lawyer's trust account by the financial institution in which the trust account was maintained. RPC 191 still allows lawyers to disburse provisionally credited but uncollected funds from the trust account, but only in consequence of trust account deposits in the form of cash, wired funds, or certain types of negotiable instruments specified in the Good Funds Settlement Act, G.S. 45A. It is further provided that disbursements against such provisionally credited funds should be made only where the lawyer reasonably believes that the underlying deposited item is virtually certain to be honored when presented for collection, and the lawyer has sufficient assets or credit to fund any outstanding trust account checks issued in regard to a provisionally credited item which may be dishonored. *See also* 01 FEO 3 (limitation on disbursements applicable to all transactions including disbursement of personal injury settlement) and 06 FEO 8 (disbursements in reliance on bank funding schedule).

29. What should a lawyer do if he or she properly disburses against a provisionally credited item which is ultimately dishonored?

RPC 191 provides that the lawyer, upon learning that a deposited item has been dishonored, must act immediately to protect the property of the lawyer's other clients by personally paying the amount of the failed deposit or by securing or arranging for payment from sources available to the lawyer other than the trust funds of other clients. A lawyer should take care not to disburse against uncollected funds in situations where the lawyer's assets or credit would be insufficient to fund the trust account checks in the event that a provisionally credited item is dishonored.

30. May a lawyer disburse against provisionally credited items in cases other than real estate closings?

RPC 191 specifically provides that it applies to transactions other than real estate closings. *See* 01 FEO 3.

What If a Trust Account Check Bounces?

(Questions 31-32)

31. What should a lawyer do if his or her trust account check bounces?

Theoretically, of course, this should never happen. As a practical matter, however, mistakes do happen and bank errors or administrative snafus within the lawyer's own office can result in an item's being returned for insufficient funds. If a trust account check is dishonored, the lawyer should immediately ascertain the nature of the problem and promptly correct it, even if this requires a deposit of the lawyer's own funds into the trust account. Under no circumstances should the lawyer allow the trust funds of another client to be used impermissibly. Finally, the lawyer should immediately document the problem and any corrective action taken in a memorandum for his or her own files.

32. Must a report be made to the State Bar?

Every lawyer must instruct his or her bank, at the time that the account is opened, to notify the State Bar when any check drawn on a trust account or a fiduciary account is presented for payment against insufficient funds. Rule 1.15-2(k). That being the case, a lawyer who overdraws a trust account or a fiduciary

account may soon expect to be contacted by a representative of the State Bar who will informally request an explanation of the problem. Once it is verified that an innocent mistake caused the shortage or apparent shortage in the account, the inquiry will be concluded and no further action will be taken. If, however, no adequate explanation is immediately forthcoming, a grievance file will be established and a formal investigation initiated. Rule 1.15-2(k). See Appendix Item K for a copy of the bank directive form.

How Should Accountings Be Handled?

(Questions 33-35)

33. How often should a lawyer provide an accounting to a client for the client's trust funds?

An accounting must be provided to the client upon the completion of the disbursement of the client's funds and at such other times as may be reasonably requested by the client. If trust funds are retained for more than one year, the lawyer must provide annual accountings. All accountings must be in writing. Rule 1.15-3(e).

34. How often should a lawyer provide an accounting for fiduciary funds received in connection with the lawyer's service as a professional fiduciary such as a personal representative or a trustee?

Inventories and accountings of fiduciary funds received in connection with professional fiduciary services must be given to the clerk of court, or other appropriate judicial official, as required by law. If an annual or more frequent account is not required by law, a written accounting of all transactions concerning the fiduciary funds must be given to the beneficial owners, or their representative at least annually and upon the termination of the lawyer's services. Rule 1.15-3(f).

35. Do accountings for funds in a trust account have to be in a particular form?

No. It is often possible to satisfy the accounting requirement by providing copies of documents generated during the representation, such as a settlement statement describing disbursements incident to the resolution of a tort claim or a HUD-1 statement describing the disbursement of the proceeds of sale in a real property transaction. In addition, the accounting requirement can generally be satisfied by providing the client with a copy of a properly maintained ledger card which describes all receipts and disbursements of the client's funds. An example of a client ledger card is found in Appendix Item D. Sample accounting forms are attached in Appendix Items I and J.

What Should Be Done with Unclaimed Trust Funds?

(Question 36)

36. Suppose a lawyer holds funds in a general trust account and does not know either the identity or the location of the owner of those funds. What should be done with the money?

Under such circumstances, the lawyer must first make a diligent attempt to determine the identity and location of the owner of the funds in order that an appropriate disbursement might be made. If the lawyer is unsuccessful in ascertaining the identity and location of the owner of the funds, the lawyer should consider whether the funds must be escheated to the state of North Carolina. Pending escheatment, such funds should be held and accounted for in the lawyer's trust account. Rule 1.15-2(q). *See* N.C. Gen. Stat. Chapter 116B.

Is There FDIC Protection Against Bank Failure for a Trust Account?

(Questions 37-38)

37. Does the Federal Deposit Insurance Corporation (FDIC) insure the funds in a trust account against bank failure?

Yes. Each client's funds deposited in a trust account will be insured by the FDIC (up to the insurance limit which was \$250,000 as of January 1, 2010) provided the account satisfies the FDIC disclosure requirements. A client's insurance limit includes all of the client's funds held at that bank; if a client

holds funds in a different account (e.g., the client's own account or different lawyer's trust account) at the same bank in addition to the funds in the lawyer's trust account, they will be included when determining total coverage.

38. What are the requirements for FDIC coverage?

There are two disclosure requirements: (1) the fiduciary nature of the account must be disclosed in the bank's records, and (2) the name and ownership interest of each owner must be ascertainable from the deposit account records of the insured bank or from records maintained by the fiduciary. Compliance with the trust accounting and record keeping requirements in Rule 1.15 of the Rules of Professional Conduct satisfies both of the FDIC disclosure requirements.