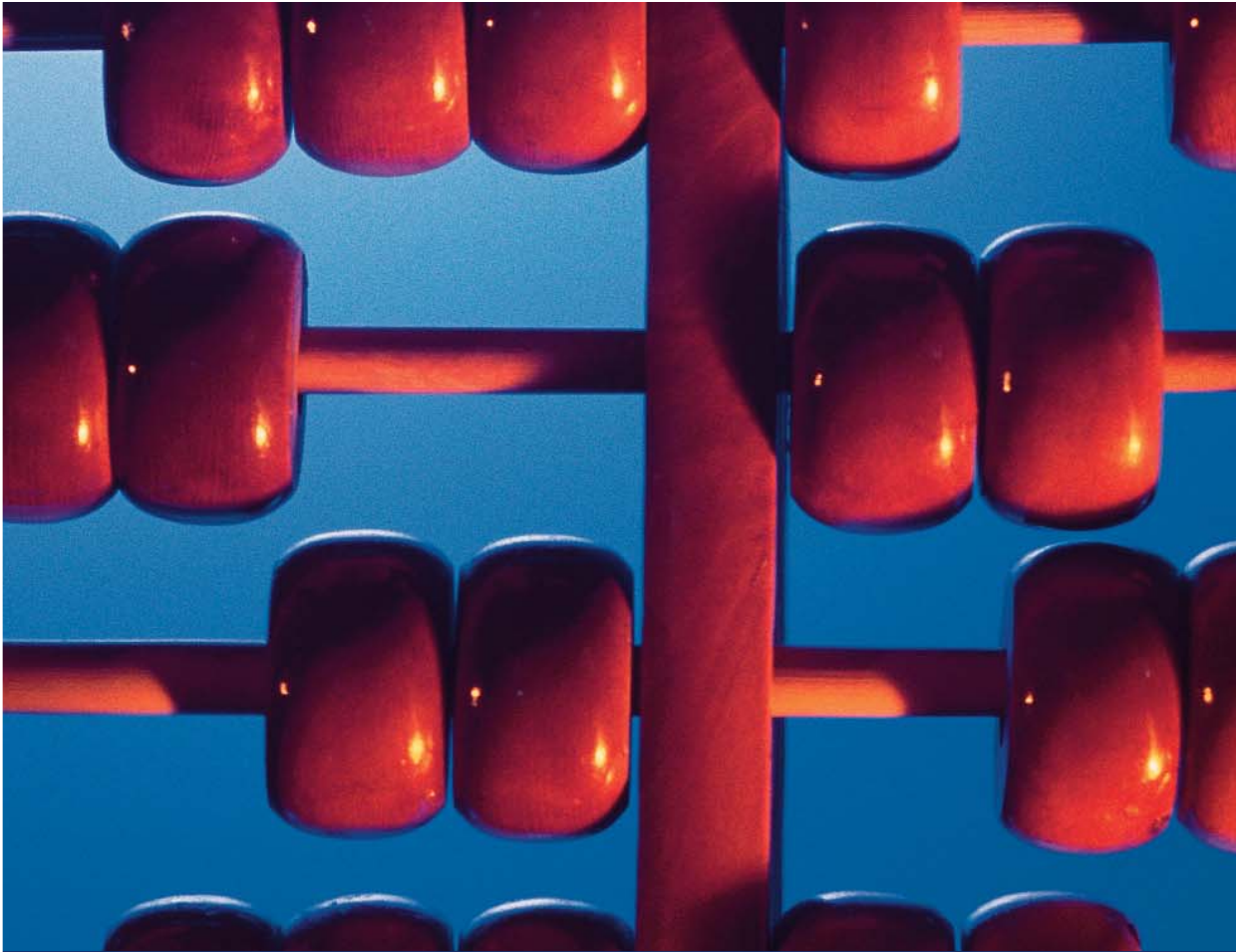


Lawyer's Trust Account Handbook

The North Carolina State Bar



A publication designed to aid lawyers in understanding the procedures and guidelines for trust accounts.

Revised 11/2017

DISCLAIMER

This handbook contains legal information, not legal advice. While the State Bar will make every effort to update the manual as necessary, it is the responsibility of the member to make sure that they are following the most current version of the Rules of Professional Conduct. Nothing contained in this handbook is intended to address any specific inquiry, nor is it to substitute for independent legal research to original sources or for obtaining the advice of legal counsel with respect to legal problems.

ACKNOWLEDGEMENTS

Selected portions of this handbook were adopted, adapted, and/or reprinted from the materials originally authored by the following jurisdictions with their permission:

The State Bar of Arizona, *Client Trust Accounting for Arizona Attorneys*, 2010. For the current online version of the *Arizona Handbook*, please go to: myazbar.org/Members/Archives/Trust_Account_Manual.pdf

at NC State Bar Trust Account Handbook Section VI, Pages 28-32, Section VII, Pages 33-42, Appendix B, Pages 90-107.

The State Bar of California, *Handbook on Client Trust Accounting for California Attorneys* © 2009. All rights reserved. No part of this work may be reproduced, stored in a retrieval system, or transmitted in any medium without prior written permission of the State Bar of California. For the current online version of the *California Handbook*, please go to: ethics.calbar.ca.gov at NC State Bar Trust Account Handbook Section I, Pages 1-14.

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INTRODUCTION

On a daily basis, a lawyer in private practice will receive, hold, and disburse 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 Rule 1.15 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.

SECTION I: TRUST ACCOUNTING RULES

NC Rule of Professional Conduct 1.15, Safekeeping Property—This rule has four subparts: Rule 1.15-1, Definitions; Rule 1.15-2, General Rules; Rule 1.15-3, Records and Accountings; and Rule 1.15-4, Alternative Trust Account Management Procedure for Multi-Member Firm. The comment to the rules appears after the text for Rule 1.15-4. Rules 1316 and 1317 of Subchapter 1D of Chapter 27 of the NC Administrative Code also appear in this section. These rules require that lawyer's trust accounts to be established as OLTA accounts and explain comparability requirements for OLTA accounts.

Rule 1.15-1 Definitions

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

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

(b) "Client" denotes a person, firm, or other entity for whom a lawyer performs, or is engaged to perform, any legal services.

(c) "Dedicated trust account" denotes a trust account that is maintained for the sole benefit of a single client or with respect to a single transaction or series of integrated transactions.

(d) "Demand deposit" denotes any account from which deposited funds can be withdrawn at any time without notice to the depository institution.

(e) "Entrusted property" denotes trust funds, fiduciary funds and other property belonging to someone other than the lawyer which is in the lawyer's possession or control in connection with the performance of legal services or professional fiduciary services.

(f) "Fiduciary account" denotes an account, designated as such, maintained by a lawyer solely for the deposit of fiduciary funds or other entrusted property of a particular person or entity.

(g) "Fiduciary funds" denotes funds belonging to someone other than the lawyer that are received by or placed under the control of the lawyer in connection with the performance of professional fiduciary services.

(h) "Funds" denotes any form of money, including cash, payment instruments such as checks, money orders, or sales drafts, and receipts from electronic fund transfers.

(i) "General trust account" denotes any trust account other than a dedicated trust account.

(j) "Item" denotes any means or method by which funds are credited to or debited from an account; for example: a check, substitute check, remotely created check, draft, withdrawal order, automated clearinghouse (ACH) or electronic transfer, electronic or wire funds transfer, electronic image of an item and/or information and electronic form describing an item, or instructions given in person or by telephone, mail, or computer.

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

(l) "Professional fiduciary services" denotes compensated services (other than legal services) rendered by a lawyer as a trustee, guardian, personal representative of an estate, attorney-in-fact, or escrow agent, or in any other fiduciary role customary to the practice of law.

(m) "Trust account" denotes an account, designated as such, maintained by a lawyer for the deposit of trust funds.

(n) "Trust funds" denotes funds belonging to someone other than the lawyer that are received by or placed under the control of the lawyer in connection with the performance of legal services.

History Note: Statutory Authority G.S. 84-23

Adopted July 24, 1997

Amended May 4, 2000; March 1, 2003; March 6, 2008; October 8, 2009; August 23, 2012; June 9, 2016

Rule 1.15-2 General Rules

(a) **Entrusted Property.** All entrusted property shall be identified, held, and maintained separate from the property of the lawyer, and shall be deposited, disbursed, and distributed only in accordance with this Rule 1.15.

(b) **Deposit of Trust Funds.** All trust funds received by or placed under the control of a lawyer shall be promptly deposited in either a general trust account or a dedicated trust account of the lawyer. Trust funds placed in a general account are those which, in the lawyer's good faith judgment, are nominal or short-term. General trust accounts are to be administered in accordance with the Rules of Professional Conduct and the provisions of 77 NCAC Chapter 1, Subchapter D, Sections 1300.

(c) **Deposit of Fiduciary Funds.** All fiduciary funds received by or placed under the control of a lawyer shall be promptly deposited in a fiduciary account or a general trust account of the lawyer.

(d) **Safekeeping of Other Entrusted Property.** A lawyer may also hold entrusted property other than fiduciary funds (such as securities) in a fiduciary account. All entrusted property received by a lawyer that is not deposited in a trust account or fiduciary account (such as a stock certificate) shall be promptly identified, labeled as property of the person or entity for whom it is to be held, and placed in a safe deposit box or other suitable place of safekeeping. The lawyer shall disclose the location of the property to the client or other person for whom it is held. Any safe deposit box or other place of safekeeping shall be located in this state, unless the lawyer has been otherwise authorized in writing by the client or other person for whom it is held.

(e) **Location of Accounts.** All trust accounts shall be maintained at a bank in North Carolina or a bank with a branch office in North Carolina except that, with the written consent of the client, a dedicated trust account may be maintained at a bank that does not have offices in North Carolina or at a financial institution other than a bank in or outside of North Carolina. A lawyer may maintain a fiduciary account at any bank or other financial institution in or outside of North Carolina selected by the lawyer in the exercise of the lawyer's fiduciary responsibility.

(f) **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 funds belonging to a 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;

(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 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 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 the item is drawn. Any item that does not include this information may not be used to withdraw funds from a trust account or 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.

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

(k) No 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) Bank Directive. Every lawyer maintaining a trust account or fiduciary account with a demand deposit at a bank or other financial institution shall file with the bank or other financial institution a written directive requiring the bank or other institution to report to the executive director of the North Carolina State Bar when an instrument drawn on the account is presented for payment against insufficient funds. No trust account or fiduciary account shall be maintained in a bank or other financial institution that does not agree to make such reports.

(m) Notification of Receipt. A lawyer shall promptly notify his or her client of the receipt of any entrusted property belonging in whole or in part to the client.

(n) Delivery of Client Property. A lawyer shall promptly pay or deliver to the client, or to third persons as directed by the client, any entrusted property belonging to the client and to which the client is currently entitled.

(o) Property Received as Security. Any entrusted property or document of title delivered to a lawyer as security for the payment of a fee or other obligation to the lawyer shall be held in trust in accordance with this Rule 1.15 and shall be clearly identified as property held as security and not as a completed transfer of beneficial ownership to the lawyer. This provision does not apply to property received by a lawyer on account of fees or other amounts owed to the lawyer at the time of receipt; however, such transfers are subject to the rules governing legal fees or business transactions between a lawyer and client.

(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) Interest on Deposited Funds. Under no circumstances shall the lawyer be entitled to any interest earned on funds deposited in a trust account or fiduciary account. Except as authorized by Rule 1.1316 of subchapter 1D of the Rules and Regulations of the North Carolina State Bar, any interest earned on a trust account or fiduciary account, less any amounts deducted for bank service charges and taxes, shall belong to the client or other person or entity entitled to the corresponding principal amount.

(r) Abandoned Property. If entrusted property is unclaimed, the lawyer shall make due inquiry of his or her personnel, records and other sources of information in an effort to determine the identity and location of the owner of the property. If that effort is successful, the entrusted property shall be promptly transferred to the person or entity to whom it belongs. If the effort is unsuccessful and the provisions of C.S. 16B-53 are satisfied, the property shall be deemed abandoned, and the lawyer shall comply with the requirements of Chapter 16B of the General Statutes concerning the escheat of 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.

History Note: Statutory Authority G.S. 84-23

Adopted July 24, 1997

Amended March 1, 2003; March 6, 2008; February 5, 2009; August 23, 2012; June 9, 2016

Rule 1.15-3 Records and Accountings

(a) Check Format. All general trust accounts, dedicated trust accounts, and fiduciary accounts must use business-size checks that contain an Auxiliary On-Us field in the MICR line of the check.

(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) All records listing the source and date of receipt of any funds deposited in the account including, but not limited to, bank receipts, deposit slips and wire and electronic transfer confirmations, and, in the case of a general trust account, all records also listing the name of the client or other person to whom the funds belong;

(2) All canceled checks or other items drawn on the account, or 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 balance each item is drawn, provided, that:

(A) digital images must be legible reproductions of the front and back of the original items with no more than six images per page and no images smaller than 1-3/16 inches; and

(B) the bank must maintain, for at least six years, the capacity to reproduce electronically additional or enlarged images of the original items or records related thereto upon request within a reasonable time.

(3) All instructions or authorizations to transfer, disburse, or withdraw funds from the trust account (including electronic transfers or debits), or a written or electronic record of any such transfer, disbursement, or withdrawal showing the amount, date, and recipient of the transfer or disbursement, and, in the case of a general trust account, also showing the name of the client or other person to whom the funds belong;

(4) All bank statements and other documents received from the bank with respect to the trust account, including, but not limited to, notices of return or dishonor of any item drawn on the account against insufficient funds;

(5) In the case of a general trust account, a ledger containing a record of receipts and disbursements for each person or entity from whom and for whom funds are received and showing the current balance of funds held in the trust account for each such person or entity; and

(6) Any other records required by law to be maintained for the trust account.

(c) Minimum Records for Accounts at Other Financial Institutions. The minimum records required for dedicated trust accounts and fiduciary accounts at financial institutions other than a bank shall consist of the following:

(1) All records listing the source and date of receipt of all funds deposited in the account including, but not limited to, depository receipts, deposit slips, and wire and electronic transfer confirmations;

(2) A copy of all checks or other items drawn on the account, or 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);

(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 showing the amount, date, and recipient of the transfer or disbursement;

(4) All statements and other documents received from the depository with respect to the account, including, but not limited to, notices of return or dishonor of any item drawn on the account for insufficient funds; and

(5) Any other records required by law to be maintained for the account.

(d) Reconciliations of General Trust Accounts.

(1) Quarterly Reconciliations. 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. Each month, the balance of the trust account as shown on the lawyer's records shall be reconciled with the current bank statement balance for the trust account.

(3) The lawyer shall review, sign, date, and retain a 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. The lawyer shall render to the client a written accounting of the receipts and disbursements of all trust funds (i) upon the complete disbursement of the trust funds, (ii) at such other times as may be reasonably requested by the client, and (iii) at least annually if the funds are retained for a period of more than one year.

(f) Accountings for Fiduciary Property. Inventories and accountings of fiduciary funds and other entrusted property received in connection with professional fiduciary services shall be rendered to judicial officials or other persons as required by law. If an annual or more frequent accounting is not required by law, a written accounting of all transactions concerning the fiduciary funds and other entrusted property shall be rendered to the beneficial owners, or their representatives, at least annually and upon the termination of the lawyer's professional fiduciary services.

(g) Minimum Record Keeping Period. A lawyer shall maintain, in accordance with this Rule 1.15, complete and accurate records of all entrusted property received by the lawyer, which records shall be maintained for at least the six (6) year period immediately preceding the lawyer's most recent fiscal year end.

(h) Audit by State Bar. The financial records required by this Rule 1.15 shall be subject to audit for cause and to random audits by the North Carolina State Bar; and such records shall be produced for inspection and copying in North Carolina upon request by the State Bar.

(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 1.3(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.

History Note: Statutory Authority G.S. 84-23

Adopted July 24, 1997; Amended March 1, 2003, October 6, 2004; March 6, 2008; June 9, 2016

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

(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 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 TAOOs 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), (d)(2), (d)(4), and (d)(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 minimum record-keeping period set forth in Rule 1.15-3(g).

History Note: Statutory Authority S.S. 84-23

Adopted June 9, 2016

Comments to Rule 1.15 and All Subparts

[1] The purpose of a lawyer's trust account or fiduciary account is to segregate the funds belonging to others from those belonging to the lawyer. Money received by a lawyer while providing legal services or otherwise serving as a fiduciary should never be used for personal purposes. Failure to place the funds of others in a trust or fiduciary account can subject the funds to claims of the lawyer's creditors or place the funds in the lawyer's estate in the event of the lawyer's death or disability.

Property Subject to These Rules

[2] Any property belonging to a client or other person or entity that is received by or placed under the control of a lawyer in connection with the lawyer's furnishing of legal services or professional fiduciary services must be handled and maintained in accordance with this Rule 1.5. The minimum records to be maintained for accounts in banks differ from the minimum records to be maintained for accounts in other financial institutions (where permitted), to accommodate brokerage accounts and other accounts with differing reporting practices.

Client Property

[3] Every lawyer who receives funds belonging to a client must maintain a 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, is held in trust and should be placed in the trust account. All client money received by a lawyer, except that to which the lawyer is immediately entitled, must be deposited in a trust account, including funds for payment of future fees and expenses. Client funds must be promptly deposited into the trust account. Client funds must be deposited in a general trust account if there is no duty to invest on behalf of the client. Generally speaking, if a reasonably prudent person would conclude that the funds in question, either because they are nominal in amount or are to be held for a short time, could probably not earn sufficient interest to justify the cost of investing, the funds should be deposited in the general trust account. In determining whether there is a duty to invest, a lawyer shall exercise his or her professional judgment in good faith and shall consider the following:

- a) The amount of the funds to be deposited;
- b) The expected duration of the deposit, including the likelihood of delay in the matter for which the funds are held;
- c) The rates of interest or yield at financial institutions where the funds are to be deposited;
- d) The cost of establishing and administering dedicated accounts for the client's benefit, including the service charges, the costs of the lawyer's services, and the costs of preparing any tax reports required for or income accruing to the client's benefit;
- e) The capability of financial institutions, lawyers, or law firms to calculate and pay income to individual clients;
- f) Any other circumstances that affect the ability of the client's funds to earn a net return for the client.

When regularly reviewing the trust accounts, the lawyer shall determine whether changed circumstances require further action with respect to the funds of any client. The determination of whether a client's funds are nominal or short-term shall rest in the sound judgment of the lawyer or law firm. No lawyer shall be charged with an ethical impropriety or breach of professional conduct based on the good faith exercise of such judgment.

[4] A law firm with offices in another state may send a North Carolina client's funds to a firm office in another state for centralized processing provided, however, the funds are promptly deposited into a trust account with a bank that has branch offices in North Carolina, and further provided, the funds are transported and held in a safe place until deposited into the trust account. If this procedure is followed, a client's consent to the transfer of the funds to an out-of-state office of the firm is not required. However, all such client funds are subject to the requirements of these rules. Funds delivered to the lawyer by the client for payment of future fees or expenses should never be used by the lawyer for personal purposes or subjected to the potential claims of the lawyer's creditors.

[5] This rule does not prohibit a lawyer who receives an instrument belonging wholly to a client or a third party from delivering the instrument to the appropriate recipient without first depositing the instrument in the lawyer's trust account.

Property from Professional Fiduciary Service

[6] The phrase "professional fiduciary service," as used in this rule, is service by a lawyer in any one of the

various fiduciary roles undertaken by a lawyer that is not, of itself, the practice of law, but is frequently undertaken in conjunction with the practice of law. This includes service as a trustee, guardian, personal representative of an estate, attorney-in-fact, and escrow agent, as well as service in other fiduciary roles "customary to the practice of law."

[7] Property held by a lawyer performing a professional fiduciary service must also be segregated from the lawyer's personal property, properly labeled, and maintained in accordance with the applicable provisions of this rule.

[8] When property is entrusted to a lawyer in connection with a lawyer's representation of a client, this rule applies whether or not the lawyer is compensated for the representation. However, the rule does not apply to property received in connection with a lawyer's uncompensated service as a fiduciary such as a trustee or personal representative of an estate. Of course, the lawyer's conduct may be governed by the law applicable to fiduciary obligations in general, including a fiduciary's obligation to keep the principal's funds or property separate from the fiduciary's personal funds or property, to avoid self-dealing, and to account for the funds or property accurately and promptly.

[9] Compensation distinguishes professional fiduciary service from a fiduciary role that a lawyer undertakes as a family responsibility, as a courtesy to friends, or for charitable, religious, or civic purposes. As used in this rule, "compensated services" means services for which the lawyer obtains or expects to obtain money or any other valuable consideration. The term does not refer to or include reimbursement for actual out-of-pocket expenses.

Property Excluded from Coverage of Rules

[10] This rule also does not apply when a lawyer is handling money for a business or for a religious, civic, or charitable organization as an officer, employee, or other official regardless of whether the lawyer is compensated for this service. Handling funds while serving in one of these roles does not constitute "professional fiduciary service," and such service is not "customary to the practice of law."

Burden of Proof

[11] When a lawyer is entrusted with property belonging to others and does not comply with these rules, the burden of proof is on the lawyer to establish the capacity in which the lawyer holds the funds and to demonstrate why these rules should not apply.

Prepaid Legal Fees

[12] Whether a fee that is prepaid by the client should be placed in the trust account depends upon the fee arrangement with the client. A retainer fee in its truest sense is a payment by the client for the reservation of the exclusive services of the lawyer, which is not used to pay for the legal services provided by the lawyer and, by agreement of the parties, is nonrefundable upon discharge of the lawyer. It is a payment to which the lawyer is immediately entitled and, therefore, should not be placed in the trust account. A "retainer," which is actually a deposit by the client of an advance payment of a fee to be billed on an hourly or some other basis, is not a payment to which the lawyer is immediately entitled. This is really a security deposit and should be placed in the trust account. As the lawyer earns the fee or bills against the deposit, the funds should be withdrawn from the account. Rule 1.16(d) requires the refund to the client of any part of a fee that is not earned by the lawyer at the time that the representation is terminated.

Abandoned Property

[13] Should a lawyer need technical assistance concerning the escheat of property to the State of North Carolina, the lawyer should contact the escheat officer at the Office of the North Carolina State Treasurer in Raleigh, North Carolina.

Disputed Funds

[14] A lawyer is not required to permit to the client funds that the lawyer reasonably believes represent fees owed. However, a lawyer may not hold funds to coerce a client into accepting the lawyer's contention. The disputed portion of the funds must be kept in a trust account and the lawyer should suggest means for prompt resolution of the dispute, such as the State Bar's program for fee dispute resolution. See Rule 1.5(f). The undisputed portion of the funds shall be promptly distributed.

[15] Third parties may have lawful claims against specific funds or other property in the lawyer's custody, such as the client's creditor who has a lien on funds recovered in a personal injury action. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client. In such cases, when the third-party claim is not frivolous under applicable law, the lawyer must refuse to surrender the property to the client until the claim is resolved. A lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party, but, when there are substantial grounds for dispute as to the person entitled to the funds, the lawyer may file an action to have a court resolve the dispute.

Responsibility for Records and Accountings

[16] It is the lawyer's responsibility to assure that complete and accurate records of the receipt and disbursement of entrusted property are maintained in accordance with this rule. The required record retention period of six years set forth in this rule does not preclude the State Bar from seeking records for a period prior to the retention period and, if obtained, from pursuing a disciplinary action based thereon if such action is not prohibited by law or other rules of the State Bar.

[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 FEOB.

[18] Many businesses are now converting paper checks to automated clearinghouse (ACH) debits to decrease costs and increase operating efficiencies. When a check is converted, the check is taken either at the point-of-sale or through the mail for payment, the account information is captured from the check, and an electronic transaction is created for payment through the ACH system. The original physical check is typically destroyed by the converting entity (although an image of the check may be stored for a certain period of time). If a check drawn on a trust account is converted to ACH, the lawyer will not receive either the physical check or check image. The transaction will appear on the lawyer's trust account statement as an ACH debit with limited information about the payment (e.g., dollar amount, date processed, originator of the ACH debit).

[19] To prevent conversion of a check to ACH without authorization, a lawyer is required to use checks with an "Auxiliary On-Use" field. A check will not be eligible for conversion to ACH if it contains an Auxiliary On-Use field, which is an additional field that appears in the left-most position of the MICR (magnetic ink character recognition) line on a business size check. The lawyer should confirm with the lawyer's financial institution that the Auxiliary On-Use field is included on the lawyer's trust account checks, including an Auxiliary On-Use field on the check will require using checks that are longer than six inches. As with the other information in the MICR line of a check, the routing, account and payment numbers, the financial institution issuing the check determines the content of the Auxiliary On-Use field.

[20] Authorized ACH debits that are electronic transfers of funds (in which no checks are involved) are allowed provided the lawyer maintains a record of the transaction as required by Rule 1.15-3(b)(3) and (c)(3). The record, whether consisting of the instructions or authorization to debit the account, a record or receipt from the register of deeds or a financial institution, or the lawyer's independent record of the transaction, must show the amount, date, and recipient of the transfer or disbursement, and, in the case of a general trust account, also show the name of the client or other person to whom the funds belong.

[21] The lawyer is responsible for keeping a client, or any other person to whom the lawyer is accountable, advised of the status of entrusted property held by the lawyer. In addition, the lawyer must take steps to discover any unauthorized transactions involving trust funds as soon as possible. Therefore, it is essential that the lawyer regularly reconcile the general trust account. This means that, at least once a month, the lawyer must reconcile the current bank statement balance with the balance shown for the entire account in the lawyer's records, such as a check register or its equivalent, as of the date of the bank statement. At least once a quarter, the lawyer must reconcile the individual client balances shown on the lawyer's ledger with the current bank statement balance. Monthly reconciliation will help to uncover unauthorized ACH transactions promptly. The current bank balance is the balance obtained when subtracting outstanding checks and other withdrawals from the bank statement balance and adding outstanding deposits to the bank statement balance. With regard to trust funds held in any trust account, there is also an affirmative duty to produce a written accounting for the client and to deliver it to the client, either at the conclusion of the transaction or periodically if funds are held for an appreciable period. Such accountings must be made at least annually or at more frequent intervals if reasonably requested by the client.

Bank Notice of Overdrafts

[22] A properly maintained trust account should not have any items presented against insufficient funds. However, even the best-maintained accounts are subject to inadvertent errors by the bank or the lawyer, which may be easily explained. The reporting requirement should not be burdensome and may help avoid a more serious problem.

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) Ensuring 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 non-lawyers 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 the 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 the 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 3.3. See also Rule 5.1 and Rule 3.3.

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 Services to 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 15.20), 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 on-line banking, or basic accounting.

History Note: Statutory Authority G.S. 84-23

Amended March 7, 2003; March 6, 2008; June 9, 2016

27 N.C.A.C. 1D, Rule .1316, IOLTA Accounts

(a) **IOLTA Account Defined.** Pursuant to an order of the North Carolina Supreme Court, every general trust account, as defined in the Rules of Professional Conduct, must be an interest or dividend-bearing account. (As used herein, "interest" shall refer to both interest and dividends.) Funds deposited in a general, interest-bearing trust account must be available for withdrawal upon request and without delay (subject to any notice period that the bank is required to reserve by law or regulation). Additionally, pursuant to N.C.G.S. 45A-9, a settlement agent who maintains a trust or escrow account for the purposes of receiving and disbursing closing funds and loan funds shall direct that any interest earned on funds held in that account be paid to the NC State Bar to be used for the purposes authorized under the Interest on Lawyers Trust Account Program according to Section 1316(d) below. For the purposes of these rules, all such accounts shall be known as "IOLTA Accounts" (also referred to as "Accounts").

(b) **Eligible Banks.** Lawyers may maintain one or more IOLTA Account(s) only at banks and savings and loan associations chartered under North Carolina or federal law, as required by Rule 1.15 of the Rules of Professional Conduct, that offer and maintain IOLTA Accounts that comply with the requirements set forth in this subchapter (Eligible Banks). Settlement agents shall maintain any IOLTA Account as defined by N.C.G.S. 45A-9 and paragraph (a) above only at an Eligible Bank; however, a settlement agent that is not a lawyer may maintain an IOLTA Account at any bank that is insured by the Federal Deposit Insurance Corporation and has a certificate of authority to transact business from the North Carolina Secretary of State, provided the bank is approved by NC IOLTA. The determination of whether a bank is eligible shall be made by NC IOLTA, which shall maintain (i) a list of participating eligible banks available to all members of the State Bar and to all settlement agents, and (ii) a list of banks approved for non-lawyer settlement agent IOLTA Accounts available to non-lawyer settlement agents. A bank that fails to meet the requirements of this subchapter shall be subject only to termination of its eligible or approved status by NC IOLTA. A violation of this rule shall not be the basis for civil liability.

(c) **Notice Upon Opening or Closing IOLTA Account.** Every lawyer/law firm or settlement agent maintaining IOLTA Accounts shall advise NC IOLTA of the establishment or closing of each IOLTA Account. Such notice shall include (i) the name of the bank where the account is maintained, (ii) the name of the account, (iii) the account number, and (iv) the name and bar number of the lawyer(s) in the firm and/or the name(s) of any non-lawyer settlement agent(s) maintaining the account. The North Carolina State Bar shall furnish to each lawyer/law firm or settlement agent maintaining an IOLTA Accounts a suitable plaque explaining the program, which plaque shall be exhibited in the office of the lawyer/law firm or settlement agent.

(d) **Directive to Bank.** Every lawyer or law firm and every settlement agent maintaining a North Carolina IOLTA Accounts shall direct any bank in which an IOLTA Account is maintained to:

(1) Permit interest, less any deduction for allowable reasonable bank service charges or fees, (as used herein, "service charges" shall include any charge or fee charged by a bank on an IOLTA Account) as defined in paragraph (e), at least quarterly to NC IOLTA;

(2) Transmit with each remittance to NC IOLTA a statement showing for each account: (i) the name of the law firm/lawyer or settlement agent maintaining the account, (ii) the lawyer/law firm's or settlement agent's IOLTA Account number, (iii) the earnings period, (iv) the average balance of the account for the earnings period, (v) the type of account, (vi) the rate of interest applied in computing the remittance, (vii) the amount of any service charges for the earnings period, and (viii) the net remittance for the earnings period; and

(3) Transmit to the law firm/lawyer or settlement agent maintaining the account a report showing the amount remitted to NC IOLTA, the earnings period, and the rate of interest applied in computing the remittance.

(e) **Allowable Reasonable Service Charges.** Eligible Banks may elect to waive any or all service charges on IOLTA Accounts. If a bank does not waive service charges on IOLTA Accounts, allowable reasonable service charges may be assessed but only against interest earned on the IOLTA Account or funds deposited by the lawyer/law firm or settlement agent in the IOLTA Account for the purpose of paying such charges. Allowable reasonable service charges may be deducted from interest on an IOLTA Account only at the rates and in accordance with the bank's standard practice for comparable non-IOLTA accounts. Allowable reasonable service charges for IOLTA Accounts are: (i) a reasonable account maintenance fee, (ii) per check charges, (iii) per deposit charges, (iv) a fee in lieu of a minimum balance, (v) federal deposit insurance fees, and (vi) automated transfer (Sweep) fees. All service charges other than allowable reasonable service charges assessed against an IOLTA Account are the responsibility of and shall be paid by the lawyer or law firm. No service charges in excess of the interest earned on the Account for any month or quarter shall be deducted from interest earned on other IOLTA Accounts or from the principal of the Account.

History Note: Statutory Authority G.S. 24-23
Readopted effective December 8, 1994

Amendments Approved by the Supreme Court: March 6, 2008; February 25, 2009; January 28, 2010; March 28, 2012; August 23, 2012

27 N.C.A.C. 1D, Rule .1317, Comparability Requirements for IOLTA Accounts

(a) **Comparability of Interest Rate.** Eligible Banks that offer and maintain IOLTA Accounts must pay to an IOLTA Account the highest interest rate generally available from the bank to non-IOLTA Accounts (Comparable Rate) when the IOLTA Account meets or exceeds the same minimum balance or other account eligibility qualifications, if any. In determining the highest interest rate generally available from the bank to non-IOLTA accounts, an Eligible Bank may consider factors, in addition to the IOLTA account balance, customarily considered by the bank when setting interest rates for its customers, provided that such factors do not discriminate between IOLTA accounts and non-IOLTA accounts.

(b) **Options for Satisfying Requirement.** An Eligible Bank may satisfy the Comparable Rate requirement by electing one of the following options:

- (1) Use an account product that has a Comparable Rate;
- (2) Without actually changing the IOLTA Account to the bank's Comparable Rate product, pay the Comparable Rate on the IOLTA Account;
- (3) Pay the benchmark rate (Benchmark), which shall be determined by NCAOLTA periodically, but not more frequently than every six months, to reflect the overall Comparable Rate for the NCAOLTA program. The Benchmark shall be a rate equal to the greater of: (i) 0.65% or (ii) 65% of the Federal Funds Target Rate as of the first business day of the IOLTA remitting period, and shall be net of allowable reasonable service charges. When applicable, NCAOLTA will express the Benchmark in relation to the Federal Funds Target Rate.

(c) **Options for Account Types.** An IOLTA Account may be established as:

- (1) Subject to paragraph (d), a business checking account with an automated investment feature (Sweep Account), such as an overnight investment in financial institution daily repurchase agreements or money market funds invested solely in or fully collateralized by US government securities, which are US Treasury obligations and obligations issued or guaranteed as to principal and interest by the United States or any agency or instrumentality thereof;
- (2) A checking account paying preferred interest rates, such as market based or indexed rates;
- (3) A public funds interest-bearing checking account, such as accounts used for governmental agencies and

other non-profit organizations;

(4) an interest-bearing checking account such as a negotiable order of withdrawal (NOW) account, or a business checking account with interest;

(5) any other suitable interest-bearing deposit account offered by the bank to its non-IOLTA customers.

(d) **Financial Requirements for Sweep Accounts.** If a bank establishes an IOLTA Account as described in paragraph (c)(1), the following requirements must be satisfied: an overnight investment in a financial institution daily repurchase agreement shall be fully collateralized by United States government securities, as described in this Rule, and may be established only with an eligible bank that is "well capitalized" or "adequately capitalized" as those terms are defined by applicable federal statutes and regulations. A "money market fund" is an investment company registered under the Investment Company Act of 1940, as amended, that is qualified to hold itself out to investors as a money market fund under Rules and Regulations adopted by the Securities and Exchange Commission pursuant to said Act. A money market fund shall be invested solely in United States government securities or repurchase agreements fully collateralized by United States government securities, as described in this Rule, and, at the time of the investment, shall have total assets of at least two hundred fifty million dollars (\$250,000,000.00).

(e) **Interest Calculation.** Interest shall be calculated in accordance with an eligible bank's standard practice for comparable non-IOLTA accounts.

(f) **Higher Rates and Waiver of Service Charges Allowed.** Nothing in this rule shall preclude a participating bank from paying a higher interest rate than described above or electing to waive any service charges on IOLTA accounts.

History: Order of the N.C. Supreme Court
Adopted January 28, 2010

SECTION II: KEY CONCEPTS IN CLIENT TRUST ACCOUNTING

The following seven key concepts provide the background you need to understand your client trust accounting responsibilities.

Key Concept 1: Separate Clients are Separate Accounts

Client A's money has nothing to do with Client B's money. Even when you keep them in a general trust account (also known as an IOLTA account), each client's funds are completely separate from those of all your other clients. In other words, you are **NEVER** allowed to use one client's money to pay another client's or your own obligations.

In a general trust account, the way to distinguish one client's money from another's is to keep a client ledger for each individual client's funds. A client ledger tells you how much money you've received on behalf of a client, how much money you've paid out on behalf of that client, and how much money that client has left in your general trust account. If you are holding money in your general trust account for ten clients, you have to maintain ten separate client ledgers. If you keep each client's ledger properly, you will always know exactly how much of the money in your general trust account belongs to each client. If you don't, you will lose track of how much money each client has, and when you make payments out of your general trust account, you won't know which client's money you are using.

Also note, if your client's money can earn income because the funds are large enough in amount or are held for a long period of time, then you cannot place the funds in a general trust account. The funds must be deposited in an account dedicated to that client or transaction. *For more information on dedicated trust accounts, see Section III, Trust Account Basics.*

Key Concept 2: You Can't Spend What You Don't Have

Each client has only his or her own funds available to cover their expenses, no matter how much money belonging to other clients is in your general trust account. Your general trust account might have a balance of \$100,000, but if you are only holding \$10 for a certain client, you can't write a check for \$10.50 on behalf of that client without using some other client's money.

The following example graphically illustrates this concept. Assume you are holding a total of \$5,000 for four clients in your general trust account as follows:

Client A	\$1,000
Client B	\$2,000
Client C	\$1,500
Client D	\$500
Total	\$5,000

If you write a check for \$1,500 from the general trust account for Client D, \$1,000 of that check is going to be paid for by Clients A, B, and C. The funds you are holding in trust for them are being used for Client D's expenses. You should have a total of \$4,500 for Clients A, B, and C, but you only have \$3,500 left in the trust account. In State Bar disciplinary matters, the failure to maintain a sufficient client trust account balance will support a finding of misappropriation.

Key Concept 3: There's No Such Thing as a "Negative Balance"

It's not uncommon in personal checkbooks for people to write checks against money they haven't deposited yet or a check that has not cleared yet, and show this as a "negative balance." In client trust accounting, there's no such thing as a negative balance. A "negative balance" is at best a sign of negligence and, at worst, a sign of theft.

In client trust accounting, there are only three possibilities:

- You have a **positive** balance (while you are holding money for a client);
- You have a **zero** balance (when all the client's money has been paid out); or
- YOU HAVE A PROBLEM because the balance is **less than zero** (a so-called "negative balance").

Key Concept 4: Timing is Everything

It takes anywhere from a day to several weeks after you make a deposit before the money becomes available for use. "A client's funds aren't available" for you to use on the client's behalf until they have cleared the banking process and been credited by the bank to your general trust account. (This is especially true when you receive an insurance company's settlement draft—which cannot clear until the company actually receives the draft at its home office during the bank collection process and honors the draft. Thus, insurance company settlement drafts will take longer to clear your account.) If you write a check for a client at any time *before* that client's funds clear the banking process and are credited to your general trust account, ordinarily either the check will bounce or you will be using other clients' money to cover the check.

The time it takes for trust account funds to become available after deposit depends on the form in which you deposit them. Every bank has different procedures, so when you open your trust account, get the bank's schedule of when funds are available for withdrawal. Depending on the instrument, you may have to wait as many as 15 working days before you can be reasonably confident that the funds are available. For example, even if you make a cash deposit, the money may not be available for use until the following day. If you deposit a personal check from an out-of-state bank, the money will take longer to be available. Either way, until the bank has credited the deposit to your general trust account, you can't pay out any portion of that money for that client.

You also need to know what time your bank has set as the deadline for posting deposits to that day's business

and for paying checks presented to it. Otherwise, even when you have deposited cash, you may end up drawing on uncollected funds. For example, let's say your bank credits any deposit made after 3PM on the following day, but stays open for business until 5PM. Your client arrives at 3:30 and gives you \$5,000 in cash, which you immediately deposit. At 4PM you write a general trust account check against that money to pay an investigator. If the investigator presents the check for payment at the bank before it closes at 5PM, the check will either bounce or be covered by other clients' money.

You may be tempted to do your client a favor by writing a check from your trust account to the client for settlement proceeds before the settlement check has cleared because you know there's money belonging to other clients in your general trust account to cover his client's check. Depending on the circumstances, your client may insist that you do this. Don't. If you do, you'll end up writing a check to one client using another client's money. You should never help one client at the expense of your obligations to your other clients. In other words, no matter how expedient or kind or convenient it seems, don't make payments on your clients' behalf before their deposited funds have cleared. Otherwise, sooner or later, you'll end up spending money your clients don't have.

Some banks offer an "instant credit" arrangement where the bank agrees to immediately credit accounts for deposits while the bank waits for the funds from another financial institution. For more information on "Instant Credit," see Section 4 of *Funds Go Out*.

Key Concept 5: You Can't Play the Game Unless You Know the Score

In client trust accounting, there are two kinds of balances: the "running balance" of the money you are holding for each client, and the "running balance" of the general trust account.

A "running balance" is the amount you have in an account after you add in all the deposits (including interest earned, etc.) and subtract all the money paid out (including bank charges for items like wire transfers, etc.). In other words, the running balance is what's in the account at any given time. The running balance for each client is kept on the client ledger, and the running balance for each trust account is kept on the account journal. (A sample client ledger is shown in Appendix B.2.)

Maintaining a running balance for a client is simple. Every time you make a deposit on behalf of a client, you write the amount of the deposit in the client ledger and add it to the previous balance. Every time you make a payment on behalf of the client, you write the amount in the client ledger and subtract it from the previous balance. The result is the running balance. That's how much money the client has left to spend.

You figure out the running balance for the general trust account the same way. Every time you make a deposit to the general trust account, you write the amount of the deposit in the account journal and add it to the previous balance. Every time you make a payment from the general trust account, you write the amount in the account journal and subtract it from the previous balance. The result is the running balance. That's how much money is in the account.

Since "you can't spend what you don't have," you should check the running balance in each client's ledger before you write any general trust account checks for that client. That way, if your records are accurate and up to date, it's almost impossible to pay out more money than the client has in the account.

Key Concept 6: The Final Score is Always Zero

The goal in client trust accounting is to make sure that every dollar you receive on behalf of a client is ultimately paid out to the client at the conclusion of the representation or to third parties on the client's behalf. What comes in for each client must equal what goes out for that client; no more, no less.

Many lawyers have small, inactive balances in their general trust accounts. Sometimes these balances are the result of a mathematical error, sometimes they are part of a fee you forgot to take, and sometimes a check you wrote never cleared or wasn't cashed.

Whatever the reason, as long as the money is in your general trust account, you are responsible for it. The longer these funds stay in the bank, the harder it is to account for them. Therefore, you should take care of those small, inactive balances as soon as possible, including, if necessary, following up with payees to find out why a check hasn't cleared.

If you take steps to take care of these small balances and are still unable to pay out the funds, you should consider whether the unclaimed monies must be escheated to the state. For more information on abandoned or unclaimed funds, see Section 11, Part D.

Key Concept 7: Always Maintain an Audit Trail

An "audit trail" is the series of bank-created records, like cancelled checks, bank statements, etc., that make it possible to trace what happened to the money you handled. An audit trail should start whenever you receive funds on behalf of a client and should continue through the final check you issue against them. Without an audit trail, you have no way to show that you have taken proper care of your clients' money, or to explain what you did with the money if any questions come up. The audit trail is also an important tool for tracking down accounting errors. If you don't maintain an audit trail, you will find it hard to correct the small mistakes, like errors in addition or subtraction, and the big mistakes, like miscredited deposits, that are inevitable when you handle money.

The key to making good audit trails is being descriptive. Let's say you are filling out a deposit slip for five checks relating to three separate clients. All the bank requires you to do is write down the bank identification code for each check and the check amounts. This doesn't identify which client the money belongs to. If you include the name of the client and keep a copy or make a duplicate, you will know which client the check was for, which is the purpose of an audit trail. That will make it easy to answer any questions that come up, even years later.

By the same token, every check you write from your general trust account should identify on the face of the check the client on whose behalf it is written, so that it is easy to match up the money with the client. That means you should NEVER make out a general trust account check to cash, because there is no way to know later who actually cashed the check. If you are handling more than one case for the client, indicate which matter the payments and receipts relate to on your checks and deposit slips.

SECTION III: TRUST ACCOUNT BASICS

A. Trust Accounts: What Are They and How Many Do You Need?

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. See Rule 1.15-1.

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. See 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.

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. See Rule 1.15-1(h) and Rule 1.15-2. If desired, a lawyer may have multiple trust accounts for administrative purposes. For example, lawyers often have trust accounts for real estate transactions which are

distinct from the trust accounts used for other client matters.

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. See Rule 1.15-2.

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

Yes. The size of the deposit or the length of time the deposited funds are to be held could be such that a prudent person acting in a fiduciary capacity would be expected to invest the funds on behalf of the beneficiary, and 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 1.15-4 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 is the property of the client. See Rule 1.15-2(q).

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. See Rule 1.15-2(b) and 7 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. For more information on IOLTA accounts, see Section X.

B. Opening a Trust Account

Choosing a Trust Account Bank

Rule 1.15 of the North Carolina Rules of Professional Conduct, and its subparts, contains many provisions about the duty to deposit client funds in a trust account to protect and secure the funds. For example, Rule 1.15-2(b) admonishes: "All trust funds received by or placed under the control of a lawyer shall be promptly deposited in either a general trust account or a dedicated trust account of the lawyer." The rule does not say where a lawyer should establish a trust account except that it must "be maintained at a bank in North Carolina." Upon written consent of the client, a dedicated trust account can be maintained at an institution outside of the state. See Rule 1.15-2(e). "Bank" is defined in Rule 1.15-1(a) as "a bank, savings and loan association, or credit union chartered under North Carolina or federal law."

The depository bank for a lawyer's trust account must agree to the following:

- Report to the North Carolina State Bar when an item drawn on the trust account is presented for payment against insufficient funds. See Rule 1.15-2(l). A lawyer may not maintain a trust or fiduciary account at a bank that does not agree to make the reports. See Appendix B for a copy of the directive.
- Provide the lawyer with all cancelled checks or other items drawn on the trust account or digital images of the checks. The digital images must be legible reproductions of the front and back of the original item with no more than six items per page and no images smaller than 3/16 inches. See Rule 1.15-3(b)(A).
- If the bank provides only digital images of cancelled checks and items, it must maintain the capacity to reproduce additional or enlarged images of the original items upon request for a period of six years. See Rule 1.15-3(b)(B).

- Agree to pay IOLTA accounts the highest interest rate available to that bank's other customers when the IOLTA accounts meet the same minimum balance or other account qualifications (also known as the "comparability requirement"). See Rule 1.1317. Banks will be certified as "eligible" by NCIOLTA upon finding that they are in compliance with this comparability requirement, and NCIOLTA will maintain a list of eligible banks. Banks not found on the eligible list must submit a compliance statement and receive approval before IOLTA accounts may be opened with them.

Please review the "Opening a General (IOLTA) Trust Account: Information Packet" before opening a trust account. It includes a helpful checklist for items to bring with you to the bank and contains images of important documents. See Appendix B4 for a copy of the checklist.

If your bank is not doing these things, you are professionally responsible—not the bank. Compliance with the requirements varies substantially from bank to bank and from branch office to branch office. Some banks regularly fail to notify the State Bar when a trust account check is presented against insufficient funds. This occurs despite the fact the lawyer properly filed a directive with the bank, pursuant to Rule 1.15-2(l), instructing the bank to notify the State Bar.

How do you fulfill your professional responsibility to choose the right bank?

Since you are responsible for the bank's compliance with the notice and record-keeping requirements, the only way for you to act in a professionally responsible manner is to investigate the banks in your community to find out which banks understand the requirements and are willing to comply. If the bank maintains only digital images of cancelled checks, you must ensure that the size and front/back requirements are being met and that the bank maintains the ability to reproduce the records for a period of at least six years. Once you choose a bank (www.nciolta.org/eligible-banks), monitor the bank's compliance and, if the bank changes its procedures, insist upon compliance or move your trust account to a bank that will comply. If a local branch manager does not understand the notice and recordkeeping rules, or the IOLTA comparability requirement, encourage the manager to contact the home office for instructions or call the State Bar. The lawyers in the ethics department and the staff auditor would be glad to explain the rules and requirements.

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, and credit unions located in North Carolina or with branch offices in North Carolina. See Rule 1.15-2(e) and Rule 1.15-1(a). Dedicated trust accounts may be maintained at an institution outside the state upon written consent of the client.

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 into a trust account with a bank that has branch offices in North Carolina. See Rule 1.15-4, Comment [4].

Dedicated Trust Accounts

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. See Rule 1.15-2(e).

Labeling a Trust Account

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, Lawyer' or 'Smith, Jones & Williams Trust Account.' For an example of a properly labeled general trust account check, see Appendix B6. Although the tax identification number of NCIOLTA will be assigned to all general trust accounts, the trust account checks should bear the name assigned by the firm to the account.

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. See Rule 1.15-1(c), (e), (h), (i). 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").

Trust Account Checks

Rule 1.15-3(b)(2) requires that all items drawn on the general trust account indicate client name, file number, or other identifying information of the client from whose balance the items are drawn. Therefore, any check written from the trust account must have client reference data on the check. The client's name or identification number may appear on the check stub, check register, journal, etc.; however, this information must also appear on the face of the check. If a trust account software program or a check-writing program cannot record this reference data on the check, it should be manually recorded.

If a check drawn on the trust account includes payment of fees or cost reimbursement for more than one client, the check should indicate the respective individual payments.

The purpose for the disbursement may be indicated after the client's name (i.e., fees, cost reimbursement, etc.). [See Appendix B6 for an example.]

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-Us" field in the MICR (magnetic ink character recognition) line of the check. See Rule 1.15-3(a). 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 the lawyer's record of the transaction. [For an example of a business-sized trust account check, see Appendix B5.]

Proper Signatories

Checks drawn on a trust account may be signed by lawyers and supervised nonlawyer employees. However, a nonlawyer employee may not have signatory authority if he or she is responsible for performing monthly or quarterly reconciliations. See Rule 1.15-2(s). Additionally, prior to exercising signature authority, a lawyer or supervised nonlawyer must take a one-hour trust account management CLE approved by the State Bar for this purpose. **NOTE: The initial deadline for completing the 1-hour CLE is the end of the 2017 CLE year (Feb. 18).**

Subject to the restrictions noted above, a lawyer may grant signatory authority to a nonlawyer employee. However, a lawyer is still professionally responsible for the actions of those under his or her supervision.

Signature Requirements

Trust account checks may not be signed by using signature stamps, preprinted signatures, or electronic signatures. See Rule 1.15-2(s).

C. Trust Account Management

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

Yes, however, unless the firm has appointed a trust account oversight officer (TAOO) pursuant to Rule 1.15-4 (see below), 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. See Rule 1.1.

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 nonlawyer. See 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.

Rule 1.15-4 Trust Account Oversight Officer (TAOO)

Rule 1.15-4 allows, but does not require, a multi-member firm to designate, annually and in writing, one or more partners as oversight officers for any general trust account. The rule helps a firm ensure that it is properly maintaining its trust and fiduciary accounts, and avoid reliance on an assumption that trust accounts are being maintained by someone else in the firm. Designation as the TAOO requires the lawyer to complete a certain amount of training to gain proficiency in the trust accounting rules and the firm's accounting system, and requires the firm to adopt a written policy detailing the firm's trust account management procedures. Again, this rule is optional for multi-member firms that want to add an *extra* level of oversight to their firm's trust account management.

May a lawyer "link" her trust account with her business account for the purposes of determining interest earned or charges assessed?

A lawyer cannot permit the bank to link her trust and business accounts for the purpose of determining interest earned or charges assessed if such an arrangement causes the lawyer to use client funds from the trust account to offset service charges assessed on the business account. *RPC 150 [Appendix A]*.

D. Abandoned or Unclaimed Funds/Property

If 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?

The lawyer must first make a diligent attempt to determine the identity and/or the location of the owner of the funds in order that an appropriate disbursement might be made. This means questioning personnel and investigating records and other sources of information in an effort to determine the identity and location of the owner of the funds. See Rule 1.15- 2(q). If that effort is successful, the entrusted property shall be promptly transferred to the person or entity to whom it belongs. If the lawyer is unsuccessful in ascertaining the identity or the location of the owner of the funds, the lawyer must determine whether the funds qualify for escheatment to the State of North Carolina pursuant to N.C. Gen. Stat. Chap 116B. Pending escheatment, the funds should be held and accounted for in the lawyer's trust account. If qualified, such funds must be escheated to the state even if it is believed, but cannot be conclusively documented, that the funds belong to the lawyer.

How do I escheat unidentified or unclaimed funds in my trust account?

If you have diligently attempted to determine the identity and location of the owner of the funds without success, the funds should be sent to the Escheat and Unclaimed Property Section of the Office of the North Carolina State Treasurer. Contact the State Treasurer's Office for the forms necessary to transfer funds or for assistance in completing the forms:

NC Department of State Treasurer Unclaimed Property Program
3200 Atlantic Avenue
Raleigh, NC 27604-1668
Phone: (919) 814-4200
Email: unclaimed.property@nctreasurer.com
Website: www.nctreasurer.com

The primary purpose of the escheat fund is to provide a means by which unclaimed property can be brought under the control of the state and converted to the benefit of the people of North Carolina. The state treasurer invests the

escheated in the same manner that the state retirement funds are invested. The income derived from this investment is distributed annually to the State Education Assistance Authority to be used to make loans to worthy and needy North Carolina students who are enrolled in state public institutions offering post-secondary education. If there are questions concerning any aspect of the Escheat and Unclaimed Property Program, inquiries should be directed to the Department of the State Treasurer, Unclaimed Property Program.

For more information about escheating funds, please see Appendix C and the NCHolder Reporting Guide, available here: https://www.nctreasurer.com/upp/Resources/NC_Holder_Reporting_Guide.pdf.

How do I handle trust funds for a deceased client?

When there are excess funds left in a lawyer's trust account after a client dies, the lawyer must comply with the original fee agreement for the representation of the client and disburse the funds accordingly. See EA 2295 [Appendix A].

May I charge a dormancy fee against unclaimed funds?

A lawyer may charge a reasonable dormancy fee against unclaimed funds if the client agrees in advance and the fee meets other statutory requirements. See 2006 FEO 15 [Appendix A].

E. Closing a Trust Account

Closing Account with Remaining Funds

If you have an account that you no longer use, but funds remain in the account, then either transfer the funds from the old account into a new account or disburse the funds to the owners as shown on the client ledgers for the account. See Rule 1.15-3(b)(5). Any funds on deposit for a client who is no longer represented by the lawyer or the law firm should be disbursed to the owners thereof. If transfer to a new account is appropriate, you must document the transfer of the funds from the old account to the new account and accurately note the deposit of funds on the appropriate clients' ledgers. See Rule 1.15-3(b)(5). If any interest was credited to the dormant account, this money should be sent to the NCOILTA program. If there are unclaimed or unidentified funds in the account, see the discussion of abandoned funds in the preceding pages.

Law Firm Dissolution and Withdrawal from Practice

The property of clients entrusted to the firm should be protected during the dissolution of a law firm. RPC 48 states:

All full and complete accounting of all fiduciary property of clients entrusted to the firm should be made to each client, with a written request for their return or future disposition. Failure of the client to respond should be taken as a request for the return of said fiduciary property to the client, unless governed by a court order or proceeding to the contrary.

For information on the wind-down of a missing, incapacitated, deceased, or disciplined lawyer's sole practice, see Appendix A.

SECTION IV: FUNDS GO IN

A. What Goes Into a 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 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. See Rule 1.15-2(b) and (c), and Comment following Rule 1.15-4.

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

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 items drawn on the account which are presented for payment against insufficient funds. Such funds should not be deposited in the lawyer's general trust account. Rules 1.15-1(e) and (f); Rule 1.15-2(c), (e), (f), (k); Rule 1.15-3. *For more information, see Section VIII, "Fiduciary Accounts."*

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

Generally speaking, any negotiable item 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. See Rules 1.15-1(i) and 1.15-2(g); see also, RPC 91 [Appendix A]; 01 FEO 6 [Appendix A]; and 06 FEO 6 [Appendix A].

Must a lawyer deposit very small sums of money received from a client into a trust account?

Yes. A lawyer who receives from his or her client a small sum of money (for example, money which is to be used to pay the cost of recording a deed) must deposit that money in a trust account. RPC 7 [Appendix A].

May a lawyer who receives a lump sum payment in advance, which is inclusive of the costs of litigation, deposit the payment in his operating account as fees?

No. Where a lawyer receives a lump sum payment in advance which is inclusive of the costs of litigation, the portion representing the costs must be deposited in the trust account. Some of the money collected by the firm as "fees" is actually entrusted funds intended to defray the costs of litigation. The rules require that funds received in the fiduciary capacity, however characterized, be directly deposited into a trust account. RPC 25.1 [Appendix A].

May a lawyer closing a residential real estate transaction ask borrowers and sellers to agree in writing to waive the return of very small sums, especially where the lawyer bears similar risk of loss?

Yes. While Rule 1.15-2(h) provides that a lawyer must disburse property or trust funds held on behalf of the client as the client directs, the rules do not appear to prohibit a lawyer from requesting that clients on occasion agree to waive the return of certain insubstantial or *de minimis* amounts. If the party or parties involved refuse to agree, then the lawyer must abide by their wishes for the return of the funds. EA 217 [Appendix A].

B. What Does Not Go in the Trust Account?

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 are funds belonging in part to a client and in part presently or potentially to the lawyer, such as where deposited item represents both the client's recovery and the lawyer's fee. In such 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. See Rule 1.15-2(f).

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 [Appendix A]. Since a general retainer is deemed earned when paid, it is 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. A lawyer has an ethical obligation to refund the unearned portion of any fee paid in advance upon discharge or withdrawal, therefore, 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); 1.15, Comment [12]; and Rule 1.16(d). [See 2008 FEO 10 for a complete overview of the different types of fees and where they should be deposited. Appendix A.]

What about funds belonging to an organization in lawyer's possession as an official of the organization?

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. See Rule 1.15-1(d) and (m); Rule 1.15-2(c); Rule 1.15, Comment [10].

C. Depositing Funds into a Trust Account

Example: Depositing a Mix of Trust and Non-trust Funds

A lawyer advises a client that a domestic matter will involve a legal fee of \$150.00, earned upon receipt, as agreed up front, a recording fee of \$30.00, and a sheriff fee of \$4.00, totaling \$184.00.

Alternative (a): The client presents the lawyer with a check for \$184.00. The check is deposited into the general trust account. A check for \$150.00 is then disbursed to the lawyer and the remaining fees are paid when required (Rule 1.15-2(g)).

Alternative (b): The client pays with two checks, one for \$150.00 and another for \$34.00. The \$34.00 check is deposited into the general trust account. The \$150.00 is deposited in the firm operating account or otherwise paid to the lawyer.

Alternative (c): The client pays in cash. \$34.00 is deposited into the general trust account. The remaining cash is deposited in the firm operating account or otherwise paid to the lawyer.

If the lawyer previously advanced the recording and sheriff fees, all funds received from the client would in each instance be deposited into the office account.

If, however, a check is submitted by a client it contains any funds that are to be used to pay client expenses in the future, the check must be deposited into the trust account intact. Some lawyers ask the bank to split a client's check at the time of deposit: the cost portions deposited in the trust account and the fee portions deposited in the office account. This violates Rule 1.15-2(g). [For a Sample Deposit Slip, see Appendix 7 and 8.]

Credit Card Payments from Clients

Lawyers may accept payment of legal fees by electronic transfer and credit card. Deposits to the trust account by credit card are permitted subject to the requirements explained in 2007 Formal Ethics Opinion [Appendix A]. Client funds cannot be deposited by credit card to the office operating account and then transferred to the trust account. A lawyer must arrange to have all credit card payments deposited into the trust account if the lawyer's bank cannot or will not distinguish between the operating account, into which earned fees are deposited, and the trust account, into which unearned fees and entrusted funds are deposited.

Cash Reimbursements

When the cost of recording documents at the Register of Deeds is overestimated, the Register of Deeds often reimburses the lawyer in cash. Rule 1.15-2(b) requires client funds to be promptly deposited in a lawyer trust account and Rule 1.15-3(b) requires a lawyer to maintain a complete record of all client funds received by the lawyer. Therefore, cash refunds must be recorded on the client's ledger card and deposited in the trust account. The receipt from the Register of Deeds should also be retained.

Some lawyers ask clients to execute an agreement (sometimes called "Recording Fee Refund Waiver") wherein *de minimus* cash refunds from the Register of Deeds (of a designated amount or less) are retained by the lawyer and refunds exceeding that amount are deposited in the trust account for reimbursement to the client. This practice, although permitted, is not encouraged. It is permitted only if the agreement with the client fully discloses the arrangement and the client consents in advance. A copy of the agreement should be retained. See EA 217(A) Appendix A.

SECTION V: FUNDS GO OUT

A. What Disbursements are Inappropriate?

Immediate Disbursement

Disbursement against a client check should not be made until the check is collected unless the lawyer's depository bank grants provisional credit for deposited items and the requirements of RPC 91 are met. The risk that the check will not clear may not be borne by other client funds in the trust account.

Trust account checks are returned for insufficient funds on occasion because of the failure to make a deposit before the close of the banking day (usually 2:00 PM). Such deposits are not posted until the following business day. Timely deposits ensure availability of funds for disbursement.

Bank Charges

Some lawyers inadvertently pay the bank service charges for check printing, wires, returned checks, etc., from client funds. This occurs when a bank debits the trust account for a service charge. Rule 1.15-2(f)(1) permits a lawyer to deposit in advance sufficient personal funds in the trust account to pay for service charges, thereby avoiding the use of client funds. When this is done, a record (i.e., ledger card) should be maintained concerning the deposit and disbursement of these funds. Some lawyers direct their bank to bill the office operating account for service charges on the trust account if both accounts are maintained at the same bank. On occasion, the bank will incorrectly debit the trust account. If the trust account is incorrectly charged, the error may result in client funds being used to pay the charge and the trust account must be reimbursed promptly.

Outstanding Checks

There are several ways to address the problem of trust account checks that are not cashed for a significant period of time. Some lawyers print "Void after 90 Days" on trust account checks to persuade payees not to hold the checks. The notation does not guarantee that the bank will not honor the check after 90 days. This issue should be addressed with the bank in advance. Other lawyers contact all recalcitrant payees who fail to negotiate a trust account check after a certain period of time (usually six to nine months). Certified mail should be used if warranted by the amount of the check. If the payee cannot be located or reply is not received within a reasonable time, the check is voided or a stop payment is placed on the check. The stop payment charge has to be paid and a stop payment is usually good for only six months. If the check is voided, it may still be negotiable. Therefore, a stop payment order may be more appropriate depending on the amount of the check. If a stop payment order is placed on a check, the check may still be cashed. The bank's procedures for stop payment orders should be understood in advance. After payment is stopped on a check, the funds are noted as returned on the client's ledger card. There is not a restriction on issuing a second trust account check. If the lawyer believes that funds have been abandoned, the lawyer must follow the escheat requirements set forth in G.S. 116B. See Rule 1.15-2(r).

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. See Rule 1.15-2(m).

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 item 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. See Rules 1.15-2(f)(2) and (g).

May a lawyer serving as an escrow agent disburse funds in a manner not contemplated in the escrow agreement?

A lawyer serving as an escrow agent may not disburse funds in a manner not contemplated in the escrow agreement unless all parties agree. RPC 6 [Appendix A].

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 125 [Appendix A]. For situations when the client provides no direction and the lawyer wants to pay a bill, see RPC 75 [Appendix A].

May a lawyer make a conditional delivery of trust account checks to a real estate agent before depositing loan proceeds against which checks were to be drawn?

No. The lawyer may not ethically deliver trust account checks to the real estate agent, even if such delivery is made "in trust" or "conditionally," until the lawyer has recorded the closing documents and deposited the closing proceeds in his or her trust account. Funds deposited in a trust account are funds received by the lawyer as a fiduciary, which must be held and disbursed only for the benefit of those entitled to them, in accordance with appropriate instructions. Accordingly, the lawyer cannot violate or delegate his or her fiduciary duty by putting into the hands of an unrelated third-party a check drawn on a trust account containing only the funds of others. RPC 78 [Appendix A].

Is it improper for a lawyer to disburse settlement funds conditionally delivered by opposing counsel before satisfying the settlement conditions under which the lawyer received the settlement check?

Yes. When a lawyer accepts conditional delivery of settlement proceeds from opposing counsel, the lawyer implicitly agrees to abide by the prescribed conditions. While it may not be a violation of Rule 1.15, any deliberate failure to abide by those conditions, such as by disbursing the proceeds without first having obtained a signed release, would be dishonest and violative of Rule 3.4(c), which prohibits conduct involving dishonesty, fraud, deceit, or misrepresentation. RPC 127 [Appendix A].

Is it ever proper for a lawyer to make disbursements from the trust account from provisionally credited but uncollected funds represented by a deposited item which has not yet cleared banking channels?

RPC 191 [Appendix A] 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 items specified in the Good Funds Settlement Act, G.S. 245A. Disbursements against provisionally credited funds should be made only where the lawyer reasonably believes that the underlying deposited items are 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. The lawyer should use caution when disbursing against provisional credit due to the recent increase of counterfeit check scams. See also 2017 FEO 23 (limitation on disbursements applicable to all transactions including disbursement of personal injury settlement) [Appendix A], 2016 FEO 8 (disbursements in reliance on bank funding schedule) [Appendix A], and an article about check scams from the State Bar Journal [Appendix A].

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.

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

Yes, subject to the conditions set forth in RPC 191. See *01 FEOB [Appendix A]*.

B. Overdrafts and Checks Presented Against Insufficient Funds

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 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 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. Reimbursement of the trust account should NOT be held in abeyance pending resolution of the error (e.g., by locating the party responsible for a bad check). Any delay in reimbursing the account may result in the use of other client funds to cover the shortage, which is not permitted.

Finally, the lawyer should immediately document the problem and any corrective action taken in a memorandum for his or her own files.

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(I). Note that the reporting requirement applies to the presentation of an instrument against insufficient funds, not just to the return of an instrument for insufficient funds.

The rule requires a lawyer to maintain trust accounts and fiduciary accounts only at a bank that agrees to notify the State Bar pursuant to the directive. The lawyer must ensure that the bank understands that the directive applies to all trust and fiduciary accounts of the lawyer, not just to general trust accounts (sometimes called "IOLTA accounts" by banks). For a copy of the bank directive, see Appendix B. Lawyers with signatory authority on fiduciary accounts, such as estate accounts, should also comply with this requirement.

The purpose of the directive is to prevent defalcations by giving the Bar notice when a trust account may be overdrawn. The requirement greatly diminishes the possibility that a lawyer engaged in misappropriation of trust funds can hide such activity by directing the depository bank to notify him or her prior to the return of a check for insufficient funds in order that the lawyer might deposit funds into the account before the item is returned and thereby avoid the reporting requirement.

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 conducted. See Rule 1.15-2(k).

Are there other times I must report mistakes to the State Bar?

Yes. Rule 1.15-2(p) requires lawyers who discover or reasonably believe that entrusted property has been misappropriated or misapplied to inform the trust account compliance counsel at the State Bar. When an accounting or bank error results in 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).

C. ACH Transactions

To reduce the possibility of unauthorized ACH check conversions, all general trust accounts, dedicated trust accounts, and fiduciary accounts must use business-size checks with an “Auxiliary On-Us” field in the MICR (magnetic character recognition) line of the check. See Rule 1.15-3(a). NACHA rules state that a check is ineligible for ACH conversion if the check contains the “Auxiliary On-Us” field, which is an additional field that appears to the left of the bank’s routing number in the MICR line to accommodate the field, the check must be longer than six inches. Most unauthorized ACH conversions of trust account checks will be prevented by the required use of business-size checks for all trust accounts. For more information on business checks and the “Auxiliary On-Us” field, see Section 11, “Trust Accounting Basics.”

Unauthorized ACH conversions may occur, on occasion, despite the use of the larger business-size checks. Therefore, the trust accounting rules include the requirement that the balance of a general trust account, as shown on the lawyer’s records, must be reconciled on a monthly basis with the current bank statement balance. See Rule 1.15-3(e). In addition to being a sound financial practice, monthly reconciliation of the bank statement helps to ensure that unauthorized ACH conversions recorded on the bank statement are discovered at a time when the lawyer may remember the disbursement and still be able to obtain the check from the bank.

ACH transactions, as a direct payment from a trust account, may be demanded by clients or third parties (e.g., the registrar or deeds or clerk of court) to increase the efficiency of the collection and return process. For this reason, the rules do not prohibit authorized ACH transactions initiated by the lawyer. However, the record keeping requirements are expanded for all authorizations to transfer or disburse funds from a trust account by requiring a lawyer to retain the following:

- all instructions or authorizations to transfer, disburse, or withdraw funds from the trust account (including electronic transfers or debits), or a written or electronic record of any such transfer, disbursement or withdrawal showing the amount, date, and recipient of the transfer or disbursement, and, in the case of a general trust account, also showing the name of the client or other person to whom the funds belong. See Rule 1.15-3(b)(3).

SECTION VI: RECORDKEEPING

A. What Records are Required?

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

- 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). For examples of properly composed deposit slips, see Appendix 7, 8.]
- All canceled items drawn on the account or digital images thereof. Rule 1.15-3(b)(2). Digital images stored on CD-ROM will satisfy the requirements of Rule 1.15-3(a)(2) and (b)(2). 2001 FEO 4.
- 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 which shall accurately maintain the current balance of funds held for that person or entity. Rule 1.15-3(b)(5). [For examples of general trust account ledgers, see Appendix B2, B9].

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 pertaining to the quarterly and monthly reviews. Rule 1.15-3(i).

8. All records required by law. Rule 1.15-3(b)(6).

How long should you keep records?

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).

May trust account and fiduciary account records be kept electronically?

Yes, if the records otherwise comply with Rule 1.15-3, are maintained in industry-standard formats, can be printed on demand, and are regularly backed up by an appropriate storage device. Rule 1.15-3(j).

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). [For an example of written accounting, see Appendix B11, B12.]

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 a 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. [Examples of client ledger card and written accountings are found in Appendix B9-12.]

A copy of the client's ledger card may be provided to the client as written accounting of the receipt and disbursement of funds. When this is done, the client should sign and date the original to show that the client was given written accounting of his or her funds as required by Rule 1.15-3(c). If a copy of the ledger card is mailed, retain a copy of the transmittal letter.

B. Accounting Systems and Resources: Electronic versus Manual Records

Manual

A bookkeeping system for a lawyer's trust account must do the following things:

- document deposits to and disbursements from the trust account
- document deposits to and disbursements from each client's funds deposited in the trust account
- maintain current balance for the funds of each client deposited in the trust account
- provide a means of reconciling, on a monthly basis, the current bank statement balance for the trust account with the balance for the trust account shown on the lawyer's record

- provide means of reconciling, on a quarterly basis, the current bank balance for the trust account with the total of the individual client balances
- provide means of performing monthly and quarterly reviews of the trust account
- retain records of deposits and disbursements
- provide annual accountings to each client for funds deposited in the trust account.

When properly maintained, the check register contains the record of each deposit to and disbursement from the trust account. It also provides the running balance for funds in the account. Individual ledger cards record deposits to and disbursements from the trust account for each client, and show the current balance for each client's funds. This information is necessary to reconcile the trust account.

When multiple deposits cannot be posted on a checkbook stub, the client's name and the amount of each deposit may be recorded on the backside of the preceding page of the stub. If this is done, only the date and total amount deposited must be indicated. Some firms, instead of recording the information on the back of the preceding checkbook stub page, staple a copy of the deposit slip behind the respective check stub.

Software

Automating your trust account recordkeeping process can reduce the amount of data entry and calculation errors. You can search and find trust account information quickly, and perhaps from remote locations. Automating can organize the routine process of maintaining your trust account. It can save you space, but ALWAYS print copies of your client ledgers, general ledger, and monthly and quarterly reconciliations.

SECTION VII: RECONCILIATIONS AND REVIEWS

"Reconciliation" means checking the three basic records you are required to keep—the bank statements, the client ledgers, and the general ledger/checkbook register—against each other so you can find and correct any mistakes.

Rule 1.15-3(d) requires you to reconcile your client trust account records because mistakes are bound to happen when people keep track of money. Even banks make mistakes when it comes to recording money transactions. That's because when you are working with numbers, mistakes are easy to make and difficult to notice. No amount of training can completely eliminate these mistakes.

To make sure that you find and correct these mistakes, you must record every client trust account transaction twice (in your client ledger and your general ledger/checkbook register), and check these records against each other and against the bank's records. For example, let's say you deposit a check for \$1,000 into your client trust account but mistakenly record it as \$10,000 in your client ledger and add \$10,000 to your client's running balance. In your general ledger/checkbook register, you recorded the check correctly and added \$1,000 to your client trust account's running balance. How will you find the mistake? The general ledger/checkbook register balance is right, so you won't find the mistake by bouncing a check. The numbers in the client ledger will add up so there is no way to tell you made a mistake. Unless you compare your client ledger balance to your general ledger/checkbook register balance, you won't be able to find the recording error. And unless you compare your client ledger and general ledger/checkbook register against the bank statement, you won't know which entry was right - \$10,000 or \$1,000.

We have just described the quarterly reconciliation process. The theory is that it is unlikely that the same mistakes will be made in three different records—the client ledgers, the general ledger/checkbook register, and the bank statement—so if those records are all checked against each other, any mistakes will show up.

Rule 1.15-3(d) requires both quarterly and monthly reconciliations of the trust account balance to the current bank statement for the trust account. However, there is an important distinction between the basic reconciliation that must be done monthly and the more thorough reconciliations that must be done each quarter.

A. Monthly Reconciliation

You cannot do reconciliation for a month until you are sure you have correct balances in all your client ledgers and general ledger/checkbook register for the previous month. If you have not recently reconciled your books, or if you are worried that they are wrong, you may want to bring in a bookkeeper to straighten them out before you take on the monthly and quarterly reconciliations yourself.

Once you have correct balances for the previous month, you are ready to reconcile. The steps required for this type of reconciliation are not unlike those necessary to balance a personal checking account.

There are two main steps in reconciling monthly:

1. From the balance shown on the bank statement for the monthly reporting period, subtract all outstanding checks. To this amount, add all deposits that have not cleared the bank. This is the current bank balance.
2. Confirm that the current bank balance equals the total balance for the trust account as shown on the lawyer's records (if using manual accounting, this would include check stubs on the account register).

The cut-off date for the bank statement and the trust account balance must be the same for the two balances may not reconcile. Note that the "Reconciliation Summary" produced by accounting software will typically satisfy the monthly requirement to reconcile the current bank balance to the total trust account balance (a different software report may be necessary for the quarterly reconciliation).

All reconciliations—monthly and quarterly—must be signed and dated by a lawyer. Remember, nonlawyer employees who reconcile the trust account may not be signatories on trust account checks.

A reconciliation form is available in Appendix B 13.

B. Quarterly Reconciliation

Rule 1.15-3(d)(1) states that each quarter a report must be prepared that shows all of the following balances and verifies 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.

Quarterly reconciliations promote accurate accounting for client funds by ensuring that the running balances for each client, when totaled, equal the total funds on deposit in the trust account.

Remember that a three-way reconciliation should be conducted **every quarter** for **every** client trust account. It is recommended, however, that three-way reconciliations be performed monthly.

When completing the three-way reconciliation, it is a good idea to use an adding machine or other calculator that will produce a printed record of the calculation you performed. That way, if your records do not match, you can easily check to see if the reason is a mathematical mistake made while performing the reconciliation.

Quarterly reconciliations must be signed and dated by a lawyer, and you are required to retain these records and the reconciliation reports for six years to satisfy the recordkeeping requirement in Rule 1.15-3(d).

You are permitted to retain electronic copies of all reconciliation reports, as long as you follow the requirements in Rule 1.15-3(j):

- (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 1.3(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.

It is fine to hire a bookkeeper or the equivalent, but you are still personally responsible for accounting to your clients and to the State Bar for the money in your client trust accounts. Therefore, even if you never intend to do the reconciling, you should understand the process. Even if it is your bookkeeper’s mistake, if you bounce a client trust account check, you are the one your client or the State Bar is going to come to for an explanation. Remember, a nonlawyer employee cannot be responsible for reconciling the trust account and be a trust account signatory.

C. Example of Three-Way Reconciliation

The detailed example below illustrates a manual method that can be used to perform the three-way reconciliation on a general trust account required each quarter. This is not the only method that can be used, as any method that satisfies the rules will be sufficient.

These are the client ledgers that will be used for the three-way reconciliation example (Note: the “R” box is a check-box for use during the reconciliation):

Client: Alpha, A.		Matter: 111111				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	01/1/2017	Deposit fees		\$250	\$250
	1001	01/7/2017	Dee Fender, Esq. - Earned fees	\$260		(-\$10)

Client: Beta, B		Matter: 222222				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	1/04/2017	Deposit - \$1,500 fees and costs		\$1,500	\$1,500
	1002	1/8/2017	Superior Court - Nowhere County Filing Fee - Cost	\$125		\$1,375
	1003	1/11/2017	Vital Records - Birth Cert	\$75		\$1,300
	1004	1/11/2017	Dee Fender, Esq. - Earned fees	\$600		\$700
	1005	1/12/2017	Dee Fender, Esq. - Earned fees	\$400		\$300

Client: Gamma, G		Matter: 333333				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	1/08/2017	Deposit - \$1,200 fees and costs		\$1,450	\$1,450
	1006	1/13/2017	Record Round Up - costs	\$150		\$1,300
	1007	1/15/2017	Dee Fender, Esq. - Earned Fees	\$1,200		\$100

Client: Delta, D		Matter: 444444				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	1/25/2017	Deposit - \$15,000 fees (unearned)		\$15,000	\$15,000
	1008	1/29/2017	Dee Fender, Esq. - Earned Fees 8 hrs @ \$250/hr	\$2,000		\$13,000
	1009	1/30/2017	D. Delta Refund	\$13,000		\$0

Client: Epsilon, E		Matter: 555555				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	1/15/2017	Deposit \$2,000 fees (unearned)		\$2,000	\$2,000
	Returned Deposit	1/17/2017	Returned deposited check for insufficient funds	\$2,000		\$0
	Deposit	1/31/2017	Deposit \$2,000 fees (unearned)		\$2,000	\$2,000

Client: Administrative Funds, Dee Fender, Esq			Matter: 999999			
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	1/1/2017	Deposit to open account		\$50	\$50
	Bank Fee	1/17/2017	Client Epsilon Returned Deposit Fee	\$5		\$45
	Deposit	1/31/2017	Client Epsilon reimbursement for \$5 returned deposit bank charge		\$5	\$50

This is the general ledger/checkbook register that will be used for the three-way reconciliation example:

General Ledger/Checkbook Register						
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	1/1/2017	Deposit to open account		\$50	\$50
	Deposit	1/1/2017	Deposit - Alpha fees		\$250	\$300
	1001	1/7/2017	Dee Fender, Esq. - Alpha earned fees	\$260		\$40
	Deposit	1/4/2017	Deposit - Beta		\$1,500	\$1,540
	1002	1/8/2017	Superior Court - Nowhere County Filing Fee - Beta	\$125		\$1,415
	Deposit	1/08/2017	Deposit - Gamma		\$1,450	\$2,865
	1003	1/10/2017	Nowhere Vital Records - Birth Cert. - Beta	\$75		\$2,790
	1004	1/11/2017	Dee Fender, Esq. - Beta earned fees	\$600		\$2,190
	1005	1/12/2017	Dee Fender, Esq. - Beta earned fees	\$400		\$1,790
	1006	1/13/2017	Record Round Up - Gamma costs	\$150		\$1,640
	Deposit	1/15/2017	Deposit - Epsilon		\$2,000	\$3,640
	1007	1/15/2017	Dee Fender, Esq. - Gamma earned fees	\$1,200		\$2,440
	Returned Deposit	1/17/2017	Epsilon - returned deposited check for insufficient funds	\$2,000		\$440
	Bank Fee	1/17/2017	Epsilon Returned Deposit Fee	\$5		\$435
	Deposit	1/25/2017	Deposit - Delta		\$15,000	\$15,435
	1008	1/29/2017	Dee Fender, Esq. - Delta earned fees	\$2,000		\$13,435
	1009	1/30/2017	Delta - refund of unused fee	\$13,000		\$435
	Deposit	1/31/2017	Deposit - Epsilon		\$2,005	\$2,440

This is the trust account bank statement that will be used for the three-way reconciliation example:

Bank of Wegottayourmoney

Dee Fender, Esq.
 Dee Fender's OLTA Trust Account 1201 E.
 Easy Street, Suite #100
 Sunnyvale, NC 20010

Account Number: 000200800888
 Activity through: 1/01/2017 - 1/31/2017

Beginning Balance \$50.00
Ending Balance \$510.00
1/31/2017

Deposits/Credits

<u>Date</u>	<u>Dollar Amount</u>	<u>Type</u>
1/01/17	\$50.00	Deposit
1/01/17	\$250.00	Deposit
1/04/17	\$1,500.00	Deposit
1/08/17	\$1,450.00	Deposit
1/15/17	\$2,000.00	Deposit
1/25/17	\$15,000.00	Deposit

Total Deposits/Credits \$20,250.00

Withdrawals/Debits

<u>Check #</u>	<u>Dollar Amount</u>	<u>Date</u>
1001	\$260.00	1/07/17
1002	\$125.00	1/08/17
1004*	\$600.00	1/11/17
1005	\$400.00	1/12/17
1006	\$150.00	1/13/17
1007	\$1,200.00	1/15/17
1008	\$2,000.00	1/29/17
1009	\$13,000.00	1/30/17

*Indicates preceding check (or checks) is outstanding.

Other Withdrawals/Debits

<u>Type</u>	<u>Dollar</u>	<u>Date</u>
Returned Deposit	\$2,000.00	1/17/17
Returned Deposit Fee	\$5.00	1/17/17

Total Withdrawals/Debits \$19,740.00

General Information

- Complete one form for *each* trust account
- Attach the following: list of clients with corresponding balances, copy of general ledger/checkbook register, list of outstanding deposits, list of outstanding checks, corresponding bank statement

Reconciliation of Lawyer's Trust Account Records

1. **Total of positive client ledger balances** as of 01/31/2017 \$ 2,450
 (Attach a list of clients with corresponding balances)

Do any clients show a negative balance? **Yes** **No** If yes, attach explanation and corrective action.

2. **General ledger/checkbook register balance** as of 01/31/2017 \$ 2,440
 (Attach copy of general ledger/checkbook register)

Bank Statement Reconciliation

3. **Account Balance** as of 01/31/2017 (per appended bank statement)..... \$ 510

Plus: Deposits in transit (deposits made to the account through end of month yet not reflected on bank statement) + \$ 2,005

Number of deposits in transit 1
 (attach list of outstanding deposits)

Less: Outstanding (uncleared) checks (checks issued through end of month not reflected in bank statement)..... - \$ 75

Number of outstanding checks..... 1
 (attach list of outstanding checks)

4. **Subtotal** \$ 2,440

5. **Other Adjustments (describe and attach supporting documentation)**

6. **Adjusted Trust Account Bank Balance** (as of end of report month)..... \$ 2,440

7. The balance on line #6 *agreed* **did not agree** with the balances reflected in lines #1 and #2. If different, attach explanation and corrective action.

Reconciliation prepared by: Employee for Dee Fender
 Name and Position Signature

Reconciliation reviewed by: Dee Fender, Esq
 Lawyer Name Signature

Reconcile the General Ledger/Checkbook Register with the Client Ledgers

The first part of reconciliation is to reconcile the general ledger/checkbook register with the client ledgers. The purpose of this step is to make sure that the entries in your client ledgers agree with the entries in your general ledger/checkbook register.

Step 1: Enter the total of positive client ledger balances as of the cut-off date on the bank statement (in this case, January 31, 2017). This includes any administrative funds ledger or firm funds ledger that you maintain to service the account. **Do not include balances that are negative.** If the client ledger shows a negative balance (as it does in this example), check the box. On another page, explain the reason for the negative balance and show your corrective action. Attach a list of clients and their respective balances to the worksheet.

Step 2: List the balance shown in your general ledger/checkbook register as of the cut-off date on the bank statement. Using the same cut-off date on all documents is imperative to avoid mismatched numbers. Notice that the "Total of Client Ledger Balances as of 1/31/2017" does not match the "General Ledger/Checkbook Register Balance." That means that your individual client ledger balance entries do not agree with your general ledger/checkbook register entries, and you are **must** determine why before you move on to the next step of the reconciliation process.

When the "Total of Client Ledger Balances" does not exactly match the "General Ledger/Checkbook Register Balance," do not panic; you have found a mistake, and that is what a reconciliation is for. You can call an accountant to help you, or make the correction yourself. Since you record every deposit and withdrawal twice, if you systematically compare each entry in the general ledger/checkbook register with the corresponding entry in the client ledger, and check the new balance you entered after each entry, you will always find the mistake.

When you have found and corrected any mistakes, attach a copy of your general ledger/checkbook register to the worksheet and move on to Step 3.

Reconcile the General Ledger/Checkbook Register with the Bank Statement

Step 3: List the ending balance as shown on the bank statement. On the next line list the deposits that have yet to appear on the bank statement (probably because they were made at the end of the month). You should provide a list of these outstanding deposits and note the number of these deposits in the provided line. Do the same for outstanding/uncleared checks. Take this time to examine the list of outstanding checks and to investigate why those checks have not cleared.

The purpose of these steps is to make sure that the bank's records of the deposits and withdrawals you've made on your general trust account during the past month match your records. Since you've already reconciled the client ledgers with the general ledger/checkbook register, you know that the entries in the client ledgers agree with the ones in the general ledger/checkbook register. Therefore, unless you find a mistake during this stage of the reconciliation process, you only have to compare the bank statement with the general ledger/checkbook register.

Deposits and withdrawals not posted on bank statement. Generally, the bank sends out statements one to three weeks after the end of the month. As a result, by the time you reconcile the account, you will usually have made deposits or withdrawals that are not shown on the bank statement. In addition, checks you wrote or deposits you made may not have cleared by the time the bank produced the statement, and therefore the amounts of those checks or deposits won't be reflected in the account balance shown on the bank statement. Thus, to compare the balance of the bank statement for the end of the month with the balance of your general ledger/checkbook register shows for the end of the month, you have to adjust the general ledger/checkbook register balance by **adding** all uncredited deposits and **subtracting** all undebited withdrawals.

To find out which transactions have not been posted, you have to compare the entries on the bank statement with the entries in your general ledger/checkbook register.

Go through each entry on the bank statement and compare it to the corresponding entry in your general ledger/checkbook register. If the entry in the general ledger/checkbook register exactly matches the entry on the bank statement, mark off the entry in the general ledger/checkbook register to show that the money has cleared.

the banking process, and mark off the entry on the bank statement to show that you have verified it against the general ledger/checkbook register. The marks in the general ledger/checkbook register will help you keep track of items like checks that are never cashed, which otherwise can become those small, inactive balances that make your account harder to reconcile. The marks should be permanent (i.e., ink) and clearly visible, but should not make it hard to read the entries. You should use the same mark consistently, to avoid confusion later.

When you are finished, all the entries on the bank statement should be checked off to show that you have verified them against the corresponding entries in the general ledger/checkbook register. Now go back through the general ledger/checkbook register to find any entries that are unmarked; these transactions haven't yet been debited or credited by the bank.

As you go through the bank statement, there are two kinds of mistakes you may find:

1. A deposit or withdrawal listed on the bank statement that is not in your general ledger/checkbook register. To correct this mistake, go through your canceled checks (if it is a withdrawal) or deposit slips (if it is a deposit) until you find the one that reflects the transaction on the bank statement. If you cannot find a canceled check or deposit slip that matches the entry on the bank statement, contact your banker and ask him or her to help you track down the transaction. **DO NOT** record the bank statement entry in your records until you verify that the transaction occurred; banks make mistakes, too.

2. An entry in the bank statement is different from the corresponding entry in the general ledger/checkbook register. You correct this mistake the same way you correct a transaction you forgot to record. First, find the canceled check or deposit slip that shows the transaction to figure out which record is correct—the general ledger/checkbook register or the bank statement. If you cannot find a canceled check or deposit slip for this transaction, contact your banker and ask him or her to help you track it down before you make any changes in your records.

If the canceled check or deposit slip shows that the bank statement is wrong, write a note on the bank statement that clearly describes the mistake, then contact your banker and tell him or her to correct their records. If it shows that your general ledger/checkbook register is wrong, record the correction in the general ledger/checkbook register and the appropriate client ledgers. These must be entered twice in both the general ledger/checkbook register and the client ledger for the client on whose behalf you deposited or paid out the money.

When you have found and corrected any mistakes, move on to Step 4.

Step 4: Add the outstanding deposits to the ending balance and subtract the outstanding checks to find your Subtotal.

Step 5: This section is provided for lawyers to explain any necessary adjustments to their reconciliation. Adjustments might be required if, for example, you identify bank errors in your review of the bank statement. Adjustments that are made to balances must be explained with documentation. Do not use this section to explain/correct negative balances.

Make sure that bank charges reflected on the bank statement are also reflected in your records. Since you may not know what these bank charges are until you receive the bank statement, you need to enter them into your records after you receive the bank statement.

All bank charges must be recorded in the general ledger/checkbook register. If a bank charge was incurred on behalf of a specific client (as for example, a charge for wiring money to a client), the charge must also be entered in that client's ledger. This ensures that the general ledger/checkbook register balance will continue to match the total of the individual client ledger balances. If the charge was not for a specific client (for example, a charge for printing general trust account checks), the charge must also be entered in the Administrative Funds/Bank Charges ledger.

Calculate the Adjusted Balance

Step 6: Calculate the following to find your adjusted balance:

1. Ending bank statement balance
2. Plus all outstanding deposit amounts
3. Minus all outstanding check amounts
4. Plus or minus any necessary adjustments listed in Step 6.

Step 7: The balances listed in Step 1, 2, and 3 should all agree. If they are different, attach an explanation and show how this imbalance has been corrected. The person who completed the reconciliation (if not the lawyer) should sign the form, as well as the lawyer who reviewed the reconciliation and supporting documents. Lawyers are required to sign and date all monthly and quarterly reconciliations and reviews. Save this reconciliation for six years as required in Rule 1.15-3.

Trust Account Reconciliation Sheet

The State Bar has created a Trust Account Reconciliation Sheet for lawyers to use when reconciling trust accounts. The completed sheet shown on a previous page reflects the reconciliation completed above. A copy of this sheet can be found in *Appendix B 13* and fillable forms are available on the State Bar website, www.ncbar.gov.

Monthly Review

Rule 1.15-3(i)(1) requires lawyers to review check images and bank statements for all trust accounts and fiduciary accounts on a monthly basis. This review requirement cannot be delegated, so lawyers must make sure to look at bank statements and corresponding check images each month. Lawyers must certify monthly that they have reviewed these documents.

The reason for a monthly review of check images is so that the lawyer might see a check made out to an improper payee such as an employee. If the lawyer never reviews cancelled check images, then the lawyer may not know if someone has been stealing funds from the trust account by avoiding legitimate checks and writing checks to themselves for the same amount.

D. Quarterly Review

Rule 1.15-3(j)(2) requires lawyers to review 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 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.

In order to perform a proper quarterly review, the lawyer must select the random transactions and conduct the review herself. This review requirement cannot be delegated to a nonlawyer.

The lawyer must examine each transaction's source documents (settlement statement, closing document, etc.), client ledger, and cancelled checks in order to ensure that the amount and payee of the transaction was correct and that the check actually cleared the account.

After conducting the review on at least three transactions, the lawyer must sign a report indicating that the transaction was completed and attach the supporting documents.

The State Bar has developed a form to help lawyers complete this process, available in *Appendix B 14* or online at www.ncbar.gov.

SECTION VIII: TRUSTEES, PERSONAL REPRESENTATIVES, AND OTHER FIDUCIARY ROLES

A lawyer is always acting as a fiduciary when holding client funds such as an advance fee payment or the settlement check for a personal injury claim. However, there are fiduciary roles that do not constitute the practice of law *per se*, but nonetheless frequently arise out of the client-lawyer relationship; for example: personal representative of an estate, guardian, trustee of a trust, attorney-in-fact, and escrow agent. A lawyer serving in one of these customary fiduciary roles is subject to the requirements of the trust accounting rules if the lawyer is providing the service as part of his or her professional legal services, regardless of compensation, and if the lawyer is compensated for the service as a fiduciary even though the service is provided outside of law practice. Funds received by the lawyer while serving as an uncompensated “volunteer” fiduciary, such as the trustee of a trust for the lawyer’s family, do not have to be managed in accordance with the record keeping and accounting requirements of the Rules of Professional Conduct. The following explains the lawyer’s professional responsibilities when holding funds pursuant to professional service and/or as a compensated fiduciary.

A. Fiduciary Accounts

The trust accounting rules include the definition Section found in Rule 7.15-1. To understand the requirements of the rules, a lawyer must be familiar with several of the defined terms in this Section. “Entrusted property” is defined in Rule 7.15-1 as “trust funds, fiduciary funds, and other property belonging to someone other than the lawyer which is in the lawyer’s possession or control in connection with the performance of legal services or professional fiduciary services.” “Trust funds” are funds belonging to someone other than the lawyer that are received by or placed under the control of the lawyer in connection with the performance of legal services. “Fiduciary funds” are funds belonging to someone other than the lawyer that are received by or placed under the control of the lawyer in connection with the performance of professional fiduciary services. “Professional fiduciary services” refers to “compensated services (other than legal services) rendered by a lawyer as a trustee, guardian, personal representative of an estate, attorney-in-fact, or escrow agent, or in any other fiduciary role customary to the practice of law.” A “fiduciary account” is “an account designated as such, maintained by a lawyer solely for the deposit of fiduciary funds or other entrusted property of a particular person or entity.” In other words, a fiduciary account is an account in which a lawyer deposits funds that he or she receives in connection with compensated service as a trustee, guardian, personal representative, attorney-in-fact, or escrow agent.

What sort of an account should a lawyer who is serving as a personal representative maintain?

A lawyer who is serving as a trustee, guardian, attorney-in-fact, or personal representative should usually maintain a separate, specially denominated account called a fiduciary account. Rule 7.15-1(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 7.15-2(c), (p). Any interest generated would be the property of the trust, estate, principal, or other beneficiary. Rule 7.15-2(p).

How often should a lawyer provide an accounting for fiduciary funds received in connection with the lawyer’s services 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 accounting 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 7.15-3(f).

B. Segregation of Fiduciary Funds

Rule 7.15-2 sets forth the general requirements applicable to entrusted property. All entrusted property must be properly labeled and maintained separately from the property of the lawyer. This duty is better known as the prohibition against commingling of the lawyer’s funds with funds that belong to clients or third parties. Fiduciary funds must be segregated and promptly deposited in a separate fiduciary account or deposited with client funds or other fiduciary funds in the general trust account of the lawyer. Determining whether to deposit the funds in the general trust account or in a separate fiduciary account depends upon how long the funds are related to be held and the nature of the funds. See Rule 7.15-4 comment [3]. If the fiduciary obligation to manage the funds wisely

necessitates prudent investment of the funds, depositing the funds into a separate fiduciary account is probably imperative. The only funds of the lawyer that may be deposited in a fiduciary account are funds sufficient to open and maintain the account, such as the funds necessary to pay bank service charges, and funds belonging in part to the client or a third party and in part to the lawyer, such as a disputed legal fee.

C. Location of Fiduciary Account

The depository requirements for a standard lawyer's trust account (designated as "general trust account" in Rule 1.15-1) differ from those for a fiduciary account. All trust accounts must be maintained in a bank in North Carolina except a trust account dedicated to the funds of one client (designated as "dedicated trust account" in Rule 1.15-1). A dedicated trust account may be maintained in a bank or other financial institution in or outside of North Carolina, but only with the written consent of the client.

By contrast, a lawyer in the exercise of his or her fiduciary responsibilities (as a personal representative, for example) may select a bank or other financial institution in or outside of North Carolina in which to deposit fiduciary funds. Consent of the beneficiaries or the client is not required. Unlike a general trust account that earns interest for the OLTA program, a fiduciary account can and should earn interest for its beneficiaries. The authority to deposit fiduciary funds in a financial institution other than a bank is important. A fiduciary has the legal obligation to invest entrusted funds prudently. The choices for sound investment of fiduciary funds are expanded if the fiduciary funds are deposited in investment institutions other than a North Carolina bank. Unfortunately, permitting a lawyer to deposit fiduciary funds in an out-of-state bank or financial institution makes it more difficult for the state bar to investigate and audit an account. There is also the possibility that federal deposit insurance will not cover losses from an investment account. Nevertheless, the benefits of enhanced investment opportunities outweigh the costs of following a lawyer-fiduciary to choose the appropriate depository for trust accounts.

D. When Are Funds Held by a Lawyer in a Fiduciary Capacity Subject to the Requirements of the Rules of Professional Conduct?

The answer to this question seems clear when the fiduciary service arises out of a traditional client-lawyer relationship. If the lawyer receives compensation, and provides the service as part of his or her professional services, the lawyer's conduct is clearly subject to the Rules of Professional Conduct. Therefore, the duties set forth in the trust accounting rules apply to any funds managed by a lawyer acting in one of these traditional fiduciary roles in the context of a client-lawyer relationship.¹⁶ Unfortunately, here remain many unanswered questions. What if the lawyer declines compensation? What if the lawyer is not in private practice and is serving in the role as an accommodation to his or her employer or as part of a business transaction? What if the lawyer is serving in the role because of a familial or personal relationship precisely because the family member or friend wants the lawyer to serve? What if the lawyer is compensated for the services even though he is managing an estate or trust for a family member? Should the trust accounting rules apply to funds that a lawyer handles in non-traditional fiduciary roles, such as a cookie chair or the girl scouts treasurer of a church?

The problem is how to create a bright line between fiduciary funds held outside of the lawyer's legal practice or a client-lawyer relationship from funds held in conjunction with the lawyer's practice or a client-lawyer relationship. An appropriate and justifiable distinction can be made between compensated service as a fiduciary and uncompensated service.

In most situations, a lawyer will decline compensation or none will be provided when the lawyer is volunteering her services as a fiduciary for the benefit of family, friends, or charity. For this reason, Rule 1.15-1 defines "fiduciary funds" that are subject to the requirements of the rules as "funds belonging to someone other than the lawyer that are received by or placed under the control of the lawyer in connection with the performance of professional fiduciary services." "Professional fiduciary services" are subsequently defined as "compensated services (other than legal services) rendered by a lawyer as trustee, guardian, personal representative in an estate, attorney-in-fact, or escrow agent, or in any other fiduciary role customary to the practice of law." "Funds received by a lawyer while serving as an uncompensated volunteer" fiduciary, whether as a personal representative in an estate or a cookie chair, do not have to be managed in accordance with the trust accounting rules.

Endnote:

1. These duties include the following: (a) avoiding commingling of the lawyer's funds with clients' funds by depositing the clients' funds in a separate trust or fiduciary account; (b) maintaining minimum records of the funds on deposit in

the account; making annual accountings to the client(s) for the funds deposited in the account; reconciling trust account balances to client funds on a monthly and quarterly basis; and properly disbursing client funds.

Words to the Wise

There are three important caveats to keep in mind:

- First, if you are acting as a fiduciary within the context of the client-lawyer relationship, your conduct will be subject to the trust accounting rules even though you are not compensated for your services. It is possible that whether a fiduciary role arises out of a client-lawyer relationship may now become a contested issue in a disciplinary case. The prudent lawyer will, however, avoid the issue altogether by erring on the side of complying with the rules in most, if not all, situations in which the lawyer is serving as a fiduciary.
- Second, although a lawyer's handling of fiduciary funds may, in some limited instances, be exempt from the money management requirements of the trust accounting rules (record keeping, annual accountings, monthly and quarterly reconciliation, etc.), **it is not exempt from the prohibitions on illegal conduct, dishonesty, fraud, and deceit in the misconduct rule, Rule 8.4. In other words, a lawyer who steals fiduciary funds, regardless of the source of the funds, will be subject to prosecution under the Rules of Professional Conduct.**
- Third, there are a number of obligations created by the law applicable to fiduciaries in general that are remarkably similar to the obligations imposed by the trust accounting rules. By law, a fiduciary is required to keep the principal's funds or property separate from the fiduciary's personal funds or property, to avoid self-dealing, and to account for the funds accurately and promptly.

E. Record Keeping Requirements for Fiduciary Accounts

Accounts Maintained at a Bank

For record keeping requirements for accounts maintained at a bank, see Section VII, Recordkeeping, Part 2.

Accounts Maintained at Other Financial Institutions

If a fiduciary account is maintained, by a choice of the lawyer-fiduciary, at an institution other than a bank, the following records are required:

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 7.15-3(c)(1).
2. A copy of all cancelled items drawn on the account or digital images of such items. Rule 7.15-3(c)(2).
3. All instructions or authorizations to transfer, disburse, or withdraw funds from the account including electronic transfers or debits) or any 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 7.15-3(c)(3).
4. All statements or documents received from the financial institution regarding the account. Rule 7.15-3(c)(4).
5. All records required by law. Rule 7.15-3(c)(5).

Minimum Record Keeping Period and Audit by the State Bar

All of the written records required in Rule 7.15-3, whether the records are for entrusted property deposited in a bank or in a financial institution, must be maintained for at least six years. Similarly, the authority of the State Bar to audit the required written records randomly or for cause has not changed.

Accountings for Fiduciary Property

Whenever a fiduciary, such as a personal representative or trustee, is required by law to make an annual or more frequent accounting to judicial officials, the trust accounting rules do not require separate written accountings to the beneficiaries of fiduciary funds. However, if the law does not require an accounting, a lawyer-fiduciary must

provide a written accounting of all transactions concerning fiduciary funds to the beneficial owners at least annually and also upon termination of the lawyer's professional fiduciary services.

SECTION IX: SAFEGUARDING FUNDS FROM EMBEZZLEMENT

The security of a trust account is proportional to the interest and attention the lawyer devotes to the operation of the account. The following safeguards are suggested:

Trust Account Checks

- Do not act in haste when signing checks to be disbursed from or deposited to a trust account. For example, an employee had a lawyer endorse checks for deposit when the lawyer was in a hurry to get out of the office. The lawyer failed to note that the office deposit stamp was not on the back of the check. The checks were deposited into the employee's personal accounts. This activity did not come to the attention of the lawyer until clients complained about their bills.
- Don't sign blank checks, and do not make a check out to cash or bearer.
- Use pre-numbered checks and periodically examine the sequential order of blank, void, and canceled checks. Question any unexplained break in numbers. Voided checks should be retained. Keep blank checks under a responsible person's control during the day and secured at night. In addition, ensure that all checks are accounted for when an employee resigns or is terminated. After resigning, one employee with access to trust account checks negotiated forged checks for over \$80,000.
- Examine signature(s) on trust account checks for forgery.
- Question any change or attempted change of a payee's name on a check.
- Compare the number of canceled checks received from the bank to the number returned as indicated on the monthly bank statement.
- Confirm that the amount on a check coincides with the check stub or disbursement journal.

Controls and Procedures

- Legal fees paid in cash are difficult to control. Office policy should require that a receipt must be given to any client who pays in cash, and the lawyer should regularly ask clients who pay in cash if they received a receipt. The numbers for receipts in the receipt book should also be examined periodically to determine if any receipts were removed or voided.
- Reconcile the trust account promptly after receiving a bank statement.
- Resolve discrepancies in a trust account reconciliation as soon as possible.
- Make sure that deposit slips agree with deposits posted on client's ledger, particularly when cash is involved.
- Ensure deposits are made in a timely manner, daily if possible.
- A client's file should contain documentation supporting disbursements.
- Bank statements and correspondence regarding the trust account should be opened and reviewed by a lawyer.
- Require supporting documentation (e.g., bank statements, canceled checks, deposit slips, correspondence, etc.) of accounting reports and reconciliations.
- Prohibit or restrict removal of trust account records from the office.
- Sloppy bookkeeping may be used to conceal embezzlement. If the responsible individual procrastinates in correcting the condition, an independent party should reconcile the account(s).
- Estate accounting should be verified. Old or inactive estates are prime targets for embezzlement.
- Personally investigate questionable activities pertaining to the trust account (e.g., lack of fee payments, missing correspondence, etc.).
- Check periodically with the post office to determine if anyone other than designated personnel has attempted to pick up the office mail. Embezzlers will pickup the mail to destroy or remove incriminating items.

Personnel:

- The tasks of posting, depositing, and disbursing trust account funds should be handled by different members of the staff. An employee is not permitted to sign trust account checks if that employee is responsible for reconciling the trust account. (Note: an exception to this rule is if trust account checks require two signatures and one of them must be a lawyer. In this case, the nonlawyer could be the second signature because signature already satisfied the requirements of the rule.)
- Question life style changes (e.g., increased social activities or travel, new wardrobe, new car, etc.) of individuals with access to the trust account.

- Personal, professional, or financial problems (e.g., family illness, marital problems, drinking, bankruptcy, etc.) may be a cause for embezzlement.
- Question the negative attitude or poor work performance of an employee maintaining the trust account especially if the employee was passed over for promotion.
- Beware of an employee who is overly possessive of the trust account. The absence of minimum internal controls and sound accounting practices creates a situation in which there is a strong potential for embezzlement to go undetected.
- Embezzlement occurs more frequently when an unsupervised person has total responsibility for the trust, office, and/or payroll accounts.
- Embezzlers tend to make draws on the office operating account first and later make draws on the trust account.

SECTION X: SCAMS

The State Bar continues to receive reports of frauds and scams in lawyer trust accounts resulting in six-figure losses. The two major types of scams are 1) **Counterfeit Check Scams** and 2) **Email hacking/wire instruction fraud**. The following is a brief summary of each scam.

Counterfeit Check Scam

By now, all lawyers should know that criminals are using email to contact potential clients (requesting representation typically commercial debt collection or divorce settlement collection). Once the lawyer responds with a request for more information, the "client" provides the lawyer with documentation of the debt, often including warehouse receipts, contracts, bills of lading, etc. Shortly after agreeing to pursue the claim and often before a demand letter is even drafted, the lawyer receives a letter and certified bank check from the supposed debtor who is paying the debt because they "don't want to deal with the law." The lawyer then deposits the certified bank check (often from a bank up north like Chase or the tellers are less familiar with it) into the trust account. Almost immediately the client begins demanding this payment via wire. Since the funds are available via provisional credit (due to the Good Funds Settlement Act), the lawyer wires out the money to the client minus the lawyer's share. The client is never heard from again. Three days later, the bank tells the lawyer that the check was counterfeit and removes the already wired amount from the trust account. Since the lawyer is disbursed on provisional credit, the lawyer is responsible for replenishing any trust account deficit. This type of scam has cost lawyers hundreds of thousands of dollars and at least one law license. For tips on detecting and avoiding this scam, view this fact sheet created by Canadian Indemnity Company, LawPro: <http://practicepro.ca/practice/pdf/FraudInfoSheet.pdf>

Email Hacking/Wire Instructions Fraud

The most recent and most alarming type of scam is one where the criminal gains access to the email account of the party to a real estate transaction and initiates a fraudulent wire transfer. Once an account has been hacked, the criminal learns the details of the real estate transaction and, acting like the seller, emails the lawyer (or the seller) with wiring instructions for the seller's funds.

If the law firm does not have a procedure in place to authenticate the emailed wire instructions, they may unknowingly wire the seller's proceeds to the hacker's bank account. The bank will deny any liability because it merely followed the lawyer's instructions. This scheme has caused millions of dollars of losses since it first appeared in North Carolina in 2015. In order to protect against this scam, lawyers should:

- Verify all emailed wired instructions via a second method of communication that the lawyer knows is authentic (such as a phone number listed in the client's file). Do not call a phone number provided via email, because that number could be the hacker's number.
- Look for small differences in email addresses (although hackers have also used the actual email accounts of real estate agents or sellers to conduct these scams).
- Notify clients of this scam so that they may be aware of any suspicious activity or emails.
- Refuse to accept changes in wiring instructions via email (this is not a state bar rule, but it is strongly

recommended).

- Train employees to be on the lookout for this attempted scam and implement a policy that must be followed for every single wire.
- Use encrypted email and suggest that all parties to a transaction avoid sending any personally identifying information or financial information via unsecured email.
- Stay up to date with the ever-changing details of these scams. This handbook will never be able to stay current with emerging trends, so lawyers must seek current information and advice from the State Bar, the FBI, Lawyers Mutual, and other organizations.

Even law firms with two-level confirmation procedures for wire instructions have been defrauded because the criminal calls the firm as the seller and confirms the wiring instructions. To prevent this type of theft, law firms should initiate the phone call to confirm the emailed wire instructions, calling only the number listed in the client file regardless of whether a different number is provided in the email.

While these scams vary in sophistication, all have the potential to cause significant harm and lawyers must remain vigilant for any fraudulent trust account activity. If you or your firm has been subject to any attempted scams, or if you have any questions regarding these scams, please contact the State Bar at (919) 28-4620.

SECTION XI: INTEREST ON LAWYERS TRUST ACCOUNTS- IOLTA

A. What is IOLTA?

The North Carolina State Bar Plan for Interest on Lawyers' Trust Accounts (NC IOLTA) is a non-profit program established in 1983 by the State Bar and North Carolina Supreme Court to receive interest income from lawyers' general trust accounts to fund programs for the public benefit. NC IOLTA works with lawyers and banks across the state to coordinate income generated from lawyers' general trust accounts for the purpose of funding grants to providers of civil legal services for the indigent and to programs that further the administration of justice. All active NC lawyers maintaining general trust accounts in North Carolina are required to establish all general client trust accounts as interest-bearing IOLTA accounts.

As of July 2010, IOLTA rules require lawyers to hold their IOLTA accounts only at eligible banks that will agree to pay IOLTA accounts the highest rate available to that bank's other customers when the IOLTA accounts meet the same minimum balance or other account qualifications. NC IOLTA maintains the eligible bank list on its website, www.nciolta.com.

B. How it Works

Lawyers often handle money that belongs to clients—such as settlement checks or money to pay various fees. Often, the amount of money that a lawyer handles for a single client is quite small and/or is held for only a short period of time. Traditionally, lawyers have placed these individual deposits together into combined, or pooled, trust accounts. Before the establishment of IOLTA programs, trust funds pooled in this manner earned no interest. Now, by virtue of IOLTA, lawyers place these nominal and/or short-term client funds into pooled, interest-bearing trust accounts from which banks forward the interest net of allowable service charges to the state IOLTA program, which uses the money to fund law-related charitable causes.

IOLTA administration costs are paid from program income and, for the North Carolina program, have consistently been under ten percent of income since its inception. IOLTA is administered and staffed independently from the client security fund, trust account audit program, and other activities of the State Bar. No funds from NC State Bar dues are used to support the program.

C. How are IOLTA Funds Used?

NC IOLTA has been a vital source of funding for the provision of civil legal services to the poor through grants made to staffed legal services programs and volunteer lawyer programs that serve every county in the state and for other programs that work to improve the administration of justice. Since its first grants were made in 1985, NC IOLTA has

provided over \$55 million for legal assistance for at-risk children, the elderly, the disabled, and the poor in need of basic necessities, and to help lawyers connect with those who need their *pro bono* assistance.

Other grants have supported innovative programs such as the following: work of the Administrative Office of the Courts to meet the need for interpreter services; public interest summer internships for law students; training of local officials on how to provide safe and humane jails; judicial education; and the leveraging of state funds to assist young lawyers in public interest practice to pay off law school loans.

IOLTA funds are not used for the Client Security Fund that reimburses clients who have suffered financial loss as the result of dishonest conduct of lawyers engaged in the private practice of law in North Carolina.

D. Questions and Answers about the Management of IOLTA Accounts

Which of my law practice accounts must be established and maintained as IOLTA accounts?

All general trust accounts must be established and maintained as interest-bearing IOLTA accounts, interest from which is remitted to NC IOLTA. General trust accounts are those accounts that hold nominal and short-term deposits of client funds. For guidance on what funds should be held in a general trust account or a dedicated trust account for a specific client, see comment [3] after Rule 1.15-4. Dedicated and fiduciary accounts established for one client, entity, or transaction are not established as IOLTA accounts.

How do I comply with the rules governing NC IOLTA?

All active members of the North Carolina State Bar must ensure that all general trust accounts in North Carolina are established as interest-bearing IOLTA accounts at eligible banks. All active members of the State Bar must annually certify that they are fulfilling this requirement. Certification is made when responding to the State Bar Dues Notice sent at the beginning of each calendar year. The certification may be made on the dues notice or through the Member Access Login page of the State Bar website. Lawyers who do not maintain client trust accounts in North Carolina must certify that they are exempt. Lawyers must be in compliance with this requirement no later than June 30. Lawyers must also inform NC IOLTA when opening or closing IOLTA accounts. The NC IOLTA Status Update Form should be used for this purpose. A copy of the form can be found in Appendix B.15. The form should also be used to report employment or address changes. See www.ncbar.gov/media/283969/Status-Update-Form.pdf.

What happens if I do not comply with the rules governing NC IOLTA?

According to the rules implementing the mandatory program, the lawyer who fails to comply shall be reported to the NC State Bar's Administrative Committee, which may initiate proceedings to administratively suspend the lawyer's active membership status and eligibility to practice law.

Does maintaining my general client trust accounts as interest-bearing IOLTA accounts affect my trust account practices?

No. Maintaining general client trust accounts as interest-bearing IOLTA accounts does not affect a lawyer's trust account practices. The depository bank will calculate and remit all accumulated interest, less any service charges, directly to NC IOLTA. The principal balance of the account will never be affected. Of course, lawyers still retain complete discretion to determine whether a trust deposit is of sufficient size or duration to justify placement in a separate (dedicated) interest-bearing account.

How are bank service charges on IOLTA accounts handled?

NC IOLTA pays allowable service charges on IOLTA accounts. It is permissible for banks that do not waive service charges on IOLTA accounts to deduct from interest or utilize earnings credit for allowable service charges associated with the account. Allowable service charges include monthly account maintenance charges, per item check or deposit charges, etc. Business costs or costs billable to others are the responsibility of the law firm and should not be charged against client funds in the account or against the interest or the earnings credit of an IOLTA account. These charges may be deducted from the firm's operating account, billed to the firm, or deducted from funds maintained or deposited by the lawyer in the IOLTA account for that purpose. Examples of such costs include but are not limited to check printing, NSF/OD fees, stop payment orders, wire transfer fees, account reconciliation, remote capture capability, online banking, digital imaging, CD-ROM statements, or interest charged on uncollected balances (float).

What are the tax consequences of IOLTA participation?

According to the Internal Revenue Service, maintaining IOLTA accounts imposes no tax consequences on the client or the lawyer. See Revenue Ruling 81-209. Each IOLTA account bears the tax identification number of the NC IOLTA Board of Trustees to ensure that all accumulated interest is reported as income to the IOLTA program. If your bank needs IOLTA's tax ID number, please contact the IOLTA office.

How are clients informed about IOLTA?

In 1988 the North Carolina Supreme Court approved the posting of a Client Notice Certificate to inform clients about the IOLTA program. NC IOLTA provides Client Notices to lawyers at no charge.

Does maintaining IOLTA accounts deprive clients of any funds to which they are entitled?

No. Trust moneys of the type placed in IOLTA accounts (nominal in amount or expected to be held for a short duration) have traditionally been deposited in lawyers' pooled trust accounts. Prior to IOLTA, such accounts did not earn interest. The North Carolina State Bar now requires general trust accounts to earn interest, which is remitted to NC IOLTA for funding law-related charitable purposes. Of course, lawyers still retain complete discretion to determine whether trust deposits of sufficient size or duration justify placement in a separate (dedicated) interest-bearing account. If funds are placed in a general client trust account in error, NC IOLTA has policies for ensuring the refund of interest on those funds.

Which banks have IOLTA accounts?

A list of eligible North Carolina banks is maintained by NC IOLTA. See www.nciolta.com/iolta_banklist.asp. If you and/or your banker need assistance to establish an IOLTA account at a bank that is not listed, please contact the IOLTA office at 19-828-0477 or contact IOLTA via its website, www.nciolta.com.

There are a number of banks that go above and beyond the eligibility requirements of the IOLTA rule to support the NC IOLTA program in its mission to ensure that low-income North Carolinians have access to critically needed legal aid. These banks are given the distinction of "Prime Partner Banks" by NC IOLTA, and a list of these banks can be found on the NC IOLTA website.

Many banks waive service charges on IOLTA accounts, and some banks apply a policy to IOLTA accounts that results in a higher income yield from that bank. Banks that waive service charges are noted on the bank list.

If a law firm holds funds of NC clients in an out-of-state account, how should that account be set up?

Under the Rules of Professional Conduct, all general trust accounts must be maintained at a bank in North Carolina or a bank with branch offices in North Carolina. As the comment to the trust account rules notes, a law firm with offices in another state may send a North Carolina client's funds to a firm office in another state or a centralized processing though the client funds are still subject to the requirements of the NC Rules of Professional Conduct. Therefore, the NC client funds should be placed into a general trust account, the interest from which will be remitted to NC IOLTA.

Who makes the IOLTA grant decisions?

Grant decisions are made annually by the NC IOLTA Board of Trustees, which administers the program according to the rules promulgated by the NC State Bar Council and approved by the NC Supreme Court. 27 NCAC 1D 1301-20. The Board is a standing committee of the NC State Bar Council, the representative governing body of the State Bar, whose members are elected by the Bar membership through the judicial districts. IOLTA Trustees are appointed by the NC State Bar Council. NC IOLTA grants are for the calendar year, and all grant applications are reviewed annually by all the trustees. A current list of members of the IOLTA Board of Trustees can be found on the State Bar's website. See www.ncbar.gov/for-lawyers/directories/agencies-boards-commissions.

Where can I find rules governing NC IOLTA?

See 27 NCAC 1D, Sections 1301-.1316 and Rule 7.15-2(b) of the Rules of Professional Conduct.

For more information about NC IOLTA, please contact our office.

Mary Irvine, Executive Director
Claire Mills, Accounts Manager
Aaliyah Pierce, Accounting Data

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(919) 828-0477
(888) 828-1718 Fax
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SECTION XII: FDIC INSURANCE

A. Coverage Amount

The amount of FDIC coverage available to a single depositor in an FDIC insured bank or savings association is \$250,000.

What is a lawyer's professional responsibility when choosing the depository bank for a trust account?

A lawyer is acting as a fiduciary when holding client funds in his or her trust account. This means that the lawyer must be prudent when making financial decisions relative to those funds including the decision as to the depository bank for the lawyer's trust account. However, in the absence of information tending to suggest the imminent failure of a bank, a lawyer is presumed to be acting ethically if the lawyer establishes his or her trust account at a financial institution insured by the Federal Deposit Insurance Corporation (FDIC). In other words, if the government has made the determination that the institution is insurable, the lawyer may rely upon the government's assessment.

What are the requirements for insurability; to what extent are the funds insured?

A lawyer's general trust account (sometimes referred to as an "IOLTA account") is a fiduciary account and, as such, each client's funds deposited therein will be insured by the FDIC (up to the insurance limit) provided the account satisfies the FDIC disclosure requirements. There are two disclosure requirements for fiduciary accounts: (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. It is incumbent on the lawyer to make sure his or her bank knows that an account is a fiduciary account so that the bank can title the account as such in its records. Banks typically do not maintain records of the ownership interest of each client whose funds are held in a trust account. Therefore, it is the lawyer's responsibility to maintain these records. If you are complying with the trust accounting and record keeping requirements in Rule 7.15 of the Rules of Professional Conduct, you have already satisfied both of the FDIC "disclosure" requirements.

Contact the FDIC

For more information from the FDIC, call toll-free at:
1-877-ASK-FDIC (1-877-275-3342) from 8AM until 8PM (Eastern Time) Hearing Impaired Line: **1-800-925-4618**

Calculate insurance coverage using the FDIC's online Electronic Deposit Insurance Estimator at: fdic.gov/edie

Read more about FDIC insurance online at: fdic.gov/deposit/deposits

Order FDIC deposit insurance products online at: fdic.gov/depositinsuranceregister

Send questions by e-mail using the FDIC's online Customer Assistance Form at: fdic.gov/starmail

Mail questions to:

Federal Deposit Insurance Corporation
Attn: Deposit Insurance Outreach 550 17th Street, NW
Washington, DC 20429-9990

SECTION XIII: THE RANDOM AUDIT PROGRAM

A. Introduction

In April 1985 the North Carolina State Bar initiated a program of random audits of the trust accounts of active members of the North Carolina State Bar. The purpose of the program was to reduce the incidence of misappropriation and mishandling of clients' funds by monitoring compliance with the procedures and record keeping requirements established by the Rules of Professional Conduct. The program was specifically limited to procedural audits as opposed to the more familiar and extensive financial audit. The focus was record keeping and, when needed, education of lawyers in the proper management of client funds and trust accounts. Although the program has, on occasion, uncovered gross improprieties such as commingling, inadequate balances, and use of trust accounts as personal checking accounts, after operating for over 25 years, it is clear that the random audit program has been most successful in raising the overall level of compliance with and understanding of the rules governing lawyer trust accounts.

B. Authority for Random Audits

The authority for the random audit program is granted in Rule 20128(b) of the State Bar's Rules for Discipline and Disability of Attorneys, 27 N.C.A.C. 2B, Section 20100, where it states:

The chairperson of the Grievance Committee may randomly issue investigative subpoenas to members compelling the production of any records required to be kept relative to the handling of client funds or property by the Rules of Professional Conduct for inspection by the counsel or any auditor appointed by the counsel to determine compliance with the Rules of Professional Conduct. Any such subpoena will disclose upon its face its random character and contain verification of the Secretary that it was randomly issued. No member will be subject to random selection under this Section more than once in three years. The auditor may report any violation of the Rules of Professional Conduct discovered during the random audit to the Grievance Committee for investigation. The auditor may allow the lawyer a reasonable amount of time to correct any procedural violation in lieu of reporting the matter to the Grievance Committee. The auditor shall have authority under the original subpoena for random audit to compel the production of any documents necessary to determine whether the lawyer has corrected any violation identified during the audit.

C. Selection Process

On occasion, a lawyer concludes that he is being audited because he has done something to draw attention to herself. More often, audited lawyers are indignant because they believe that the Bar should be investigating another, unnamed lawyer in town who is the "type" to mishandle trust funds. But, despite the rumors to the contrary, lawyers are not picked for trust account audit because they have drawn attention to themselves or they "fit the profile." Rather, every effort is made to be random in the selection of the lawyers whose trust accounts will be audited by the State Bar during a particular quarter.

Lawyers randomly selected for audit are drawn from a list generated from the State Bar's database based upon judicial district membership designations in the database. Each quarter the staff auditor audits the trust accounts of 60 lawyers from our database of two randomly selected judicial districts. The week before the quarterly meeting of the Council of the State Bar, a computer software program randomly selects six judicial districts from all the judicial districts in the State. Although only two judicial districts participate each quarter, the field of six names is necessary to avoid redundancy. A truly random software program that picks only two judicial districts each quarter has the disadvantage of potentially selecting the same judicial districts quarter after quarter. Under the current procedure, six districts are initially selected by computer to generate the field from which the final selections are made. The staff auditor reviews the list of six to determine how many times and the dates on which each district was selected since the inception of the random audit program. The staff auditor identifies the two judicial district bars that will be used to draw names from our database during the quarter by eliminating from the list the four judicial districts that have been audited most recently and infrequently.

After the staff auditor selects the two district bars, the names of the 60 individual lawyers whose accounts will be audited must be determined. To do this, a software program that scrambles, or randomizes, the alphabetical

listing of lawyers listed as members of the two chosen judicial districts in our database. The number of lawyers audited in each district is determined by prororation. For example: The two districts selected are District 1 and District 18. District 1 has 200 lawyers and District 18 has 1,300. Therefore, District 18 has 7% of the 1,500 total lawyers to be drawn from. District 18 would therefore receive 7% of the 60 allocated random audits, or 4.2 but not 4. District 1, with only 1.3% of the total lawyers to be drawn from, would receive eight random audits. Starting at the top of the computer-generated list of random names of lawyers drawn from each judicial district bar, the staff auditor schedules appointments for audits until the respective number of lawyers from each judicial district list is reached. The lawyer selected for random audit does not have to be a signatory on the trust account or a partner or shareholder in the law firm: **All general, dedicated, and fiduciary accounts for a law firm are reviewed when any lawyer practicing with the firm is selected for random audit.** Lawyers who do not maintain trust accounts (e.g., judges, prosecutors, public defenders, corporate lawyers, etc.) are eliminated from the list.

D. Scope of Audit

Random audits are usually procedural audits of limited scope. However, audits conducted pursuant to the State Bar's random audit program may include a substantive inquiry into a lawyer's handling of client funds, and the State Bar auditor has the authority to take appropriate steps to ensure that the audited lawyer corrects procedural problems discovered during the random audit.

Members selected for random audit are required to produce all records necessary to demonstrate compliance with the record keeping requirements of the Rules of Professional Conduct concerning activity during the preceding year. Audits are scheduled in advance by agreement whenever possible. There are no surprise inspections.

When a lawyer associated with or belonging to a law firm is selected for random audit, the auditor inspects the records for any trust account maintained by the lawyer or by the law firm. If some of the trust accounts maintained by the firm were subject to random audit within the preceding three years, the audit is limited to records for any trust account which was not audited during the three-year period.

During an audit, the records for the past 24 months of activity are examined. The audit includes the examination of canceled checks, deposit slips, bank statements, ledger cards, and the bookkeeping/software system (i.e., check stubs, receipts, disbursement journals, software registers, etc.).

During an audit, the lawyer does not have to be at the auditor's beck and call. Usually, an appropriate member of the lawyer's staff can answer the auditor's questions. At the conclusion of the review, the auditor meets with the lawyer to critique the procedures the firm is using to maintain its trust account(s). The lawyer is welcome to invite the other lawyers in the firm or members of the staff to be present during the critique. A copy of the auditor's memo outlining any procedural deficiency is provided to the lawyer. In some situations, the lawyer must provide written assurance to the State Bar that certain deficiencies will be corrected. For example, a lawyer who has failed to reconcile a trust account on a quarterly basis (see Rule 1.15-3(d)) may be asked to state, in writing, that monthly or quarterly reconciliations will be immediately undertaken. The trust accounts are then monitored to ensure that the lawyer complies. In some instances when discipline may be appropriate, a grievance file may be opened. If the grievance is not based on dishonesty, fraud, or receipt, the lawyer may be offered entry into the Trust Account Compliance (TAC) program, as described in detail below.

E. Trust Account Compliance Program (TAC)

The State Bar has created a new program pursuant to Discipline and Disability Rules of the North Carolina State Bar, 27 N.C.A.C. Chapter 1, Subchapter B, Section 0112(l), which was approved by the North Carolina Supreme Court in March 2011.

The Trust Account Compliance Program (TAC) is a voluntary program. Participation is confidential. When a lawyer is found after a procedural audit to have significant trust account compliance issues, a grievance file may be opened by the State Bar. The Grievance Committee may elect to stay the grievance and offer the lawyer entrance into the program. If the lawyer consents to participate in the program, the bar will be required to communicate with the State Bar's trust account compliance counsel, who will monitor the lawyer's trust account, review the lawyer's trust accounting records, and inspect the lawyer's handling of entrusted funds for as long as two years. Participation in the program is generally confidential, but the trust account compliance counsel will communicate with the Grievance Committee about the lawyer's participation. If the lawyer timely complies with all requirements of the

program and satisfactorily completes the program, the Grievance Committee may consider successful completion of the program as an mitigating circumstance in determining what discipline, if any, is warranted in the lawyer's grievance. The Grievance Committee may, but is not required to, dismiss the grievance for good cause shown.

If the lawyer does not consent to participate in the program, or if he or she consents to participate but does not timely comply with all requirements of the program, the trust account compliance counsel will dismiss the lawyer from the program and return the grievance to the Grievance Committee's agenda at the subsequent quarterly meeting for consideration of imposition of discipline in the underlying matter.

This program is not intended for, and will not be offered to, lawyers in cases involving possible misappropriation of entrusted funds, criminal conduct, dishonesty, fraud, misrepresentation, deceit, or any other case the chair of the Grievance Committee deems inappropriate for referral. These cases will continue to be handled by the Office of Counsel and the Grievance Committee.

F. Exemption from Audit

Lawyers who do not handle client funds or property because, for example, they are government employees or in-house legal counsel, are exempt from the random audit program. Other lawyers may seek an exemption from random audit by having a CPA perform an examination of the lawyer's trust accounts pursuant to Agreed Upon Procedures and submitting the CPA report to the North Carolina State Bar. The exemption is valid for 15 months. The exemption applies to any lawyer who files a proper report within 15 months of the selection of the lawyer's judicial district for random audit. The report includes representations signed by the lawyer, a copy of the CPA engagement letter, a list of Agreed Upon Procedures, and the CPA's report pursuant to Agreed Upon Procedures, all of which must be submitted to the State Bar within 90 days of the examination.

A lawyer is prohibited from seeking exemption from the random audit of his/her trust accounts during the quarter in which the lawyer's judicial district has been selected for review. *For a copy of the exemption from Random Audit forms, see Appendix B16.*

G. Confidentiality

As noted in Rule 20128(e) of the Discipline and Disability Rules, "No assertion of attorney-client privilege or confidentiality will prevent an inspection or audit of a trust account...." Information obtained as a result of or in connection with an audit is held in confidence and is disclosed by the auditor only as necessary to investigate misconduct and to conduct the business of the State Bar.

Such information may become public, however, upon the institution of formal disciplinary proceedings pursuant to the Rules of the State Bar.

H. Discipline

Minor technical violations of the trust accounting rules are addressed by the auditor and/or trust account compliance counsel and do not generally result in the institution of disciplinary proceedings. Should similar minor technical violations be discovered during a repeat random audit of the same trust account(s), the matter may be referred to the Grievance Committee. More serious violations of the trust accounting rules are reported by the auditor to the counsel of the State Bar who determines whether a grievance investigation should be instituted or if the deficiencies can be remedied with an informal follow-up letter.

I. Workshops

Trust account maintenance workshops are conducted in judicial districts selected for random audit upon request of the local district bar president. The auditor, time permitting, will also conduct workshops upon request from other groups affiliated with the practice of law.

J. Audit Check List

When inspecting a lawyer's trust account, the State Bar auditor is guided by the detailed requirements of the Rules of Professional Conduct. To ensure that each inspection is systematic and uniform, the auditor asks the following questions which track the language of Rules 1.15-1, 1.15-2, and 1.15-3. Generally speaking, a lawyer should be

able to answer each question in the affirmative.

Rule 1.15-1 Definitions

(1) Does the trust account contain only the funds of a client(s) for whom a lawyer is engaged to perform or is performing legal service? Please note the exceptions permitted in Rule 1.15- 2(f).

(2) Is a dedicated trust account "a special interest-bearing trust account" maintained solely for the benefit of a single client or a specific transaction?

(3) Is the term "general trust account" used to denote trust accounts other than dedicated trust accounts?

(4) Is a fiduciary account "designated as such and maintained solely for the deposit of fiduciary funds or other entrusted property of a particular person or entity (i.e., an estate, guardianship, power of attorney, trust, or escrow)?"

(5) Is the financial institution where the trust accounts are maintained a bank or savings and loan association chartered under North Carolina or federal law?

Rule 1.15-2 General Rules

Safekeeping

(1) Is entrusted property (i.e., trust and fiduciary funds, and other property) identified, held, and maintained separate from the property of the lawyer?

(2) Are all trust funds promptly deposited in a general or dedicated trust account?

(3) Are all general trust accounts established as IOLTA accounts, from which interest is remitted to NCIOLTA at the State Bar?

(4) Are all fiduciary funds promptly deposited in a fiduciary or general trust account?

(5) Is all entrusted property not otherwise deposited in a trust or fiduciary account (e.g. stock certificates) promptly identified and labeled as property of the person or entity for whom it is held?

(6) Is entrusted property (other than money) in a safe deposit box or other suitable place of safekeeping?

(7) Is the location of the entrusted property disclosed to the client or other person for whom it is held?

(8) Is the safe deposit box or other place of safekeeping located in North Carolina?

(9) If not, has the client or other person for whom the entrusted property is held given written authorization to maintain the property outside North Carolina?

(10) If a dedicated trust account is maintained at a bank outside the state or in a financial institution other than a bank or outside North Carolina, has the client provided a written consent to do so?

Deposits and Disbursements

(1) Are only client funds deposited in the trust account, except lawyer funds sufficient to open or service the account or funds belonging in part to a client, third party, or lawyer?

(2) When funds belonging in part to the lawyer and in part to the client (e.g., a client check for legal fees and court costs) are received, are the funds deposited intact into the trust account?

(3) Are checks for legal fees or expenses that are drawn on a trust or fiduciary account and made payable to the lawyer entered as disbursements on the client's ledger card?

(4) Are all items drawn on a trust or fiduciary account made payable to a specific person or entity and not cash or bearer?

(5) Is entrusted property used to obtain credit or other personal benefits only for the legal or beneficial owner of the entrusted property?

Notifications

(1) Has a bank directive been filed with the bank where a trust or fiduciary account is maintained (see Section VIII)?

(2) Is the client promptly notified of the receipt of any entrusted property belonging in whole or in part to the client?

Miscellaneous

(1) Is entrusted property belonging to the client and to which the client is entitled paid or delivered promptly to the client or to third persons as directed by the client?

(2) Does the lawyer hold any entrusted property or title to property as security for the payment of any fees or other obligations to the lawyer (e.g., needs of trusts or liens)?

(3) If so, is the property clearly identified as property held as security and not as a completed transfer of ownership to the lawyer?

(4) Has the lawyer promptly reported to the North Carolina State Bar any knowledge or reasonable belief that entrusted property has been misappropriated or misapplied?

(5) Has all interest earned on trust or fiduciary accounts been paid to the client or other person or entity entitled to the principal or to the State Bar OLTA program as required by Rule 1.15-2 and Rule 1316 (see Section XII)?

(6) Has the lawyer complied with the requirements of Chapter 116B concerning the escheating of abandoned/unidentified property?

Rule 1.15-3 Records & Accountings

(1) Are the checks for all general trust accounts, dedicated trust accounts, and fiduciary accounts business-sized and do they contain an Auxiliary On-Us field in the MICR line? Rule 1.15-3(a).

(2) Do bank receipts or deposit slips list source and date of deposit? For deposits to the general trust account, do bank receipts or deposit slips also list the name of the client or other person to whom the funds belong and source of funds if other than personal?

(3) If records of canceled checks are furnished by the bank in digital image or CD-Rom format, do the digital images or CD-Roms satisfy the requirements of Rule 1.15-3(b)(2)(A)?

- Do they show amount, date, and payee, and, for the general trust account, do they show the client's balance against which the item is drawn?
- Is the lawyer/firm using business checks that contain an Auxiliary On-Us field?
- Is the digital image a legible reproduction of front and back of the original item and not smaller than 3/16 inches?
- Does the bank maintain, for at least six years, the ability to reproduce electronically additional or enlarged images within a reasonable time?
- Is the lawyer retaining these records for the required six-year period?

(4) Are all instructions or authorizations to transfer, disburse, or withdraw funds from the trust account including electronic or written transfer records retained?

(5) Are all bank statements and other documents received from the bank regarding the trust account, including any notices of insufficient funds, retained?

(6) For the general trust account, is a ledger containing a record of receipts and disbursements for each person or entity from whom or for whom funds are received maintained? Does this ledger show the current and accurate balance of funds held in the trust account for each person or entity?

(7) Are depository receipts or deposit slips for all deposited funds retained and do the receipts list the source and date of receipt?

(8) Are all statements and other documents received from the depository bank regarding the account, including notices of insufficient funds, retained?

(9) Are general trust accounts reconciled at least quarterly in the following manner: the individual client balances shown on the ledgers are totaled and reconciled with the current bank statement balance for the trust accounts as a whole?

(10) Are general trust accounts reconciled monthly in the following manner: the balance of the trust accounts shown on the lawyer's records is reconciled with the current bank statement balance for the trust account?

(11) Are written accountings provided to the client upon the final disbursement of funds (i.e., when the balance reaches zero), when reasonably requested by client, and at least annually if funds are retained more than 12 months?

(12) If not required by law, is written accounting of fiduciary funds and other entrusted property rendered to the beneficial owners or representatives at least annually and upon termination of lawyers' professional fiduciary service?

(13) Are complete and accurate records of all entrusted property received by the lawyer retained for six years from last transaction to which the record pertains?

How can I get questions answered about my trust account when I call the NC State Bar?

A number of staff people in different departments at the NC State Bar may be able to assist with your trust account question depending upon the type of question. If you can let the receptionist know the type of question you have, she can better assist you in reaching the correct staff person in the first instance. Please direct questions to the staff members listed below:

- Questions regarding trust account practices: Peter Bolac, trust account compliance counsel. Peter can be reached via phone at (919) 828-4620 or via email at PBolac@ncbar.gov
- Ethics Questions: Nichole McLaughlin and Suzanne Lever
- Questions, explanations, or issues regarding the NSF (non-sufficient funds) notification: Sonja Puryear and Dawn Whaley
- Questions regarding OLTA compliance, such as how to establish an OLTA account or certify as to compliance: Mary Irvine, Claire Mills, and Aaliyah Pierce at (919) 828- 0477

APPENDIX A: ETHICS OPINIONS

Reference Guide to Trust Account Ethics Opinions

Deposits and Fees

Guidelines for **advanced fees** 08 FEO 10 (Survey of different types of advanced fees)

Advance payments of **costs** RPC 51, 13 FEO 3 (When lawyer receives lump sum payment which is inclusive of costs, the portion representing costs must be held in the trust account)

Deposit of **mixed funds** RPC 158 (Lawyer may collect payment from client that represents both criminal fines and legal fees even if lawyer is not completely sure what fines will be, under certain conditions)

Nonrefundable retainer fees RPC 50, RPC 106, 07 FEO 4, 00 FEO 5 (Opinions track evolution of "nonrefundable" fees)

Trust Accounting for **small sums** RPC 27 (No de minimis amounts in trust accounting)

Payment of legal fees by **third parties** 05 FEO 12 (Explains lawyer's duty to refund third parties under certain circumstances)

Disbursement

Disbursement in reliance on **bank's funding schedule** 06 FEO 3 (Lawyers may rely upon bank's historic funding schedule under certain conditions)

Conditional delivery of trust account checks before depositing loan proceeds RPC 78 (No conditional delivery of trust account checks before depositing proceeds into trust account)

Conditional delivery of settlement proceeds RPC 127 (Releasing settlement proceeds before satisfying settlement conditions is dishonest and unethical)

Settlement funds, **disbursement without consent** of client prohibited RPC 75 (Lawyer may not pay his or her fees from excess funds unless previously authorized by the client)

Disbursement of tort claim settlement upon deposit of **provisionally credited funds** 01 FEO 3 (Applies RPC 191 to all disbursements, not just real estate; lawyer may endorse settlement check directly to client without depositing in trust account)

Credit Cards/Online Banking

Disbursement against funds credited to trust account by **ACH transfer** or electronic funds transfer 13 FEO 13 (Lawyer may disburse upon ACH deposits immediately, but must immediately act to protect client funds upon learning of ACH reversal)

Business account, linking for purpose of determining interest or service charges RPC 150 (Can't link trust and business accounts together if the arrangement will cause trust account funds to pay service charges for business account)

Credit card, accepting fees paid by RPC 247, 07 FEO 9, 09 FEO 4 (Lawyers may collect entrusted funds via credit card provided the lawyer addresses risks such as chargebacks and commingling)

Cashing check for client / Purchasing **money order** for client RPC 24 (Rules do not prohibit lawyer from performing services for incarcerated client)

Online banking 11 FEO 7 (Law firm may use online banking to manage trust account provided the lawyers are

regularly educated on security risks associated with account and to follow recordkeeping requirements)

Recordkeeping/Abandoned Funds

Abandoned funds RPC 39, RPC 149, RPC 226 (Abandoned funds must be held for five years from the date of last activity of the funds; must be escheated to the state, not donated to charity; if firm receives a check that is not identified as client funds, can conclude after investigation that funds belong to firm)

Retaining CD-ROM with **digital images** of trust account checks 11 FEO 14 (Retaining check images on CD satisfies recordkeeping requirement. See also Rule 1.15-3(j))

Dormancy fee on unclaimed funds 6 FEO 15 (Lawyer may charge a reasonable dormancy fee on unclaimed funds if statutorily permitted and client agrees in advance)

Disputes

Application of trust funds to **client's fee obligation** RPC 37 (Lawyer may not pay this or other fees from entrusted funds unless previously authorized by the client)

Retaining funds in trust account to pay **disputed legal fee** 11 FEO 13 (Lawyer may not, absent client consent, retain funds in trust account in order to obtain legal fees if funds were not entrusted for the payment of legal fees)

Division of fee with former firm 3 FEO 11, 2008 FEO 37 (Lawyer must act honestly with former firm and employment agreements on division of fees must be reasonable and not penalize withdrawing lawyer)

Disbursement to **medical providers** in absence of lien 11 FEO 11 (Lawyer owes duty to client, but may not unilaterally decide dispute between client and medical provider in the absence of lien)

Transfer of disputed fees from trust account to lawyer upon certain conditions 6 FEO 16 (Under certain circumstances, lawyer may consider a dispute with client resolved and transfer fees out of trust account)

Real Estate

Audit of real estate trust account by title insurer 8 FEO 13 (Audit is permissible with certain conditions)

Disbursements incident to real property **closings** RPC 36 (Discusses earnest money paid outside of closing and representation of the seller after closing)

E-recording, interim account for costs 5 FEO 11 (Note: N.C.G.S. 245A has since been amended to allow disbursement of recording costs to e-recording company before recording)

Real estate closing, disbursement against **provisional credit** RPC 191 (May disburse on provisional credit if deposit instrument is listed in Good Funds Settlement Act, with certain conditions)

Depositing client's funds for **recording costs** RPC 47 (No de minimis amounts in trust accounting)

Lawyer as Escrow Agent

Dispute over disbursement, representation of one party pursuant to waiver of future conflict 99 FEO 37 (Lawyer may represent both parties in residential/real estate transaction and subsequently only one party in an escrow dispute under certain conditions)

Duties as **escrow agent** 98 FEO 11 (Lawyer as escrow agent owes fiduciary duties to both parties and cannot advocate for either party until the fiduciary duty ends)

Disbursement of **escrowed funds, dispute over** RPC 66 (Lawyer acting as escrow agent may not disburse funds in a manner not contemplated by escrow agreement without consent of both parties)

Miscellaneous

Financing litigation 00 FEO 04 (Lawyer may acknowledge finance company's interest in settlement under certain circumstances)

Out-of-state trust accounts RPC 67 (must obtain client consent to deposit client funds in out-of-state trust account; see also requirement that funds must be held in NC OLTA accounts)

Nonprofit **public interest law** corporation, legal fees collected by 13 FEO 07 (Public interest law organizations must still follow trust accounting rules)

Stolen trust account funds, duty when third party responsible 15 FEO 67 (Lawyer may have duty to replenish stolen funds under certain circumstances)

(1) RPC 47

Trust Accounting for Small Sums

October 28, 1988

Opinion rules that an attorney who receives from his or her client a small sum of money which is to be used to pay the cost of recording a deed must deposit that money in a trust account.

Inquiry:

Attorney A is employed to draft a deed for Client B who wishes to give a parcel of real property to a relative. It is contemplated that Attorney A will, in addition to drawing the deed, preside over its execution and see that it is properly recorded. Client B is expected to pay a relatively small legal fee along with the cost of recordation at the time the deed is executed. For reasons of cost and convenience, Attorney A would like to ask this client for a single check representing the fee and the cost of recordation and would prefer to deposit that check in his general office account. From that account a single check would be written to the Register of Deeds for the cost of recordation.

Would the procedure described above violate the Rules of Professional Conduct? If so, is there any professionally responsible way of handling such transactions which would not involve an intermediate deposit in the trust account and the necessity of writing multiple checks?

Opinion:

Rules 10.1(a) and (c) [Now Rules 1.15-1(a) and (c)] quite clearly require a lawyer to deposit into his or her trust account all funds received as an fiduciary. This obligation is not in any way diminished when the sum involved is small. Strict segregation of client funds from the personal funds of the lawyer is always necessary to preclude confusion as to the identity of the funds and to ensure that trust funds are not subject to the claims of the lawyer's creditors or those of his or her estate.

It should be noted that Rule 10.1(c) [1.15-1(c)] further provides that funds received from the client by the lawyer as reimbursement for expenses properly advanced by the lawyer on behalf of the client need not be deposited in the lawyer's trust account. A lawyer handling such transactions could therefore advance funds from his or her general account to pay the cost of recordation and could accept from the client a single check for the legal fee and the advanced expenses and the check could then be deposited directly and finally into the lawyer's general office account.

(2) RPC 51

Trust Accounting for Litigation Costs

January 13, 1989

Opinion rules that where a lawyer receives a lump sum payment in advance which is inclusive of the costs of litigation, the portion representing the costs must be deposited in the trust account.

Inquiry:

Is it proper for a law firm to contract for a total amount of attorney's fees, all costs inclusive, to deposit the entire

amount into the general account as fees, and pay all the costs of the action, including filing and process fees out of the general account? Assume that the client has agreed in writing to the above agreement before the receipt of any funds.

Opinion:

No. Under the circumstances described, some of the money collected by the firm as "fees" would actually be an entrustment intended to defray the costs of litigation. Rules 0.1(a) and (c) [Rules 1.15-1(a) and (c)] require that funds received in the fiduciary capacity, however characterized, be directly deposited into a trust account.

(3) RPC 66

Disposition of Escrowed Funds

July 14, 1989

Opinion Rules that an attorney serving as an escrow agent may not disburse in a manner not contemplated by the escrow agreement unless all parties agree.

Inquiry:

Purchaser entered into a residential construction contract on March 27, 1985 with builder. When the transaction was closed on July 25, 1986, \$1000 was placed in escrow with the closing attorney to be held until list items was corrected and then disbursed to the builder.

The builder has failed to correct the items although many requests have been made by the purchaser. From time to time the attorney has urged the builder to resolve the problems with the purchaser but no action has been taken.

The attorney has maintained an escrow account earning interest in the name of the purchaser and the purchaser has now requested that the attorney disburse the escrow account and interest to the purchaser in exchange for an indemnification from the purchaser to the attorney.

After the passage of three years' time on July 25, 1989, and after ninety (90) days' notice to both parties, the attorney would like to transfer the escrow account to the purchaser and assume any civil liability, provided the transfer can be made without violating any ethical standard.

Can the attorney ethically disburse the escrowed funds to the purchaser under such circumstances?

Opinion:

No. Funds received by a lawyer acting as an escrow agent must be maintained in accordance with the trust accounting provisions of Rules 0.1 and 0.2 [now 1.15-1 and 1.15-2] of the Rules of Professional Conduct. A lawyer/escrow agent stands in a fiduciary relationship with all parties to the escrow and is obligated to treat each as a client with respect to the funds held in trust. Disbursement of escrowed funds is governed in the first instance by the terms of the escrow agreement which should inform the lawyer as to which "client" is entitled to receive payment and when and in what amounts such payment ought to be made. Rule 0.2[E] [1.15-2(e)]. In unforeseen circumstances arise for which no provision was made in the escrow agreement, such as those described in the inquiry, the disposition of the escrowed funds must be agreed upon by the parties to be made the subject of a legally binding order prior to the lawyer's release of the escrowed funds. The lawyer may not, in concert with only one of the parties to the escrow agreement, determine that the funds will be disbursed to that party without the consent of the other interested party.

(4) RPC 75

Disbursement of Client Funds

October 20, 1989

Opinion Rules that a lawyer may not pay his or her fee or the fee of a physician from funds held in trust for a client without the client's authority.

Inquiry:

Last year lawyer A began representation of Ms. B for injuries she received in an automobile accident. Since that time Ms. B has failed to cooperate in the processing of her claim, has not given any response to numerous letters, has not returned telephone messages, and has not accepted a certified letter. Lawyer A feels that she is no longer in a position to provide representation to Ms. B based on her lack of cooperation.

The question which has arisen deals with the \$353.00 balance which is maintained in the trust account on behalf of Ms. B. This represents a portion of the medical payments coverage which was received on behalf of Ms. B. Lawyer E generally obtains medical payments coverage for his clients as a courtesy with no deduction of legal fees. However, Lawyer E has spent a great deal of time on this case and feels that he should be entitled to some fee. Additionally, Ms. B has signed an doctor's lien in favor of Dr. K.

Lawyer E has on several occasions written Ms. B asking her to authorize him to disburse this amount to Dr. K for his outstanding expenses and to himself in payment for legal services performed. There has been no response. May Lawyer E ethically take a reasonable legal fee from this balance and forward the remainder to Ms. B's physician for his services?

Opinion:

No. Rule 10.2(E) (now Rule 1.15-2(e)) of the Rules of Professional Conduct requires a lawyer holding client funds in trust to pay or deliver those funds only as directed by the client. In this case the client has evidently not offered any direction regarding the disbursement of the funds in question and Lawyer E should therefore continue to hold this money in trust.

Although there would appear to be a valid physician's lien against some portion of the trust funds, Lawyer E should refrain from disbursing any money to Dr. K until he obtains this client's consent to pay some or all of the amount billed or is required to pay some liquidated amount by a valid court order. Any funds which are the subject of an ongoing dispute should be retained in trust.

(5) RPC 78

Conditional Delivery of Trust Account Checks

October 20, 1989

Opinion rules that a closing attorney cannot make conditional delivery of trust account checks to a real estate agent before depositing loan proceeds against which checks were to be drawn.

Inquiry:

Attorney C closes loans for a number of real estate clients. After all documents are signed, but before recording, Attorney C gives the real estate agent the commission check and the check for the seller's proceeds, with specific instructions that the real estate agent is to hold both checks in trust until notified that the closing documents have been recorded and all closing proceeds have been deposited in Attorney's trust account. Attorney then records the necessary documents and deposits all closing proceeds in his trust account.

Attorney has been given closing instructions from the lender which require recording before disbursement. Attorney has actually signed a statement to the lender that he will follow the lender's instructions. Attorney is on the approved attorneys' list for a number of title insurance companies who have issued insured closing letters to lenders whose loans Attorney closes. The insured closing letter ensures that Attorney will comply with the lender's closing instructions. Attorney does not deposit any funds, including lender's loan proceeds, until after title update and recording. If a defect in title is discovered by Attorney in his title update after disbursement, "he will not record and will notify the real estate agent to return the checks."

1. May Attorney ethically tender to real estate agent, in trust, the commission and seller's proceeds checks with instructions that the realtor, as agent for attorney, hold such checks until the attorney has recorded the closing documents, deposited the closing proceeds in his trust account, and notified the realtor that he may disburse the checks which real estate agent is holding in trust?
2. Has Attorney violated any ethical requirements in disregarding the potential liability that would be imposed upon the title insurance company and/or his professional liability carrier if a defect is discovered after disbursement?

Opinion:

This is a variation of the inquiry addressed in RPC 44, concerning the obligation of the closing attorney to follow the instructions of his client, the lender, to record documents before disbursing loan proceeds.

1. No. The attorney may not ethically deliver trust account checks to the real estate agent, even if such delivery is

made in trust” or “conditionally,” until the attorney has recorded the closing documents and deposited the closing proceeds in this trust account.

Arguably, the conditional delivery of the trust account checks would not violate the lender’s instructions, because the attorney is, in fact, recording before depositing and disbursing the lender’s funds. Those funds have not been “disbursed.” See RPC 4.

However, by delivering to the real estate agent checks drawn on the trust account when the account has either (i) no funds or (ii) trust funds belonging to others, the attorney violates Rules 10.1 and 10.2 (now Rules 1.15-1 and 1.15-2). Under those rules, funds deposited in a trust account are funds received by the attorney as fiduciary, which must be held and disbursed only for the benefit of those entitled to them, in accordance with appropriate instructions. Accordingly, an attorney cannot violate or delegate this fiduciary duty by putting into the hands of an unrelated third-party check, regular on its face, drawn on a trust account containing only the funds of others. Similarly, an attorney cannot ethically deliver checks drawn on an account with insufficient funds, in violation of the law and the implicit requirement imposed by Rule 10.2(F) [1.15-2(f)].

2. Because of the answer to question 1, it appears unnecessary to answer question 2. Reference is made to RPC 4. As a general matter, the ultimate liability created under a title insurance policy or professional liability insurance policy will be irrelevant to the determination of the ethical issues, which must be judged independently of legal liability and insurability.

(6) RPC 125

Disbursement of Settlement Proceeds

January 17, 1992

Opinion rules that a lawyer may not pay a medical care provider from the proceeds of a settlement negotiated prior to the filing of a suit over his client’s objection unless the funds are subject to a valid lien.

Inquiry:

Lawyer A represents a plaintiff in a personal injury action. During the course of settling the case, the attorney receives medical bills from medical care providers which treated the client for the personal injuries. Settlement is reached without the filing of a lawsuit. There is no dispute over the medical bills. The client instructs Lawyer A to pay all proceeds of the settlement over to her and to not pay the medical bills. The medical care providers have not taken the steps set forth in G.S. §44-49 to perfect the lien provided in that statute, but Lawyer A has actual notice of the bills (see G.S. §44-50). Does RPC 69 mandate that the attorney pay the settlement proceeds to the client rather than following the distribution scheme set forth in G.S. §44-50?

Opinion:

RPC 69 ruled that an attorney has an ethical obligation to disburse funds belonging to the client as instructed by the client in the absence of a valid lien in favor of a health care provider.

Rule 10.2(e). From the standpoint of the Rules of Professional Conduct, the situation is the same regardless of whether the case is settled before or after the initiation of litigation. The interpretation of G.S. §44-50 is beyond the purview of the ethics committee. Suffice it to say that that statute has the effect of imposing a lien upon settlement proceeds in the hands of an attorney when the attorney has received actual notice of the medical care provider’s claim and suit has not been filed, then the attorney may pay the medical care provider’s undisputed claim in spite of his client’s objection. If, on the other hand, a lien is not perfected by the attorney’s acquisition of actual notice under such circumstances, the attorney would have to abide by the instructions of the client in regard to the disbursement of the proceeds of settlement.

(7) RPC 127

Conditional Delivery of Settlement Proceeds

April 17, 1992

Opinion rules that deliberate release of settlement proceeds without satisfying conditions precedent is dishonest and unethical.

Inquiry #1:

Attorney B is regularly employed by an automobile liability insurance company to defend claims for litigation against

its insureds, or against the insurance company when the claim is against other coverage that the company has provided (such as uninsured and underinsured motorist insurance coverage). When the settlement of any such claim or litigation is negotiated, Attorney D typically prepares the documents that he and his client or clients will require to conclude the settlement (the settlement documents). The settlement documents usually consist of a release, as well as a consent judgment, or a notice or stipulation to effect a dismissal of any pending litigation.

Attorney D routinely sends the settlement documents to opposing counsel, Attorney P, with a letter which directs the manner in which the settlement is to be concluded with the use of the settlement documents by Attorney P.

Attorney D also sends the check or checks for the settlement proceeds to Attorney P with a letter stating that each check is conditionally delivered to Attorney P in trust and upon the condition that, while in some instances the check may be deposited in the trust account of Attorney P, the check may otherwise be delivered, and no proceeds from any check may be disbursed by Attorney P until the settlement documents have been executed in the manner directed in the letter and returned to Attorney D.

With respect to this conditional delivery of the settlement check or its proceeds, is Attorney D a "client" of Attorney P as defined by Rule 1.0.1(b)(4) [now 1.15-1(b)(4)]?

Opinion #1:

No.

Inquiry #2:

Is Attorney P required to render appropriate accountings to Attorney D with respect to the receipt, delivery or disbursement of the settlement check or its proceeds?

Opinion #2:

No.

Inquiry #3:

Has Attorney P violated a rule if he delivers the settlement check or disburses any of the proceeds from the settlement check in violation of any condition under which Attorney P received the settlement check?

Opinion #3:

Yes. Whenever an attorney accepts conditional delivery of settlement proceeds from opposing counsel, the attorney implicitly agrees to abide by the prescribed conditions. Any deliberate failure to abide by those conditions, such as by disbursing the proceeds without first having obtained a signed release, would be dishonest and violative of Rule 1.2(c), which prohibits conduct involving dishonesty, fraud, deceit or misrepresentation. "It does not appear that such conduct would violate any of the provisions of Rules 1.0.1 or 1.0.2 [now 1.15-1 or 1.15-2] since the obligations imposed by those rules are owed exclusively to clients and adverse counsel cannot properly be considered a client.

Inquiry #4:

Is Attorney D required by Rule 1.3(a) to inform the North Carolina State Bar if it comes to his attention that the settlement check has or may have been delivered, or that proceeds from the settlement check have or may have been disbursed, by Attorney P without meeting the condition required for any such delivery or disbursement?

Opinion #4:

Not necessarily. Rule 1.3(a) requires only the reporting of violations of the Rules of Professional Conduct that raise substantial questions as to the offending lawyer's honesty, trustworthiness or fitness as a lawyer in other respects.... A willful failure on the part of the attorney to whom such funds were entrusted to satisfy the conditions of tender would raise a substantial question about the lawyer's trustworthiness and would necessitate a report to the apparent violator to the State Bar. If, however, it appears that the failure to satisfy the conditions of tender resulted from a mistake, as opposed to knowing disregard, a report of the misconduct would not be required. It should be noted that Rule 1.3 does not, in any case, require disclosure of confidential information. Rule 1.3(c).

Inquiry #5:

With respect to any obligation Attorney D might have to inform the North Carolina State Bar of Attorney P's

misconduct, does it make any difference whether the conditions upon which the settlement check was delivered to Attorney P are subsequently satisfied, or whether the settlement is otherwise subsequently concluded to the satisfaction of Attorney D and his client or clients?

Opinion #5:

If it appears to the attorney or the adverse party that Attorney P knowingly violated the conditions of tender, there would be the duty to report the apparent misconduct regardless of subsequent actions on the part of Attorney P to rectify the situation or otherwise satisfy Attorney D and his client.

Inquiry #6:

With respect to inquiries 4 and 5, does it make any difference whether Attorney D is also aware that Attorney P is or has been under investigation by the North Carolina State Bar for other alleged violations of Canon X or a rule promulgated thereunder?

Opinion #6:

The mere fact that Attorney D is aware that Attorney P is or has been under investigation by the State Bar for other alleged violations of the trust account rules would not necessarily compel report of Attorney P's disbursement in violation of the conditions of tender. There may exist circumstances, however, in which an attorney becomes aware of a pattern of misconduct so pronounced as to warrant the conclusion that a similar violation was knowing and intentional. Under such circumstances, an attorney would have an obligation to report the misconduct to the State Bar.

(8) RPC 150

Linking Trust and Business Accounts

January 15, 1993

Opinion rules that an attorney cannot permit the bank to link her trust and business accounts for the purpose of determining interest earned or charges assessed if such an arrangement causes the attorney to use client funds from the trust account to offset service charges assessed on the business account.

Inquiry:

Attorney A maintains a trust account and a business account with Sunshine Bank. Attorney A has been a participant in OLTA. Over the last several months, however, Attorney A's account has been incurring substantial charges (over \$400 in the last year).

After repeated inquiries, Attorney A discovered that her business account and trust account were "linked" for the purposes of determining interest earned or charges assessed. Both accounts are subject to a charge per deposit or check, and interest accrues on daily balances such that a substantial balance in the account should offset the check and deposit charges.

Since Attorney A had repeatedly instructed the bank not to debit the trust account for charges, intending to avoid charges for new checks, etc., the bank had linked the two accounts so that the charges from the trust account were assessed against the business account. Of course, being a member of OLTA, the interest on the trust account balance, which would otherwise have offset the charges, was sent to OLTA. In effect, Attorney A was paying for contributions to OLTA. Being deprived of the offsetting interest on the trust account, the numerous checks she wrote for real estate conveyances created a considerable debit.

At this point, the bank has changed both accounts to commercial accounts which do not draw interest, but the balances in the accounts create "credits" which offset the charges per check or deposit. Any negative balance on the trust account is shifted over to the business account.

Does this situation create any ethical problems? Neither account will ever yield a credit in the form of interest income, and hopefully the ongoing balances will offset the debit charges such that they will usually be "free" accounts.

Opinion:

Under Rules 10.1 and 10.3 [now Rules 1.15-1 and 1.15-3], client funds in a trust account may not be used to pay bank service charges or fees of the bank because such funds are the sole property of the client and cannot benefit

the Attorney Rules 10.1 and 10.3 now 1.15-1 and 1.15-3) do not permit the payment of bank service charges and fees of the bank from interest earned on client funds deposited in the lawyer's trust account. The new arrangement established by Attorney A's bank could create ethical problems if the credits and service charges in the trust and business accounts were not accounted for independently. Since the trust and business accounts are "linked" for the purposes of determining interest earned or charges assessed, it would be impossible for one to separate out the specific amount of interest earned or charges assessed for either account. If for a particular statement period the trust account earned more "credits" than it was assessed charges, while the business account was assessed more service charges than it earned "credits", the trust account "credits" could offset the service charges assessed on the business account. Rule 10.1 (1.15-1) does not permit the lawyer to use client funds from the trust account ("credits" from the trust account) for the lawyer's personal benefit (the offset of service charges assessed on the business account).

(9) RPC 191

Disbursements Upon Deposit of Funds Provisionally Credited to Trust Account

October 20, 1995, Revised January 24, 1997

Opinion Rules that a lawyer may make disbursements from this or other trust account in reliance upon the deposit of funds provisionally credited to the account if the funds are deposited in the form of cash, wired funds, or by specified instruments which, although they are not irrevocably credited to the account upon deposit, are generally regarded as reliable.

Introduction

In the wake of the financial failure of an out-of-state mortgage lender, the State Bar received numerous requests to reexamine prior ethics opinions CPR 58 and RPC 6 which permitted a lawyer to issue trust account checks against funds which, although uncollected, were provisionally credited to the lawyer's trust account by the financial institution with which the trust account was maintained. RPC 6 cautioned that the losing lawyer should disburse against provisionally credited funds only when the lawyer reasonably believed that the underlying deposited instrument was virtually certain to be honored when presented for collection. Nevertheless, lawyers did accept, deposit, and disburse against the residential loan proceeds checks of the out-of-state mortgage lender that failed. Some of these checks were ultimately dishonored and charged back against the trust accounts of the losing lawyers. In the meantime, some trust account checks issued for the losses were presented for collection and paid, resulting in the use of funds deposited by other clients to pay the losing checks presented for payment.

Inquiry:

In the typical residential real estate closing, the lending institution that finances the purchase of the property delivers the loan proceeds to the losing lawyer in the form of a check drawn upon financial institution which may or may not be located in North Carolina. Loan proceeds are seldom delivered to the losing lawyer in the form of wired funds. Similarly, the real estate agent sometimes delivers the earnest money to the losing lawyer in the form of a check drawn on his or her trust account and the buyer sometimes delivers a personal check to the losing lawyer to cover the difference between the loan amount and the buyer's obligations. May a losing lawyer deposit such checks in his or her trust account and, if the depository bank will provisionally credit the lawyer's trust account, immediately disburse against the items before they have been collected?

Opinion:

Yes, but only upon the conditions set forth in this opinion. A lawyer (1) may disburse funds from a trust account only in reliance upon the deposit of a financial instrument specified in the Good Funds Settlement Act, G.S. Chap. 25A (the Act), which became effective on October 1, 1996, and the securing or provisional credit for the deposited item, and (2) has an affirmative duty, must immediately act to protect the property of the lawyer's other clients by personally paying the amount of any failed deposit or securing or arranging payment from other sources upon learning that the deposited instrument has been dishonored. It shall be unethical for a lawyer to disburse funds from a trust account in reliance upon the deposit of a financial instrument that is not specified in the Act, regardless of whether the item is ultimately honored or dishonored.

In reliance on CPR 58 and RPC 6, many losing lawyers deposit the checks from the lender, the real estate agent, and the buyer into their trust accounts, receive provisional credit for the items from the depository bank and immediately disburse funds from their trust accounts in accordance with the scheduled receipts and disbursements prepared for the closing. There is typically some delay, generally three or four days but in some instances as much as fifteen days, between the time of the deposit of the checks to the lender, the buyer, and the

real estate agent into the lawyer's trust account and the time when the funds are irrevocably credited to the lawyer's trust account by the depository institution. Because of the time lag between the deposit and the collection of the checks, the closing lawyer runs the risk that a check may be ultimately dishonored and charged back against the trust account of the closing lawyer, resulting in the use of the funds of other clients to deposit in the trust account to satisfy the disbursement checks from the closing.

A lawyer who receives funds that belong to a client assumes the responsibilities of a fiduciary to safeguard those funds and to preserve the identity of the funds by depositing the funds into a designated trust account. Rule 10.1 [now 1.15-1] of the Rules of Professional Conduct. It is the lawyer's fiduciary obligation to ensure that the funds of a particular client are used only to satisfy the obligations of that client and are not used to satisfy the claims of the lawyer's creditors. Rule 10.1 [now 1.15-1] and comment. Furthermore, Rule 10.2 [now 1.15-2] of the Rules of Professional Conduct requires a lawyer to maintain complete records of all funds or other property of a client received by the lawyer and to render to the client appropriate accountings of the receipt and disbursement of any of the client's funds or property held by the lawyer. Rule 10.2 (e) [now 1.15-2(e)] recognizes a lawyer's obligation to pay promptly or deliver to the client, or to a third person as directed by the client, the funds in the possession of the lawyer to which the client is entitled. Strictly interpreted, these rules would appear to require a lawyer not to disburse upon items deposited in this or other trust account until the depository bank has irrevocably credited the items to the account.

Requiring the closing lawyer to postpone disbursement until all items have been credited to the lawyer's trust account would result in inconvenience, delay, and could have an adverse effect on the economy. Nevertheless, there is some risk that certain instruments, such as ordinary commercial checks, may be uncollectible in any given transaction. Conversely, there are financial instruments that are generally regarded as extremely reliable. In fact, other state bars that have considered the issue have held that there are certain financial instruments for which the risk of noncollectibility is so slight as to make it unnecessary to prohibit the closing lawyer from disbursing immediately against such items before they are collected. See Virginia State Bar Legal Ethics Opinion 83 and Rule 5-1.1(g) of the Rules Regulating the Florida Bar. Similarly, the North Carolina Good Funds Settlement Act permits a "settlement agent," or person responsible for conducting the settlement and disbursement of the proceeds for residential real estate closing, to disburse against uncollected funds but only if the deposited instrument is one of the forms specified in the Act.

Notwithstanding the fact that some of the forms of funds designated in the Act are not irrevocably credited to the lawyer's trust account at the time of deposit, the risk of noncollectibility is so slight that a lawyer's disbursement of funds from a trust account in reliance upon the deposit into the account of provisionally credited funds in these forms shall not be considered unethical. However, the closing lawyer should never disburse against any provisionally credited funds unless he or she reasonably believes that the underlying deposited instrument is virtually certain to be honored when presented for collection. A lawyer may immediately disburse against collected funds, such as cash or wired funds, and may immediately make disbursements from this or other trust account in reliance upon provisional credit extended by the depository institution for funds deposited into the trust account in one or more of the forms set forth in G.S. 45A-4.

The disbursement of funds from a trust account by a lawyer in reliance upon provisional credit extended upon the deposit of an item into the trust account which does not take one of the forms prescribed in the Act constitutes professional misconduct, regardless of whether the item is ultimately honored or dishonored. However, a lawyer who disburses in reliance upon provisional credit extended upon the deposit of an item prescribed in the Act shall not be guilty of professional misconduct if that lawyer, upon learning that the item has been dishonored, immediately acts to protect the property of the lawyer's other clients by personally paying the amount of any failed deposit or securing or arranging payment from sources available to the lawyer other than trust account funds of other clients. An attorney should take care not to disburse against uncollected funds in situations where the attorney's assets or credit would be insufficient to fund the trust account checks in the event that the provisionally credited item is dishonored.

To the extent that CPR 58 and RPC 86 are inconsistent with this opinion, they are overruled. However, there are provisions in both opinions that remain operative. Specifically, the provision of CPR 58 that prohibits a lawyer from disbursing against the "float" in the trust account during the time lag between the deposit of the checks to the lender, the buyer, and the real estate agent and the time when these items are irrevocably credited to the account unless provisional credit for the items is extended by the depository institution remains in effect. If provisional

credits not extended by the depository institution, the disbursing lawyer is using the funds of other clients to cover the closing disbursements until the deposited items are collected in violation of Rule 10.1 (now 1.15-1).²

It should be emphasized that this opinion shall apply to any disbursements from the trust account against items which are not irrevocably credited to the account upon deposit, whether such disbursements are for the purpose of closing a real estate transaction or for the purpose of concluding some other transaction or matter.²

(10) 97 Formal Ethics Opinion 9
Credit Card Chargebacks Against a Trust Account
January 16, 1998

*Opinion rules that, provided steps are taken to safeguard the client's funds on deposit in the trust account, a lawyer may accept fees paid by credit card although the bank's agreement to process such charges authorizes the bank to debit the lawyer's trust account in the event the credit card charge is disputed by the client.*²

Inquiry #1:

To accept charges paid by MasterCard and Visa credit cards, as well as other national credit cards, a lawyer must enter into a standard form of "Merchant Agreement" with the bank in which the bank agrees to deposit credit card payments from cardholders electronically into the merchant's account with the bank subject to certain conditions. Among other conditions, such agreements typically permit the bank to debit the merchant's account for the discount fee, or the bank's charge to the merchant for advancing the credit card payments.²

In addition, such agreements typically permit the bank to "charge back" the merchant's bank account, without prior notice, in the amount of a prior payment by credit card which is subsequently disputed by the cardholder.^{1,2} The dispute process is commenced when the cardholder notifies the credit card issuer that he disputes a charge shown on his statement. The merchant is notified of the dispute. Documentation of the charge is requested from the merchant. If the documentation is not deemed satisfactory or the merchant fails to respond, the bank may debit the disputed amount from the merchant's account with the bank without prior notice to the merchant.²

Lawyers may accept payment of legal fees by electronic transfer and credit card. RPC 2.29 and RPC 2.47. However, RPC 2.47 requires a lawyer to arrange to have all credit card payments electronically deposited into the trust account if the lawyer's bank cannot or will not distinguish between the operating account, into which earned fees should be deposited, and the trust account, into which unearned fees should be deposited. To avoid the problem of commingling the funds of clients and the lawyer's funds, the opinion provides:²

[i]f a payment by electronic transfer of an earned fee cannot be distinguished by the bank from a payment by electronic transfer of an unearned fee, all payments by electronic transfer should be deposited into a lawyer's trust account and earned fees should be withdrawn from the trust account promptly. [Citing now repealed Rule 10.1(c).] The lawyer may also deposit into the trust account funds sufficient to pay the bank's service charges for electronic transfers. [Citing now repealed Rule 10.1(c)(1).] A ledger should be maintained for the service charges posted against such funds. [Citing now repealed Rule 10.2(c)(3).]²

According to RPC 2.47, all payments of unearned fees and expenses must be deposited into a lawyer's trust account even if the payment is made by credit card. May a lawyer participate in a merchant agreement with a bank to honor credit card charges if the agreement gives the bank the authority to debit the lawyer's trust account for a chargeback without prior notice to the lawyer?²

Opinion #1:

Yes, provided the lawyer takes appropriate steps to protect the funds of other clients on deposit in the trust account.²

A lawyer who receives funds that belong to a client assumes the responsibilities of a fiduciary to safeguard those funds and to preserve the identity of the funds by depositing them into a designated trust account. Rule 1.15-1 of the Revised Rules of Professional Conduct and RPC 9.1. The responsibilities of a fiduciary include the duty to ensure that the funds of a particular client are used only to satisfy the obligations of that client and are not used to satisfy the claims of the lawyer's creditors or of other clients of the lawyer. RPC 9.1. Therefore, a lawyer may participate in a merchant agreement with a bank to honor the credit card payments of clients only if the funds of other clients on deposit in the lawyer's trust account will be protected against a chargeback.²

To avoid the potential jeopardy to the funds of other clients on deposit in a trust account, the lawyer must first attempt to negotiate an agreement with the bank that requires the bank to debit an account other than the trust account in the event of a chargeback. Some banks will route chargeback debits (and the discount fee for credit card charges) against a firm's operating account. Some banks may require a merchant to maintain a separate demand deposit account in an amount sufficient to cover chargebacks. If the bank cannot or is unwilling to debit a separate account, i.e., the bank requires all chargebacks to be debited from the account into which credit card payments are deposited, the lawyer must request that the bank arrange an inter-account transfer such that the lawyer's operating account, or other non-trust account, will be immediately debited in the event of a chargeback against the trust account and the money promptly deposited into the trust account to cover the chargeback. If the bank will not agree to debit another account or arrange for inter-account transfers, the lawyer must establish a trust account for the sole purpose of receiving advance payments by credit card. The lawyer must withdraw all payments to this trust account immediately and deposit them in the lawyer's "primary" trust account. In this way, the risk that a chargeback will impact the funds of other clients will be minimized.

Under all circumstances, a lawyer is ethically compelled to arrange for payment from his or her own funds or from some other source to the trust account sufficient to cover the chargeback in the event that a chargeback jeopardizes the funds of other clients on deposit in the account.

Inquiry #2:

May a lawyer participate in a merchant agreement that grants the bank a security interest in the accounts that the lawyer maintains with the bank?

Opinion #2:

No, Rule 1.15-1(g) prohibits the use or pledge of funds in a trust account to obtain credit. If one or more of the accounts is a trust account, the lawyer may not participate in the agreement unless the trust account or accounts are specifically exempted from the grant of a security interest.

Inquiry #3:

If the nature of a lawyer's practice is such that all fees that the lawyer collects are earned at the time of collection, may the lawyer arrange for payments by credit card to be made directly to the lawyer's operating account?

Opinion #3:

Yes, Rule 1.15-1.

Endnote

1. The Truth in Lending Act (§170, 15 USC §1666i) and Regulation Z (12 CFR §226.12(c)) contain provisions which preserve a cardholder's claim and defenses against a card issuer in certain circumstances. A cardholder is given the right to assert against the card issuer all claims (other than tort claims) and defenses arising out of the credit transaction that it would otherwise have against the merchant. Regulation Z does not provide any guidance as to the nature of the claims and defenses that may be asserted. Since it does give the cardholder the right to assert against the card issuer any claims and defenses available that would be available against the merchant, however, most merchant agreements provided for a "pass through" of the problem.

The power of a cardholder to reverse a credit card transaction is very broad. The following is the mandatory disclosure that must appear in the credit card agreement with a prospective cardholder:

If you have a problem with the quality of property or services that you purchased with a credit card, and you have tried in good faith to correct the problem with the merchant, you may have the right not to pay the remaining amount due on the property or services. There are two limitations on this right:

(A) You must have made the purchase in your home state, if not within your home state, within 100 miles of your current mailing address; and

(B) The purchase price must have been more than \$50.00.

These limitations do not apply if the card issuer owns or operates the merchant or if we mailed you the

(11) 2001 Formal Ethics Opinion 3

**Disbursement for Tort Claim Settlement Upon Deposit of Funds Provisionally Credited to Trust Account
April 27, 2001**

Opinion rules that a lawyer may settle a tort claim by making disbursements from a trust account in reliance upon the deposit of funds provisionally credited to the account if the deposited funds are in the form of financial instrument that is specified in the Good Funds Settlement Act, G.S. Chap. 45A.

Inquiry #1:

Attorney regularly represents individuals with personal injury claims. When an insurance company checks for \$5000 or more is paid in settlement of a client's claim, the check is deposited into the trust account of the attorney's firm. No disbursements are made to the client, or to third parties on behalf of the client, until the funds are actually collected because RPC 1.91 limits the disbursements that can be made against provisional credit. RPC 1.91 prohibits a lawyer from making disbursements from a trust account unless the funds are actually deposited in the account or, if the depository institution grants provisional credit, unless the financial instrument deposited into the account is one of the ones specified in the Good Funds Settlement Act, G.S. Chap. 45A (the "Act").

Attorney believes that RPC 1.91 should not apply to disbursements from a trust account for a personal injury settlement because the Act is specifically limited to the settlement of residential real estate transactions. See G.S. § 45A-2. Attorney believes that the limitations of RPC 1.91 create a hardship on his firm and the client because the client has to come to the firm's office to endorse the settlement check and, after the check clears the bank, return to the firm to collect the disbursement. This may have an adverse effect on the client's credit and delay repairs to or replacement of an automobile if there is also a property damage settlement. It also costs attorney additional time to meet with the client twice.

Is RPC 1.91 applicable to personal injury settlements? If so, is there an exemption for personal injury settlements or checks from insurance companies licensed to do business in North Carolina?

Opinion #1:

RPC 1.91 is applicable to all disbursements from a trust account against financial instruments that are not irrevocably credited to the account upon deposit. Although the Good Funds Settlement Act was adopted by the General Assembly only to regulate the settlement of residential real estate transactions, the rationale for the opinion is found in the following excerpt from the opinion:

Notwithstanding the fact that some of the forms of funds designated in the Act are not irrevocably credited to the lawyer's trust account at the time of deposit, the risk of noncollectibility is so slight that a lawyer's disbursement of funds from a trust account in reliance upon the deposit into the account of provisionally credited funds in these forms shall not be considered unethical. However, a losing lawyer should never disburse against any provisionally credited funds unless he or she reasonably believes that the underlying deposited instrument is virtually certain to be honored when presented for collection. A lawyer may immediately disburse against collected funds, such as cash or wired funds, and may immediately make disbursements from his or her trust account in reliance upon provisional credit extended by the depository institution for funds deposited into the trust account in one or more of the forms set forth in G.S. § 45A-4.

- The disbursement of funds from a trust account by a lawyer in reliance upon provisional credit extended upon the deposit of an item into the trust account which does not take one of the forms prescribed in the Act constitutes professional misconduct, regardless of whether the item is ultimately honored or dishonored.

The exception allowed in RPC 1.91 to the duty to disburse only against collected funds in a trust account is purposefully narrow to limit the potential for disbursements against instruments that are subsequently dishonored. If an instrument is subsequently dishonored, it puts at risk all client funds on deposit in the trust account. The relatively minor inconvenience of waiting for a check to clear the bank is offset by the protection that disbursement against collected funds provides to all clients with funds deposited in the trust account. The General Assembly, as a matter of public policy, has determined that the items set forth in the Good Funds Settlement Act are sufficiently reliable to exempt these items from the safeguard of waiting to collect the funds, but the Ethics Committee of the

State Bar does not have the authority to expand the exemption.

Inquiry #2:

When an attorney settles a property damage claim on a client's vehicle, she asks the insurance company to put only the name of the client on the settlement check. Attorney believes that this is the only way that the check can be given directly to the client. If the check is made out to both the client and the law firm, Attorney deposits the check into the trust account and waits until the check is collected before disbursing the entire amount of the check to the client. The delay before disbursement can be a serious inconvenience to a client who needs an automobile for transportation.

If an insurance check is made out jointly to the law firm (or attorney) and the client, may an attorney endorse the check and give the check to the client without depositing it first into the trust account?

Opinion #2:

When funds belonging presently or potentially to a lawyer are received in combination with funds belonging to a client, or other persons, the funds must be deposited intact into the trust account. See Rule 2.15-2(g). However, if all of the funds represented by the check from a third party belong to the client or the lawyer is prepared to forgo being paid for his legal services from the check proceeds (and bill the client instead), the check may be endorsed directly to the client without being deposited into the trust account.

(12) 2005 Formal Ethics Opinion 13

Unearned Portion of a Minimum Fee Must Be Returned to the Client

January 20, 2006

Opinion rules that a minimum fee that will be billed against an hourly rate and is collected at the beginning of representation belongs to the client and must be deposited into the trust account until earned and, upon termination of representation, the unearned portion of the fee must be returned to the client.

Inquiry #1:

Law firm is made up of five partners and one associate. Partnership expenses, debts, and profits are divided equally among all partners irrespective of gross receipts and repaid weekly.

Partner C, who practiced family law litigation, typically used a fee contract referred to by the firm as the "minimum fee" contract. The contract provides that the initial fee charged to the clients is the greater of (1) the flat fee established in the contract, or (2) an hourly rate applied to actual time that will be spent in representation to the client. A minimum fee paid by the client was deposited into the firm's general account. The contract, however, did not state that the fee was deemed earned and payable to the attorney upon receipt.

Partner C left Law Firm and opened his own practice. Most of his clients chose to follow C for continued representation. These clients paid the minimum fee, according to the terms of the fee contract, to Law Firm prior to C's departure. Shortly after C's departure, C sent a letter to Law Firm requesting a transfer of his clients' remaining funds to C. The remaining funds are the difference between the fees collected at the beginning of each representation and the value of the hourly services performed by C for each client prior to leaving Law Firm.

Law Firm refused to comply with C's request reasoning that the fees were deposited into the firm's operating account and used to pay ongoing expenses, including partnership draws, of which C received his share. At C's direction, the clients then began to contact Law Firm demanding a refund of their remaining funds so that the money could be paid to C for continued representation. If the remaining funds are not returned, C's clients may be precluded from having C to continue to represent them.

Are the lawyers remaining with Law Firm required to refund any funds to C's clients?

Opinion #1:

Yes. Law Firm incorrectly deposited the minimum fees into the firm's operating account. In order for payment made to an attorney to be earned immediately, the attorney must clearly inform the client that it is earned immediately, and the client must agree to this arrangement. See RPC 5.8. Even with the consent of the client, only true retainers and flat fees are deemed earned by the lawyer immediately and therefore can be deposited into the operating account upon receipt. A minimum fee that will be billed against the lawyer's hourly rate is client money.

and belongs in the trust account until earned. See Rule 1.15-2(b). In the present case, at some point during the representation, Law Firm would calculate the number of hours spent on the case and determine whether the client owed more money. The fee arrangement was therefore either a true retainer or flat fee. Furthermore, Law Firm's fee contract did not make an allowance for the fee to be deposited into the firm's operating account. Therefore, those portions of the minimum fees that were not earned by C's labor while with Law Firm remain client funds and must be returned to the clients. See Rule 1.16(d). If Law Firm does not return the unearned portions of the funds to C's clients, they will have collected an excessive fee in violation of Rule 1.5(a).

Inquiry #2:

Will the answer be different if by subsequent agreement the client consents to the deposit of the minimum fee into Law Firm's operating account?

Opinion #2:

No. A client has the right to terminate the representation at any time with or without cause. See 2007 Formal Ethics Opinion 4. When the client-lawyer relationship ends, if the fee is clearly excessive and if the services actually rendered, the portion of the fee that makes the total payment clearly excessive must be returned to the client. See 2000 Formal Ethics Opinion 5. See also opinion #1.

Inquiry #3:

What duties are owed by Law Firm and/or C to former clients of Law Firm for whom legal work is ongoing, with respect to (a) an accounting for fees previously paid to Law Firm pursuant to the fee contract, (b) a request for refund of fees, and (c) providing future legal services in accordance with the fee contract?

Opinion #3:

(a) Law Firm and C are responsible for providing an accounting of the fees to the client, upon request or at the end of the representation. See Rule 1.15-3(d).

(b) All of the lawyers in Law Firm, whether in its current incarnation or at the time the fees were collected, are responsible for refunding any unearned portions of the fees. See opinion #1.

(c) Once the fee agreement is reached between attorney and client, the attorney has an ethical obligation to fulfill the contract and represent the client's best interest, subject to the right or duty to withdraw under Rule 1.16. See Rule 1.5, Comment 5.

Inquiry #4:

Is it ethical for C to instruct former clients of Law Firm, who are represented by C, to seek a refund of fees so that they can pay for their continued representation by C?

Opinion #4:

Yes. See opinion #1.

(13) 2006 Formal Ethics Opinion 8

Disbursement of Trust Funds

July 21, 2006

Opinion rules that a lawyer may disburse against deposited items in reliance upon a bank's funding schedule under certain circumstances.

Inquiry:

Attorney receives insurance company checks for payment of workers' compensation and personal injury settlements. Upon receipt, Attorney deposits these checks into her trust account.

Because the insurance checks are not among the identified instruments in the Good Funds Settlement Act, G.S. A745A-4, she must wait until the funds have been "irrevocably credited" or collected before disbursing from the trust account to the client. RPC 1.91. Attorney has been unable to locate a bank that is willing to confirm when deposited funds have been collected.

Attorney has consulted with other lawyers in the locality with similar practices. Rather than call the bank to confirm

that the funds have been collected, the lawyers routinely disburse against items deposited in the trust account, based upon prior dealings with the banks, in accordance with the following funding schedule: 3 business days for an in-state check and 7 business days for an out-of-state check. Attorney would like to follow this funding or "float" schedule for disbursements, as it appears to be the standard in the community.

May Attorney disburse funds from the trust account in reliance upon this schedule?

Opinion:

RPC 91 permits lawyers to disburse immediately from the trust account in reliance upon the deposit of funds provisionally credited to the account if the funds are in the form of cash, wired funds, or one of the enumerated instruments listed in the Good Funds Settlement Act. For all other instruments, a lawyer has an obligation to conduct reasonable due diligence to determine whether funds deposited into the trust account have been collected prior to disbursement.

Initially, a lawyer always should consult with the bank to determine when a particular instrument has been collected or funded. Before disbursing, a lawyer should also consider the source of the funds, i.e., whether the payor is reputable and whether the instrument is likely to be honored. If a lawyer receives confirmation by the bank that the funds deposited are collected, then the lawyer may rely upon this information and disburse against the funds. A lawyer reasonably may rely upon the bank's funding or "float" schedule or policy only when the lawyer is unable to confirm whether funds have been irrevocably credited to this account and the lawyer has no reason to believe a particular instrument will not be honored under the circumstances. In any case, if the lawyer subsequently learns that an instrument has been dishonored, the lawyer must act immediately to protect the trust account property by personally paying the amount of any failed deposit or arranging for payment from other sources. An attorney should take care not to disburse against uncollected funds in situations where the attorney's assets or credit would be insufficient to fund the trust account checks in the event that an... item is dishonored." RPC 91.

Therefore, if Attorney is unable to confirm that a particular insurance check has been collected, she may reasonably rely upon and disburse in accordance with the bank's funding schedule as long as 1) she reasonably believes the trust account check will be honored, and 2) she is able to fund the check in the event it is ultimately dishonored.

**(14) 2006 Formal Ethics Opinion 15
Dormancy Fee on Unclaimed Funds
January 19, 2007**

Opinion rules that a lawyer may charge a reasonable dormancy fee against unclaimed funds if the client agrees in advance and the fee meets other statutory requirements.

Inquiry:

Rule 1.15-2(q) requires a lawyer to make due inquiry into the identity and location of the owner of unclaimed funds in this trust account. If this effort is unsuccessful and the provisions of G.S. 16B-53 are satisfied, the property shall be deemed abandoned. The lawyer must then follow the provisions of G.S. 16B for the escheat of abandoned property. Pursuant to G.S. 16B-57(a), the holder of abandoned or unclaimed funds may charge a reasonable "dormancy" fee, thereby reducing the amount of funds transferred to the State Treasurer's Office, so long as the holder has made good faith effort to locate the owners of the funds, there is a valid and enforceable written contract which imposes the charge, and the charge is applied on a regular basis.

Attorney A would like to start charging a dormancy fee for abandoned funds to cover some of the costs and time associated with reasonable efforts to locate the client. Attorney A proposes including the following language in all his fee contracts:

A reasonable dormancy fee shall be charged against any remaining funds in the client's trust account which are not claimed after notice to the client and/or issuance of a refund check six months from the date of the finalization of client's case. The charge shall be based on time and effort spent making reasonable efforts to contact client and return funds. Said charges shall not exceed \$200.00 per year.

May Attorney A charge a dormancy fee as set forth in his fee contract?

Opinion:

Attorney A may charge a dormancy fee against unclaimed funds so long as (1) the client receives prior notice of and gives written consent to the dormancy fee, (2) the amount of the fee is appropriate under Rule 1.5(a) of the Rules of Professional Conduct, and (3) the fee complies with the statutory requirements of G.S. 16B-57(a) and any other restrictions imposed by the Unclaimed Property Program of the State Treasurer's Office.

**(15) 2006 Formal Ethics Opinion 16
Distribution of Disputed Legal Fees
January 19, 2007**

Opinion rules that under certain circumstances a lawyer may consider a dispute with a client over legal fees resolved and transfer funds from the trust account to his operating account to pay those fees.

Inquiry #1:

Attorney A represents Client in a personal injury matter. Client signs a written fee agreement and agrees to pay Attorney 30% of any recovery made in this case. After negotiations with the insurance carrier, Attorney settles Client's case. Attorney receives the settlement check and release and places the funds in his trust account. Client signs the release but disputes the 30% contingent fee. Pursuant to Rule 1.15-2(g), Attorney holds the disputed fees in his trust account and disburses the remainder appropriately. Attorney then gives Client notice of the State Bar's Fee Dispute Resolution Program as required under Rule 1.5(f). Client elects to participate in the process by filing a petition. After Attorney provides a response to the petition and the State Bar staff reviews the file, it is determined that Client's dispute is not meritorious and the staff issues a dismissal letter.

Notwithstanding the dismissal, Client continues to object to the payment of the fee. Because fee dispute resolution is nonbinding, Attorney continues to hold the funds in his trust account. Attorney would like to transfer the funds from the trust account to his operating account.

When may Attorney consider the dispute resolved and transfer the funds without Client's consent?

Opinion #1:

A lawyer is required to hold disputed legal fees in his trust account until the dispute is resolved. Rule 1.15-2(g) and Rule 1.15, comment [13]. Therefore, a client who continues to dispute a legal fee but takes no action to recover the funds, in effect, forces the lawyer to hold the disputed funds in trust indefinitely. To avoid this anomalous result, the lawyer may transfer the funds from the trust account to his operating account after the dismissal of a petition by the State Bar's Fee Dispute Resolution Program, but only if he has given the client reasonable notice that the funds will be transferred to the operating account if no legal action is taken by a certain date. Providing 30 days' notice for the client to take legal action to recover the funds should be a reasonable amount of time. If, within that time frame, the client files a lawsuit to recover the funds, the lawyer must continue to hold them in trust.

Inquiry #2:

Assume the same facts as in Inquiry #1, except that Attorney indicates, in his response to the fee petition, a willingness to reduce his fee to try to resolve the controversy. Attorney and Client agree to have their dispute mediated by the State Bar's Fee Dispute Resolution Program, but they each end in impasse during the mediation process. The State Bar staff sends a letter to Client and Attorney notifying them that the file has been closed due to an impasse.

If Client continues to dispute the fee but takes no legal action, may Attorney transfer the disputed funds from the trust account to his operating account?

Opinion #2:

Yes, so long as Attorney has given adequate notice to Client of his intent to transfer the funds as set forth in Opinion #1, and Client does not file a lawsuit to recover the funds within the notice period.

Inquiry #3:

Assume Client notifies Attorney that he disputes this 30% contingent fee, but fails to file a fee dispute petition or to initiate legal action to recover the disputed funds.

When may Attorney consider the dispute resolved and transfer trust funds to the operating account to pay this fee?

Opinion #3:

In the absence of oversight from the Fee Dispute Resolution program, a lawyer may transfer disputed funds in his trust account only if (1) he has given the client 30-days written notice of the fee dispute program required under Rule 7.5(f); (2) the client fails to elect fee dispute resolution; (3) the funds held in the trust account are for services rendered and are not clearly excessive; and (4) after the 30 days has expired with no fee petition filed by the client, the lawyer gives the client a second written notice, as required in Opinion #1, that the funds will be transferred to the operating account unless the client initiates legal action within 30 days. If, at any point during the 30 days, the client elects to participate in the fee dispute program or initiates legal action to recover the funds, the lawyer must hold the funds in trust pending resolution of the dispute.

(16) 2008 Formal Ethics Opinion 10 **Guidelines for Fees Paid in Advance** **October 24, 2008**

Background:

Although there are several ethics opinions on the ethical requirements relative to the different types of legal fees that are charged and collected at the beginning of the representation of a client, the information in these opinions is not gathered in one place and the opinions appear to provide contradictory or inconsistent advice. In addition, the confusion among lawyers as to the ethical requirements for legal fees paid prior to representation has led to poorly crafted fee agreements. In response to these concerns, this opinion sets forth the key ethical obligations when charging and collecting legal fees, surveys the opinions on legal fees, reconciles the holdings in the opinions, and provides model provisions for fee agreements that satisfy the requirements of the Rules of Professional Conduct and the ethics opinions.

A. Key Ethical Obligations

Regardless of the type of fee, all legal fees must meet the following standard set forth in Rule 7.5(a) of the Rules of Professional Conduct:

A lawyer may not make an agreement for, charge, or collect an illegal or clearly excessive fee.... The factors to be considered in determining whether a fee is clearly excessive include the following:

- (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
- (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
- (3) the fee customarily charged in the locality for similar legal services;
- (4) the amount involved and the results obtained;
- (5) the time limitations imposed by the client or by the circumstances;
- (6) the nature and length of the professional relationship with the client;
- (7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
- (8) whether the fee is fixed or contingent.

It may be difficult to determine whether a legal fee is clearly excessive until the representation is concluded and all of the relevant factors are taken into consideration. At that point, a lawyer may be required to disgorge some portion of the fee that he or she has already collected to insure that the total fee is not clearly excessive. 2000 FEO 3. If the client's funds were deposited in the lawyer's trust account, the money is available to return to the client. If, because of the nature of the fee (see discussion below) the client's funds were paid to the lawyer, the lawyer may be required to make a refund to the client using his or her own funds.

In addition to avoiding clearly excessive fees, a lawyer must deposit any funds that belong to a client in the lawyer's trust account. Rule 7.15-2(a). This means that any payment that remains the property of the client until earned, usually by the performance of legal services, must be deposited into the lawyer's trust account and may not be withdrawn without the client's consent until earned. When the lawyer is discharged, any money that remains on deposit in the trust account must be paid back to the client.

Finally, a lawyer must deal honestly and fairly with his or her clients and should give a client sufficient information to make reasonable decisions about the representation, including decisions about the fee arrangement. See Rule 7

A. Survey of the Opinions

RPC 10 holds that a lawyer may charge and collect a **general retainer** as consideration for the exclusive use of the lawyer's services in a particular matter. Such retainers are sometimes referred to as "true retainers" because the money is paid for nothing more than the reservation of the lawyer's time; the legal services provided by the lawyer are separately compensated. The opinion distinguishes the general retainer from an **advance payment** as follows:

In its truest sense, a retainer is money to which an attorney is immediately entitled and should not be placed in the attorney's trust account. A "retainer" which is actually deposited by the client in advance payment of a fee to be billed on an hourly basis is not a payment to which the attorney is immediately entitled. It is really a security deposit and should be placed in the trust account. As the attorney earns the fee, the funds should be withdrawn from the account.

RPC 158 holds that an **advance payment** to a lawyer for services to be rendered in the future, in the absence of an agreement with the client that the payment is earned immediately, is a deposit securing the payment of a fee which is yet to be earned. As such, it remains the property of the client and must be deposited in the lawyer's trust account. See also 2005 FEO 1.3 (minimum fee that is collected at the beginning of a representation and will be billed against that lawyer's regular hourly rate is either a general retainer or a flat fee; therefore, a minimum fee remains the client's money until earned by the provision of legal services and must remain on deposit in the trust account until earned).

RPC 158 also holds that a lawyer may charge and collect a **flat fee** for representation on a specific, discrete legal task such as resolution of a traffic infraction. If the client agrees that the money represents a flat fee to which the lawyer is immediately entitled, the lawyer may pay the money to himself or herself or deposit the money in the firm's general operating account rather than the firm trust account. The agreement of the client that the flat fee is earned upon payment is critical. The opinion warns, however:

[w]hether the fee portion is deposited in the trust account or paid over to the operating account, any portion of the fee which is clearly excessive may be refundable to the client either at the conclusion of the representation or earlier if [the lawyer's] services are terminated before the end of the engagement.

97 FEO 2 amplifies the definitions for the **general retainer** and the **flat fee**. Both types of fees may be charged and collected at the beginning of a representation and are considered "to the lawyer." The **general retainer** is "a payment for the reservation of the exclusive services of the lawyer which is not used to pay for the legal services provided by the lawyer." [Citing and quoting Rule 1.15-1, dmt. [4].] "The true general retainer finds general application in those instances where corporate clients, merchants or businessmen have a specific need to consult the lawyer on a regular or recurring basis." The opinion admonishes that a general retainer, like all other fees, must not be clearly excessive and "[w]hat is customarily charged in similar situations may determine whether a specific true general retainer is clearly excessive."

A **flat fee** may be earned at the beginning of the representation and is payment for specified legal services to be completed within a reasonable period of time. "[T]his type of fee provides economic value to the client and the lawyer alike because it enables the client to know, in advance, the expense of the representation and it rewards the lawyer for efficiently handling the matter." A flat fee arrangement is customarily identified with isolated transactions such as representations on traffic citations, domestic actions, criminal charges, and commercial transactions. "The flat fee is collected at the beginning of the representation, treated as money to which the lawyer is immediately entitled, and paid to the lawyer or deposited in the lawyer's general operating account."

The opinion recognizes that a lawyer may charge a client **hybrid fees**. Such hybrid fees include a payment that is part general retainer or flat fee and part advance to secure the payment of fees yet to be earned. With hybrid fees, one portion of the fee is earned immediately and the other portion remains the client's property and must be deposited in the trust account to be withdrawn as earned. There should be a clear agreement between the lawyer and the client as to which portion of the payment is a true general retainer, or a flat fee, and which portion of the payment is an advance. Absent such an agreement, the entire payment must be deposited into the trust account and will be considered client funds until earned."

With regard to an advance payment, the opinion reiterates:

[t]he funds advanced by the client and deposited in the trust account may be withdrawn by the lawyer when earned by the performance of legal services on behalf of the client pursuant to the representation agreement with the client. Revised Rule 1.15-1(d) should the client terminate the relationship, that portion of the advance fee deposited in the lawyer's trust account which is unearned must be refunded to the client.

2000 FEOC prohibits the use of the term "nonrefundable fee" in fee agreements while further elucidating the differences between fees earned at the beginning of representation and payments that are security for a fee which is yet to be earned. The opinion emphasizes that a lawyer may treat an advance payment as an earned fee (and deposit the money in the firm's operating account) only if the client agrees that the payment may be treated as earned by the lawyer when it is paid. The opinion's most important paragraphs emphasize that there is a duty to refund any portion of a fee that is clearly excessive regardless of the type of fee that was paid and, therefore, no fee is truly nonrefundable. To call such a payment a nonrefundable fee is false and misleading in violation of Rule 7.1. However, a lawyer may agree with a client that some or all of a fee may be forfeited under certain conditions but only if the amount so forfeited is not clearly excessive in light of the circumstances and all such conditions are reasonable and fair to the client.

Rather than calling a flat fee "nonrefundable," the opinion instructs a lawyer to refer to such a fee as a **prepaid flat fee**.

B. The Types of Fees and Their Characteristics

Based upon the survey of the ethics opinions, these are the types of fees that are paid in advance and their characteristics.

Advance Payment: a deposit by the client of money that will be billed against, usually on an hourly basis, as legal services are provided; not earned until legal services are rendered; deposited in the trust account; unearned portion refunded upon the termination of the client-lawyer relationship.

General Retainer: consideration paid at the beginning of a representation to reserve the exclusive services of a lawyer but not used to pay for actual representation; generally used when corporate or business clients have a specific need to consult a lawyer on a regular basis; earned upon payment; paid to lawyer or deposited in firm's operating account; some or all of the retainer is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship.

Flat Fee or Prepaid Flat Fee: fee paid at the beginning of a representation for specified legal services in a discrete legal task or isolated transaction to be completed within a reasonable amount of time; fee pays for all legal services regardless of the amount of time the lawyer spends on the matter; if client consents, treated as earned immediately and paid to the lawyer or deposited in the firm's operating account; some or all of the flat fee is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship.

Hybrid Fee: fee paid at the beginning of a representation that is in part a general retainer or flat fee and in part an advance payment to secure the payment of fees yet to be earned; one portion of the fee is earned immediately and the other remains the client's property and deposited in the trust account; client must consent and agree to the portion that is a flat fee or general retainer and earned immediately; unearned portion of the advance payment refunded upon termination of the client-lawyer relationship; flat fee/general retainer portion subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship.

C. Reconciling the Opinions

If there is a seeming inconsistency in the ethics opinions it arises from the strict formulation of the general retainer. A lawyer is allowed to charge a general retainer as consideration for the reservation of the lawyer's services and to treat the money as earned immediately. But the client is not given credit for future legal services up to the value of the retainer. This strikes many lawyers as detrimental to the client's interests and it has led to the creation of hybrid fees. The strict formulation of the general retainer has been maintained by the ethics Committee for three important reasons. It avoids the client confusion that is engendered if a client is told that a payment both reserves

the lawyer's services and pays for future representation. In addition, requiring general retainers to be separate and distinct from advance fees means that, if an advance fee is charged for future legal services, there is no penalty to the client for deciding to change legal counsel before the advance fee is exhausted and, if the refund is owed to the client because expected services have not been performed, the money is readily available in the trust account.

Upon further reflection, the Ethics Committee has, nevertheless, determined that it is in the client's interest to receive legal services up to the value of the general retainer provided the client fully understands and agrees that the payment the client makes at the beginning of the representation is earned by the lawyer when paid, will not be deposited in the trust account, and is only subject to refund if the charge for reserving the lawyer's services (as opposed to the charge for the legal services performed) is clearly excessive under the circumstances. This newly acknowledged form of fee payment made by the client at the beginning of the representation will be referred to as a minimum fee and have the following characteristics:

Minimum Fee: consideration paid at the beginning of the representation to reserve the exclusive services of the lawyer; lawyer provides legal services up to the value of the minimum fee; earned upon payment; paid to lawyer or deposited in firm operating account; some or all of the minimum fee is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship.

To the extent any previous ethics opinion is inconsistent with this opinion, it is overruled.

D. Model Fee Provisions: Introduction

The Rules of Professional Conduct do not require fee agreements to be in writing unless the fee is contingent on the outcome of the matter. Rule 1.5(c). The fees discussed in this opinion are not contingent and technically the lawyer is not required to put the client's agreement to pay such fees in writing. Nevertheless, given the propensity of clients to misunderstand the purpose of the payment made prior to the commencement of the representation (and whether such payment will be refunded), a lawyer would be prudent to put in writing any fee agreement that requires the client to make payment in advance.

In addition to explaining and obtaining the client's consent to charge the specified payments prior to representation, the lawyer's written fee agreement with the client should also contain provisions that fully and clearly explain how fees and expenses are charged including, but not limited to, the following: how billable hours are calculated and the rates charged per hour for the services of the lawyers or staff members who will work on the client's matter; if some other method of billing is used, such as value billing, how the fee will be determined; and the expenses for which the client will be liable and how the cost of those expenses will be determined.

Model Fee Provisions

Note that the following paragraphs contain suggested or recommended language. Lawyers are not required to use these model fee provisions.

Advance Payment

As a condition of the employment of lawyer, client agrees to deposit \$_____ in the client trust account maintained by lawyer's firm. This money is to be deposited securing payment for the legal work for client that will be performed by lawyer and his/her staff. Legal work will be billed on an hourly basis or other appropriate basis according to the schedule attached to this agreement. Client specifically authorizes lawyer to withdraw funds from client's deposit in the trust account when payment is earned by the performance of legal services for client. When the deposit is exhausted, lawyer reserves the right to require further reasonable deposits to secure payment. Lawyer will provide client with [monthly, quarterly, etc.] accounting upon request for legal services showing the legal fees earned and payment of the fees by withdrawal against client's deposit in the trust account. Client should notify lawyer immediately if client retracts his/her consent to the withdrawal of money from client's deposit in the trust account to pay for legal services. When lawyer's representation ends, lawyer will provide client with a written accounting of the fees earned and costs incurred, and a refund of any unearned portion of the deposit that remains in the trust account [less expenses associated with the representation].

General Retainer

As a condition of the employment of lawyer, client agrees to pay \$_____ to lawyer. This money is the general retainer paid by client to ensure that lawyer is available to client in the event that legal services are needed now or in the future and to ensure that lawyer will not represent anyone else relative to client's legal matter.

without Client's consent.

Client understands and specifically agrees that:

- the general retainer is not payment for the legal work to be performed by a lawyer;
- Client will be billed separately for the legal work performed by a lawyer and his/her staff. Legal work will be billed on an hourly basis or other appropriate basis according to the schedule attached to this agreement;
- the general retainer will be earned by a lawyer immediately upon payment and will be deposited in a lawyer's business account rather than a client trust account; and
- when a lawyer's representation ends, Client will not be entitled to a refund of any portion of the general retainer unless it can be demonstrated that the general retainer is clearly excessive under the circumstances.

Flat Fee (or Prepaid Flat Fee)

As a condition of the employment of a lawyer, Client agrees to pay \$_____ to a lawyer as a flat fee for the following specified legal work to be performed by a lawyer for Client: [description of legal work]

Client understands and specifically agrees that:

- the flat fee is the entire payment for the specified legal work to be performed by a lawyer regardless of the amount of time that it takes a lawyer to perform the legal work; the flat fee will be earned by a lawyer immediately upon payment and will be deposited in a lawyer's business account rather than a client trust account; and
- when a lawyer's representation ends, Client will not be entitled to a refund of any portion of the flat fee unless (1) the legal work is not completed, in which event a proportionate refund may be owed, or (2) it can be demonstrated that the flat fee is clearly excessive under the circumstances.

Minimum Fee

As a condition of the employment of a lawyer, Client agrees to pay \$_____ to a lawyer. This money is a minimum fee for the reservation of a lawyer's services; to ensure that a lawyer will not represent anyone else relative to Client's legal matter without Client's consent; and for legal work to be performed for Client.

Client understands and specifically agrees that:

- the minimum fee will be earned by a lawyer immediately upon payment and will be deposited in a lawyer's business account rather than a client trust account;
- a lawyer will provide legal services to a client on an hourly basis or other appropriate basis according to the schedule attached to this agreement until the value of those services is equivalent to the minimum fee; thereafter, Client will be billed for the legal work performed by a lawyer and his/her staff on an hourly basis or other appropriate basis according to the schedule attached to this agreement; and
- when a lawyer's representation ends, Client will not be entitled to a refund of any portion of the minimum fee, even if the representation ends before a lawyer has provided legal services equivalent in value to the minimum fee, unless it can be demonstrated that the minimum fee is clearly excessive under the circumstances.

(17) 2009 Formal Ethics Opinion 4

**Credit Card Account that Avoids Commingling
April 24, 2009**

Opinion rules that a law firm may establish a credit card account that avoids commingling by depositing unearned fees into the law firm's trust account and earned fees into the law firm's operating account provided the problem of chargebacks is addressed.

Inquiry:

To avoid the commingling of client funds with a lawyer's own funds, Rule 1.15-2 of the Rules of Professional Conduct requires payments of mixed funds, unearned fees, and money advanced for costs to be deposited into a lawyer's trust account, and payments for earned fees and reimbursements for expenses advanced by a lawyer to be deposited into a lawyer's operating account. Although a lawyer may accept payment of legal fees by credit card, if there is no way to distinguish credit card payment for earned fees or costs advanced from payment for unearned fees or anticipated expenses, all credit card payments must be initially deposited into the lawyer's trust account. Earned fees and expense reimbursements are then withdrawn promptly from the trust account or deposited

into the operating account or payment to the lawyer. (CPR 129 and RPC 247.)

A bank has developed a credit card account specifically for law firms that separates and deposits payments of unearned and earned client funds into trust and operating accounts as appropriate. Payments for unearned fees (and for anticipated expenses) are deposited directly into the participating law firm's trust account and payments for earned fees (and costs advanced) are deposited directly into the firm's operating account. May a lawyer establish such an account?

Opinion:

Yes, the account satisfies a lawyer's professional responsibility to avoid the commingling of funds. Utilization of such an account does not violate Rule 1.15-2(g) which requires mixed funds of funds belonging to the lawyer received in combination with funds belonging to the client to be deposited into the lawyer's trust account intact and, after deposit, the funds belonging to the lawyer to be withdrawn. The law firm credit card account described in the inquiry separates the funds prior to their deposit and, therefore, the funds are not mixed when received by the lawyer.

A lawyer may set up such an account only if the lawyer is also able to comply with 97 FEO which addresses credit card agreements that give the processing bank the authority to debit or "charge back" an account in the event a credit charge is disputed. The opinion sets forth the following alternative ways to safeguard client funds in a trust account when the credit card agreement gives the bank the authority to debit the lawyer's trust account for a chargeback by the client without prior notice to the lawyer:

- attempt to negotiate an agreement with the bank that requires the bank to debit an account other than the trust account in the event of a chargeback;
- maintain a separate demand deposit account in an amount sufficient to cover any chargeback;
- request that the bank arrange an inter-account transfer such that the lawyer's operating account will be immediately debited in the event of a chargeback against the trust account;
- establish a trust account for the sole purpose of receiving advance payments by credit card which will be transferred immediately to the lawyer's primary trust account.

As noted in 97 FEO, "[u]nder all circumstances, a lawyer is ethically compelled to arrange for a payment (from this or other own funds or from some other source) to the trust account sufficient to cover the chargeback in the event that the chargeback jeopardizes the funds of other clients deposited in the account." Therefore, provided the lawyer can comply with the requirements set forth in 97 FEO, the lawyer may establish a credit card account that deposits funds into separate accounts.

Endnote

1. One such account is the Law Firm Merchant Account 99 which is offered by Affiniscape Merchant Solutions in association with Bank of America, NA.

**(18) 2011 Formal Ethics Opinion 7
Using Online Banking to Manage a Trust Account
January 27, 2012**

Opinion rules that a law firm may use online banking to manage its trust accounts provided the firm's managing lawyers are regularly educated on the security risks and actively maintain end-user security.

Inquiry:

Most banks and savings and loans provide "online banking" which allows customers to access accounts and conduct financial transactions over the internet on a secure website operated by the bank or savings and loan. Transactions that may be conducted via on-line banking include account-to-account transfers, payments to third parties, wire transfers, and applications for loans and new accounts. Online banking permits users to view recent transactions and view and/or download cleared check images and bank statements. Additional services may include account management software.

Financial transactions conducted over the internet are subject to the risk of theft by hackers and other computer criminals. Given the duty to safeguard client property, particularly the funds that a client deposits in a lawyer's trust account, may a law firm use online banking to manage a trust account?

Opinion:

Yes, provided the lawyers use reasonable care to minimize the risk of loss or theft of client property specifically including the regular education of the firm’s managing lawyers on the *ever-changing* security risks of online banking and the active maintenance of end-user security.

As noted in [Proposed] 2011 FEO, *Subscribing to Software as a Service While Fulfilling the Duties of Confidentiality and Preservation of Client Property*, the use of the Internet to transmit and store client data (or, in this instance, data about client property) presents significant challenges. In this complex and technical environment, a lawyer must be able to fulfill the fiduciary obligations to protect confidential client information and property from risk of disclosure and loss. The lawyer must protect against security weaknesses unique to the Internet, particularly “end-user” vulnerabilities found in the lawyer’s own law office. The lawyer must also engage in frequent and regular education about the security risks presented by the Internet.

Rule 1.15 requires a lawyer to preserve client property, to deposit client funds entrusted to the lawyer in a separate trust account, and to manage that trust account according to strict recordkeeping and procedural requirements. See also RPC 209 (noting the “general fiduciary duty to safeguard the property of the client”) and 8 FEO 1.5 (requiring a lawyer to exercise due care “when selecting a depository bank for trust account”). The rule is silent, however, about online banking.

Nevertheless, online banking may be used to manage a client trust account if the recordkeeping and fiduciary obligations in Rule 1.15 can be fulfilled. The recordkeeping requirements for trust accounts are set forth in Rule 1.15-3. Rule 1.15-3(b)(3) specifically requires a lawyer to maintain the following records relative to the transfer of funds from the trust account:

all instructions or authorizations to transfer, disburse, or withdraw funds from the trust account (including electronic transfers or debits), or any written or electronic record of any such transfer, disbursement, or withdrawal showing the amount, date, and recipient of the transfer or disbursement, and, in the case of a general trust account, also showing the name of the client or other person to whom the funds belong;

If the online banking software does not provide a method for making an official bank record of the required information when money is transferred from the trust account to another account, such transfers must be handled by a method that provides the required records.

To fulfill the fiduciary obligations in Rule 1.15, a lawyer managing a trust account must use reasonable care to minimize the risks to client funds deposited in the trust account by remaining educated as to the dynamic risks involved in online banking and insuring that the law firm invests in proper protection and multiple layers of security to address those risks. See [Proposed] 2011 FEO.

A lawyer who is managing a trust account has affirmative duties to regularly educate himself as to the security risks of online banking; to actively maintain 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 the hiring of an information technology consultant to advise the lawyer or firm employees; and to insure 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. Understanding the contract with the depository bank and the use of the resources and expertise available from the bank are good first steps toward fulfilling the lawyer’s fiduciary obligations.

This opinion does not set forth specific security requirements because mandatory security measures would create a false sense of security in an environment where the risks are continually changing. Instead, due diligence and frequent and regular education are required. A lawyer must fulfill this fiduciary obligation to safeguard client funds by applying the same diligence and competency to manage the risks of on-line banking that a lawyer is required to apply when representing clients.

(19) 2013 Formal Ethics Opinion 13

Disbursement Against Funds Credited to Trust Account by ACH and EFT

January 24, 2014

Opinion rules that a lawyer may disburse immediately against funds that are credited to the lawyer's trust account by an automated clearinghouse (ACH) transfer and electronic funds transfer (EFT) despite the risk that an originator may initiate a reversal.

Inquiry:

The originator of an automated clearinghouse (ACH) transfer¹ or an electronic funds transfer (EFT) can initiate a reversal of the transaction. However, the reversal must be requested by the originating bank and approved by the receiving bank. When a bank receives a reversal request, it typically will attempt to obtain authorization from the individual whose account was credited before making a reversal.

May a lawyer disburse immediately against funds that are credited to a trust account by ACH or EFT if there is some risk that the originator may initiate a reversal?

Opinion:

Yes. Electronic funds transfers, whether ACH or EFT, are designed to make funds available immediately, like wired funds. While there is some risk that the originator may initiate a reversal, the risk of reversal is slight. Moreover, the lawyer should get notice from the receiving bank in time to take action to prevent the reversal or otherwise to protect other client funds deposited in the trust account. See, e.g., 7 FEO 9 [lawyer may accept payments to trust account by credit card although the bank is authorized to debit the trust account in the event a credit card charge is disputed].

A lawyer is not guilty of professional misconduct if that lawyer, upon learning that an ACH or EFT has been reversed, immediately acts to protect the funds in the lawyer's other clients' deposited in the trust account. This may be done by personally depositing the funds necessary to address the deficit created by the reversal or by securing or arranging payment from sources available to the lawyer other than trust account funds of other clients. See RPC 191.

Nevertheless, checks drawn on a trust account should not be converted to ACH because the lawyer will not receive a physical check or check image that can be retained in satisfaction of the record-keeping requirements in Rule 1.15-3. The transaction will appear on the lawyer's trust account statement as an ACH debit with limited information about the payment (e.g., dollar amount, date processed, originator of the ACH debit). For this reason, lawyers are required to use business-size checks that contain an Auxiliary-On-Us field in the MICR line of the check because these checks cannot be converted to ACH. See Rule 1.15-3(a).

See generally Rule 1.15, comments [17] and [18].

Endnote

1. When a paper check is converted to an automated clearinghouse (ACH) debit, the check is taken either at the point-of-sale or through the mail for payment, the account information is captured from the check, and an electronic transaction is created for payment through the ACH system. The original physical check is typically destroyed by the converting entity (although an image of the check may be stored for a certain period of time). A law firm may convert the paper checks that it receives on behalf of a client or client matter for payment to the trust account through the ACH system.

Authorized ACH debits from the trust account that are electronic transfers of funds (in which no checks are involved) are allowed provided the lawyer maintains a record of the transaction as required by Rule 1.15-3(b)(3) and (c)(3). The record, whether consisting of the instructions or authorization to debit the account, a record or receipt from the register or feeds of a financial institution, or the lawyer's independent record of the transaction, must show the amount, date, and recipient of the transfer or disbursement, and, in the case of a general trust account, also show the name of the client or other person to whom the funds belong.

(20) 2015 Formal Ethics Opinion 6

Lawyer's Professional Responsibility When Third Party Steals Funds from Trust Account

October 23, 2015

Opinion rules that when funds are stolen from a lawyer's trust account by a third party who is not employed or supervised by the lawyer, and the lawyer was managing the trust account in compliance with the Rules of Professional Conduct, the lawyer is not professionally responsible for replacing the funds stolen from the account.

NOTE: This opinion is limited to a lawyer's professional responsibilities and is not intended to opine on a lawyer's legal liability.

Inquiry #1:

John Doe, a third party unaffiliated with Lawyer, created counterfeit checks that were identical to Lawyer's trust account checks. John Doe made the counterfeit checks, purportedly drawn on Lawyer's trust account, payable to himself and presented the counterfeit checks for payment at Bank. Bank honored some of the counterfeit checks. As a consequence, client funds held by Lawyer in this trust account were utilized for an unauthorized purpose. Lawyer properly supervised all nonlawyer staff participating in the record keeping for the trust account. Lawyer also maintained the trust account records and reconciled the trust account as required by Rule 1.15-3. Lawyer had no knowledge of the fraud and had no opportunity to prevent the theft.

Does Lawyer have a professional responsibility to replace the stolen funds?

Opinion #1:

No.

A lawyer who receives funds that belong to a client assumes the responsibilities of a fiduciary to safeguard those funds and to preserve the identity of the funds by depositing them into a designated trust account. Rule 1.15-2, RPC 191, and 7 FEO. The responsibilities of a fiduciary include the duty to ensure that the funds of a particular client are used only to satisfy the obligations of that client. RPC 191 and 7 FEO. Rule 1.15-3 requires a lawyer to keep accurate records of the trust account and to reconcile the trust account. A lawyer has an obligation to ensure that any nonlawyer assistant with access to the trust account is aware of the lawyer's professional obligations regarding entrusted funds and is properly supervised. Rule 3.3.

If a lawyer has managed the trust account in substantial compliance with the requirements of the Rules of Professional Conduct (see Rules 1.15-2, 1.15-3, and 3.3) but, nevertheless, is victimized by a third party theft, Lawyer is not required to replace the stolen funds. If, however, Lawyer failed to follow the Rules of Professional Conduct on trust accounting and supervision of staff, and the failure is a proximate cause of the theft from the trust account, Lawyer may be professionally obligated to replace the stolen funds. Compare RPC 191 (if a lawyer disburses against provisionally credited funds, the lawyer is responsible for reimbursing the trust account for any losses caused by disbursing before the funds are irrevocably credited).

Under all circumstances, Lawyer must promptly investigate the matter and take steps to prevent further thefts of entrusted funds. Lawyer must seek out every available option to remedy the situation including researching the law to determine if Bank is liable;¹⁰ communicating with Bank to discuss Bank's liability; asking Bank to determine if there is insurance to cover the loss; considering whether it is appropriate to close the trust account and transfer the funds to a new trust account; and working with law enforcement to recover the funds.

Inquiry #2:

Prior to learning of the fraud and theft from the trust account, Lawyer issued several trust account checks to clients and/or third parties for the benefit of the client. Despite the theft, there are sufficient total funds in the trust account to satisfy the outstanding checks. However, because of the theft, funds belonging to other clients will be used if the outstanding checks are cashed.

What is Lawyer's duty to safeguard the remaining funds in the trust account?

Opinion #2:

Lawyer must take reasonable measures to ensure that funds belonging to one client are not used to satisfy obligations to another client. Such reasonable measures include, but are not limited to, requesting that Bank issue stop payments on outstanding trust account checks; providing Bank with list of outstanding checks and requesting that Bank contact Lawyer before honoring any outstanding checks; and determining if Bank is liable and, if so, demanding the outstanding checks be covered by Bank. If Lawyer determines Bank is not liable or liability is unclear, Lawyer must maintain the status quo and prevent further loss by not issuing new trust account checks. If payment will be stopped on the outstanding checks, Lawyer must contact the payees and alert them to the problem.

Inquiry #3:

Assume the same facts in Inquiry #2 except there are insufficient funds in the trust account to satisfy the outstanding checks. Must Lawyer deposit funds into the trust account to ensure that the outstanding checks are not presented against an account with insufficient funds?

Opinion #3

No. In addition to the remedial measures listed in Opinion #2, Lawyer should notify the payees if Lawyer knows that the checks will not clear.

Inquiry #4:

Hacker gains legal access to Lawyer's computer network and electronically transfers the balance of the funds in Lawyer's trust account to a separate account that is controlled by Hacker. Lawyer's trust account now has a zero balance. Lawyer has written several trust account checks to clients and/or third parties for the benefit of clients. Because of the theft, there are insufficient funds in the trust account to satisfy the outstanding checks.

Does Lawyer have a professional responsibility to replace the stolen funds?

Opinion #4:

No, Lawyer is not obligated to replace the stolen funds provided he has taken reasonable care to minimize the risks to client funds by implementing reasonable security measures in compliance with the requirements of Rule 1.15.

Rule 1.15 requires a lawyer to preserve client property, to deposit client funds entrusted to the lawyer in a separate trust account, and to manage that trust account according to strict recordkeeping and procedural requirements. To fulfill the fiduciary obligations in Rule 1.15, a lawyer managing a trust account must use reasonable care to minimize the risks to client funds by depositing the trust account. 2011 FEO 7.

In 2011 FEO 7 the Ethics Committee opined that a lawyer has affirmative duties to educate himself regularly as to the security risks of online banking; to actively maintain end-user security at the law firm through safety practices such as strong password policies and procedures, the use of file encryption and security software, and the hiring of an information technology consultant to advise the lawyer or firm employees; and to ensure that all staff members who assist with the management of the trust account receive training and abide by the security measures adopted by the firm.

If Lawyer has taken reasonable care to minimize the risks to client funds, Lawyer is not ethically obligated to replace the stolen funds. If, however, Lawyer failed to use reasonable care in following the Rules of Professional Conduct on trust accounting and supervision of staff, and the failure is a proximate cause of the theft from the trust account, Lawyer may be professionally obligated to replace the stolen funds.

Inquiry #5:

Lawyer is retained to close a real estate transaction. Prior to the closing, Lawyer obtains information relevant to the closing, including the seller's name and mailing address. Lawyer also receives into his trust account the funds necessary for the closing. Lawyer's normal practice after the closing is to record the deed and disburse the funds. Lawyer then mails a trust account check to the seller in the amount of the seller's proceeds.

Hacker gains access to information relating to the real estate transaction by hacking the email of one of the parties (lawyer, realtor, or seller). Hacker then creates a "spoof" email address that is similar to realtor's or seller's email address (only one letter is different). Hacker emails Lawyer with disbursement instructions directing Lawyer to

wire funds to the account identified in the e-mail instead of mailing a check to Seller at the address included in Lawyer's file as previously instructed.²³ Lawyer follows the instructions in the e-mail without first implementing security measures such as contacting the Seller by phone at the phone number included in Lawyer's file to confirm the wiring instructions. After the closing and disbursement, the true Seller calls Lawyer and demands his funds. Lawyer goes to Bank to request reversal of the wire. Bank refuses to reverse the wire and will not cooperate or communicate with Lawyer without a subpoena.

While pursuing other legal remedies, does Lawyer have a professional responsibility to replace the stolen funds?

Opinion #5:

Yes. Lawyers must use reasonable care to prevent third parties from gaining access to client funds held in the trust account. As stated in Opinion #4, Lawyer has a duty to implement reasonable security measures. Lawyer did not verify the disbursement change by calling Seller at the phone number listed in Lawyer's file or confirming Seller's email address. These were reasonable security measures that, if implemented, could have prevented the theft. Lawyer is, therefore, professionally responsible and must replace the funds stolen by Hacker. If it is later determined that Bank is legally responsible, or insurance covers the stolen funds, Lawyer may be reimbursed.

Inquiry #6:

While pursuing the remedies described in Opinion #2, may Lawyer deposit his own funds into the trust account?

Opinion #6:

Yes.

Generally, no funds belonging to a lawyer shall be deposited in a trust account or fiduciary account of the lawyer. Rule 1.15-2(f). The exceptions to the rule permit the lawyer to deposit funds sufficient to open or maintain an account, pay any bank service charges, or pay any tax levied on the account. Id. The exceptions were expanded in 1997 FEO to include the deposit of lawyer funds when a bank would not route credit card chargeback debits to the lawyer's operating account. These exceptions to the prohibition on commingling enable lawyers to fulfill the fiduciary duty to safeguard entrusted funds.

Therefore, notwithstanding the prohibition on commingling, Lawyer may deposit his own funds into the trust account to replace the stolen funds until it is determined whether the Bank is liable for the loss, insurance is available to cover the loss, or the funds are otherwise recovered. If Lawyer decides to deposit his own funds, he must ensure that the trust accounting records accurately reflect the source of the funds, the reason for the deposit, the date of the deposit, and the client name(s) and matter(s) for which the funds were deposited.

Inquiry #7:

With regard to all of the situations described in this opinion, what duties does Lawyer owe to the clients whose funds were stolen?

Opinion #7:

Lawyer must notify the clients of the theft and advise the clients of the consequences for representation; help the clients to identify any source of funds, such as bank liability and insurance, to cover their losses; defer a client's matter (by seeking continuance, for example) if necessary to protect the client's interest; and explain to third parties or opposing parties as necessary to protect the client's interests. If stop payments are issued against outstanding checks, Lawyer must take the remedial measures outlined in Opinions #1 and #2 to protect the client's interest. Finally, Lawyer must report the theft to the North Carolina State Bar's Trust Accounting Compliance Counsel.

Endnotes

1. See e.g. N.C. Gen. Stat. §25-4-406.

2. The inquiry assumes that Lawyer believed that, by wiring the funds to the account designated in the e-mail, he was disbursing the funds to the Seller as required by the Settlement Statement. This opinion does not address the issues of professional responsibility raised when a lawyer knowingly makes disbursements contrary to a Settlement statement.

(21) Ethics Advisory 2217
Refunding Small Sums in Trust Account
October 23, 1998

Opinion Rules that attorney may ask borrowers and sellers to agree in writing to waive the return of very small sums, especially where attorney bears similar risk of loss.

Inquiry:

Attorney closes numerous residential loans in which Attorney receives loan proceeds and disburses the same according to settlement statement through the trust account of Attorney. On a few occasions, some fees such as taxes and recording fees are unintentionally miscalculated usually for relatively small amounts. Attorney would like to ask borrowers and sellers to agree in writing to waive the return of \$10.00 or less to eliminate Attorney from having to forward checks in small amounts which have been lost or discarded on prior occasions. Attorney would also agree to forego any requests for compensation for shortfalls of \$10.00 or less (except for loan payoff amounts, etc.).

If Attorney discloses the above described waiver to all applicable parties and such parties agree, may Attorney implement this policy?

Opinion:

Rule 1.15-2(h) of the Revised Rules of Professional Conduct provides that an attorney must disburse property or trust funds held on behalf of the client as the client directs.

The Rules do not appear to prohibit an attorney from requesting that clients on occasion agree to waive the return of certain insubstantial or de minimis amounts. Especially, as here, where Attorney also bears some minimal risk of loss, Attorney should be able to propose this waiver. If the party or parties involved refuse to agree to the waiver, then Attorney must abide by their wishes. Rule 1.15-2(h); see also A 55.

Notwithstanding the above, Attorney still has an obligation to make proper accounting of all funds held in this or her trust account.

(22) Ethics Advisory 2295
Trust Funds Held for Deceased Client
November 23, 1999

Opinion Rules that attorney must comply with the original fee agreement for the representation of the deceased client as it relates to excess funds.

Inquiry:

Attorney was hired to represent Client in Client's domestic dissolution. Client's father paid an advance fee for Client of \$1,600, and the Attorney billed against it as services were rendered to Client. This money was placed in Attorney's trust account. Recently, Client was killed in an automobile accident. After Client's death, Client's father contacted Attorney about resolving an issue relating to an outstanding medical bill for Client that was related to the domestic action. Of the funds originally deposited in Attorney's trust account on behalf of Client, \$198 still remained. May funds still on deposit in Attorney's trust account be used to pay for the legal work done by Attorney at the request of Client's father?

Opinion:

Attorney must comply with the original fee agreement for the representation of Client. He must also be truthful in his dealings with all individuals interested in the estate of Client. If the original fee agreement with Client, and Client's father, provided that any excess funds would be returned to the father, Attorney should ask the father whether those excess funds can be used to cover the outstanding bill with the firm. If, however, it was understood that the funds provided by the father were provided as a gift to Client, Attorney must treat the funds still on deposit in the trust account as funds belonging to the estate of Client and act accordingly.

APPENDIX B: EXAMPLE FORMS

B1. Key Concepts Infographic

**QUICK TIPS
ON
TRUST ACCOUNTING**

NORTH CAROLINA STATE BAR

B **ANK RECORD AUDIT TRAIL**
Identify a client on every item that transfers funds into and out of the trust account.

R **ECONCILE & REVIEW**
Promptly perform monthly and quarterly reconciliations and quarterly transaction reviews.

U **SE ONLY FUNDS AVAILABLE FOR EACH CLIENT**
Using Client A's funds for benefit of Client B is stealing from Client A.

N **O TRUST FUNDS IN OPERATING ACCOUNT**
Entrusted funds should never touch an operating account until earned by the lawyer.

O **VERSIGHT OF EMPLOYEES IS ESSENTIAL**
Employees with access to the trust account must be properly supervised by a lawyer.

for more info: www.ncbar.gov

B3. Bank Directive on NSF Trust Checks

Rule 1.15-2(l) of the Rules of Professional Conduct requires a lawyer to direct each bank where he or she maintains a trust account to notify the State Bar when any item¹ drawn on the trust account is **presented for payment** against insufficient funds. To comply with the rule, every lawyer or law firm that maintains a trust account must file a directive with the bank where the account is maintained instructing the bank to notify the Executive Director of the State Bar when any item drawn on the trust account is presented for payment against insufficient funds. The notice form below should be used for this purpose.

Notice and Authorization: Concerning Attorney Trust Account Checks Presented Against Insufficient Funds

To: _____
Financial Institution

Pursuant to Rule 1.15-2(l), of the North Carolina State Bar Rules of Professional Conduct, you are hereby authorized and directed to transmit immediate notice to the executive director of the North Carolina State Bar of any item drawn on the trust account(s) or fiduciary account(s) listed below which is presented for payment against insufficient funds.

Acct. No. _____ Acct. Name. _____

Acct. No. _____ Acct. Name. _____

Acct. No. _____ Acct. Name. _____

This the _____ day of _____, 20_____.

Signature

North Carolina State Bar
PO Box 25908
Raleigh, NC 27611

(print full name)

¹Rule 1.15-1(j): "Item" denotes any means or method by which funds are credited to or debited from an account; for example: check, substitute check, remotely created check, draft, withdrawal order, automated clearinghouse (ACH) or electronic transfer, electronic or wire funds transfer, electronic image of an item and/or information in electronic form describing an item, or instructions given in person or by telephone, mail, or computer.

B4. Opening an Account Checklist

When opening a trust account, the lawyer must ensure that the following requirements are completed (check each box when complete):

Requirements:

- The lawyer must use a bank from the NCIOLTA approved bank list. Visit www.nciolta.com/iolta_banklist.asp for more details.
- Account must use the NCIOLTA Tax ID Number (if a bank does not have it on file, please call (919) 828-0477).
- Lawyer must file an [NSF Directive](#) with bank, and retain a copy for lawyer's records.
- Account must be labeled as a "Trust Account" on documents, deposit slips, and checks.
- Lawyer must use business-size checks. (see attached sample)
- Legible check images, front/back, are to be provided with the bank statement.
- Overdraft protection must be disabled on the trust account.
- No Debit Cards are to be issued for the trust account.
- Lawyer must file a [Status Update Form](#) with IOLTA office.
- Signature authority may only be granted to (1) lawyers and (2) nonlawyer employees who are not responsible for reconciling the trust account. Any person with signature authority must complete a 1-hour trust account management CLE before exercising such authority.
- Checks may not be signed using a signature stamp or pre-printed signature line.

Recommendations:

- The lawyer should request that all bank fees and charges be drawn from lawyer's operating account, thus limiting the risk that client funds are reused for this purpose.
- If lawyer maintains other accounts at bank, the bank should request different colored trust account checks.
- Safeguards to protect inadvertent wires and ACHs should be discussed with banker.
- If lawyer wants to use online banking to transfer funds from the trust account to a different account, the bank must have a text/memo box on the transfer page that allows lawyer to properly attribute all transactions to particular clients.
- Lawyer should learn the bank's deposit deadlines and when provisional credits are made available, and inquire about typical length of time for checks to clear.
- Lawyer should develop an office policy regarding trust account procedures (reconciliations, deposits, disbursements, etc).

Note: It is the lawyer's responsibility to ensure compliance with Rule 1.15, not the bank's.

B5. Trust Account Check
(Actual Size)

1001
66-19530 NC
03700

JOHN SMITH P.L.L.C IOLTA TRUST ACCT
PO BOX 11111
CITY, NC 28278-1016

PAY
TO THE
ORDER OF _____

DATE _____

Bank of America

FOR _____

1001001 0530001961 0123456789051

\$ _____

DOLLARS





MP


B6. Trust Account Check Detail

INFORMATION AND FIELDS REQUIRED BY THE RULES

Trust Account Designation

Payee Name

Pre-Numbered Check

Dee Fender, Esq. Trust Account Raleigh, NC 27808	Date: <u>May 23, 2009</u>	101
PAY TO THE ORDER OF <u>ABCXYZ Chiropractic Center</u>	\$ <u>1,500.00</u>	
Fifteen hundred and 0/100 -----		DOLLARS
 Wegottayourmoney BANK		
MEMO <u>Omega (12345) Full and final payment</u>	<u>Dee Fender</u>	
00000101 8 031202084 000-123-12345678		

Auxiliary On-Us

Client Matter & Purpose

Account Number

LONGER THAN 6"

B7. Deposit Slip for One Client

PLEASE ENDORSE ALL CHECKS		
DATE 05/01/2008		
CHECKS AND OTHER ITEMS ARE RECEIVED FOR DEPOSIT SUBJECT TO THE RULES AND REGULATIONS OF THIS INSTITUTION.		
<p>DEPOSITS MAY NOT BE AVAILABLE FOR IMMEDIATE WITHDRAWAL.</p> <p>PLEASE LIST EACH CHECK SEPARATELY.</p>		
	DOLLARS	CENTS
CURRENCY		
COIN		
1 Alpha	\$5,000	00
2		
3		
4		
5		
6		
7		
8		
9		
10		
11		
12		
13		
14		
15		
16		
17		
FRONT SIDE TOTAL	\$5,000	00
REVERSE SIDE TOTAL	0	00
TOTAL DEPOSIT	\$5,000	00

!!!!!!!!!!!!

Deposit slips should
always be printed with
the name of the lawyer
or law firm, IOLTA or
Trust Account
Designation, account
number, and routing
number.
!!!!!!!!!!!!

:0531011211 Acct. #: 123456789
 BNY BANKING AND TRUST COMPANY
 100 EAST NORTH CAROLINA STREET
ABC LAW FIRM
TRUST ACCOUNT

B8. Deposit Slip for Multiple Clients

PLEASE ENDORSE ALL CHECKS		
DATE 05/15/2008		
CHECKS AND OTHER ITEMS ARE RECEIVED FOR DEPOSIT SUBJECT TO THE RULES AND REGULATIONS OF THIS INSTITUTION.		
<p>DEPOSITS MAY NOT BE AVAILABLE FOR IMMEDIATE WITHDRAWAL.</p> <p>PLEASE LIST EACH CHECK SEPARATELY.</p>		
	DOLLARS	CENTS
CURRENCY		
COIN		
1 Beta (Source: BB&T)	\$1,500	00
2 Gamma	\$1,450	00
3 Delta	\$5,100	00
4 Epsilon	\$2,000	00
5		
6		
7		
8		
9		
10		
11		
12		
13		
14		
15		
16		
17		
FRONT SIDE TOTAL	\$10,500	00
REVERSE SIDE TOTAL	0	00
TOTAL DEPOSIT	\$10,500	00

!!!!!!!!!!

Deposit slips should always be printed with the name of the lawyer or law firm, IOLTA or Trust Account Designation, account number, and routing number.

!!!!!!!!!!

List client names instead of check routing numbers.

BB&T
 BRIDGE BANKING AND INVESTMENT COMPANY
 1053 1011 211

ABC LAW FIRM
 TRUST ACCOUNT
 Acct. #: 123456789

B11. Zero Balance Written Accounting

Attorney/Firm's Name
 Address
 Accounting for Funds in Trust
 1/10/2001

Client: Joe Accident Victim

Receipts

Date	Source	Amount
1/3/2005	All State Ins.	\$21,712.00
Total Receipts:		\$21,712.00

Disbursements:

Date	Recipient	Purpose	Amount
1/6/2005	Heal Me Hospital	Medical Expenses	\$13,252.00
1/6/2005	Hi Motors	Car Repair	\$1,200.00
1/6/2005	What's His Name, MD	Medical Expenses	\$4,803.26
1/6/2005	Joe Accident Victim	Payment	\$2,456.74

Total Disbursements: **\$21,712.00**
Balance: **\$0.00**

This accounting of the receipt and disbursement of your funds in the trust account is provided as required by the rules of the North Carolina State Bar.

_____(Lawyer_)_____

Note: A copy of the client's ledger may be included with a letter or memo stating: A copy of your trust account ledger is being provided indicating the receipt and disbursement of your funds in the trust account.

B12. Annual Written Accounting (When There Has Been No Activity in the Account)

Lawyer/Firm Letterhead

Mr./Mrs./Ms. □

Address □

City, State Zip □

Re: Annual Accounting of Funds Held in Trust Account □

Dear □

I am writing to advise you that this office holds in trust the sum of _____ on your behalf. This information is being furnished to you as required by the Rules of the North Carolina State Bar.

This is a periodic accounting and no action is required on your part. However, if this report is incorrect, please contact this office immediately.

An accounting of your trust account record is available at any time.

Very truly yours, □

Note: This accounting is for client funds on which there has been no activity since the last accounting. If there are receipts or disbursements on a client ledger during a 12-month period, there must be an accounting for the receipts and disbursements or a copy of the client's ledger must be included with the letter. Rule 1.15-3(e).

If a lawyer is holding substantial funds for a client for a period of time, those funds should be placed in a dedicated trust account in order that they may earn interest for the client.

B13. Reconciliation Report

North Carolina State Bar

Reconciliation Report

REPORT DATE: _____ 20__

ACCOUNT #: _____

Instructions

- Complete steps 2-7 monthly for **each** general, dedicated, and fiduciary account. Complete entire form at least quarterly for **each** general trust account.
- Attach: 1) a list of clients with corresponding balances, 2) a copy of the general ledger/checkbook register, 3) a list of outstanding deposits, 4) a list of outstanding checks, 5) the corresponding bank statement and cancelled checks (or images thereof).

Reconciliation of Lawyer's Trust Account Records

1. Total of **positive** client ledger balances as of _____ \$ _____
(as of ending date shown on the corresponding bank statement)

Do any clients have a negative balance? Yes No If yes, attach explanation and corrective action taken.

2. General ledger/checkbook register balance as of _____ \$ _____
(as of ending date shown on the corresponding bank statement)

Bank Statement Reconciliation

3. Statement Ending Date _____ and Balance \$ _____

4. **Plus:** Outstanding deposits made to the account through end of month but not reflected on bank statement

Number of outstanding deposits _____ Amount of outstanding deposits + _____

5. **Minus:** Outstanding disbursements made through end of month but not reflected on bank statement

Number of outstanding disbursements _____ Amount of outstanding disbursements - _____

6. **Adjusted Bank Balance** \$ _____

7. The balance on line #6 agrees does not agree with the balances on lines #1 and #2. If the balances do not agree, attach explanation and corrective action taken.

Report prepared by: _____
Print Name and Position Signature

Report prepared by a non-lawyer? Yes No If yes, does non-lawyer have check signing authority for this trust account? Yes No

I certify that, for this account, I personally reviewed the above report, bank statement, and cancelled checks, and that all discrepancies shall be investigated, identified, and resolved within ten days of this report.

Report reviewed by: _____
Print Lawyer Name Signature

B14. Quarterly Review Report

North Carolina State Bar

Quarterly Review Report

Rule 1.15-3(i) Random Transaction Review

REPORT DATE: _____ 20____

Account Name: _____

Account #: _____

GENERAL INFORMATION

- Complete one form for *each* general trust account, dedicated trust account, and fiduciary account
- Attach the following for each transaction: statement of costs and receipts, client ledger, cancelled checks or images thereof, any other documentation necessary to complete review, and any required explanations
- At least three transactions shall satisfy the requirement in Rule 1.15-3(i), but a larger sample may be advisable

Transaction #1

1. Client Name/Matter: _____/_____ Date Range of Disbursement(s) _____:_____
2. Does client ledger show a negative balance? Yes No If yes, attach explanation and corrective action.
3. Lawyer reviewed the following:
 (Attach to Report) Statement of Costs and Receipts Yes No
 Client Ledger Yes No
 Cancelled Checks (or images thereof) Yes No
 Other _____ Yes No
4. Did the transaction involve multiple disbursements? Yes No Number of disbursements _____
5. Are any disbursements outstanding? Yes No If yes, attach explanation and corrective action.
6. Were any disbursements improperly made? Yes No If yes, attach explanation and corrective action.

Transaction #2

1. Client Name/Matter: _____/_____ Date Range of Disbursement(s) _____:_____
2. Does client ledger show a negative balance? Yes No If yes, attach explanation and corrective action.
3. Lawyer reviewed the following:
 (Attach to Report) Statement of Costs and Receipts Yes No
 Client Ledger Yes No
 Cancelled Checks (or images thereof) Yes No
 Other _____ Yes No
4. Did the transaction involve multiple disbursements? Yes No Number of disbursements _____
5. Are any disbursements outstanding? Yes No If yes, attach explanation and corrective action.
6. Were any disbursements improperly made? Yes No If yes, attach explanation and corrective action.

Transaction #3

1. Client Name/Matter: _____/_____ Date Range of Disbursement(s) _____:_____
2. Does client ledger show a negative balance? Yes No If yes, attach explanation and corrective action.
3. Lawyer reviewed the following:
 (Attach to Report) Statement of Costs and Receipts Yes No
 Client Ledger Yes No
 Cancelled Checks (or images thereof) Yes No
 Other _____ Yes No
4. Did the transaction involve multiple disbursements? Yes No Number of disbursements _____
5. Are any disbursements outstanding? Yes No If yes, attach explanation and corrective action.
6. Were any disbursements improperly made? Yes No If yes, attach explanation and corrective action.

Lawyer Certification

I certify that I personally randomly selected the above transactions, that I personally conducted the review, and that all discrepancies shall be investigated, identified, and resolved within ten days of this review.

Lawyer Name

Signature

Date

Firm Name

B15. NC IOLTA Status Update Form

NC IOLTA STATUS UPDATE FORM Field A is a Required Field for All Reported Changes Complete All Relevant Fields

I am submitting this form to:

Notify the IOLTA office of changes in employment or address (Field A)

Open a new IOLTA account or convert an existing account to IOLTA (Field B)

Close an IOLTA Account (Field C)

Update IOLTA status (Field D)

**Check All That Apply
Complete All Relevant Fields**

FIELD A – REQUIRED

Name: _____

NC State Bar #: _____

Firm/Employer Name: _____
(Please attach a list of attorneys with NC State Bar numbers and any settlement agents for which the reported change applies)

Address: _____

City, State, Zip: _____

Phone: _____

E-mail: _____

FIELD B IOLTA ACCOUNT INFORMATION

The following general trust/escrow accounts are to be established as IOLTA Accounts

I.	II.
Account Name: _____	Account Name: _____
Acct. Number: _____	Acct. Number: _____
Bank Name: _____	Bank Name: _____

(For additional accounts, please attach a separate sheet)

FIELD C CLOSING AN ACCOUNT

I am closing the following IOLTA account:

Account Name: _____

Acct. Number: _____

Bank Name: _____

(For additional accounts, please attach a separate sheet)

FIELD D IOLTA STATUS

My current IOLTA Status is:

IOLTA ACCOUNTS: I/my firm have North Carolina IOLTA accounts.

NO IOLTA ACCOUNTS: Neither I nor my employer hold any North Carolina client funds.

FIELD E

Signature: _____

Print Name: _____

Date: _____

SEND COMPLETED FORM TO:

NC IOLTA
PO Box 25996
Raleigh, NC 27611-5996

Fax Number: 919-821-9168 e-mail: iolta@ncbar.gov

NC IOLTA * PO Box 25996 * Raleigh, NC 27611-5996 * 919-828-0477
* 919-821-9168 (fax) * iolta@ncbar.gov

B16. Random Audit Exemption Documents

Lawyer's Representations Pursuant to CPA Examination of Lawyer's Trust Account(s) (Lawyer's Representation Form)

Pursuant to the policy of the North Carolina State Bar Council, a lawyer or law firm may seek exemption from the random audit of trust accounts authorized by 27 NCAC 1B, Rule 0128(b) by having a CPA or CPA firm perform an examination pursuant to the "Agreed Upon Procedures for CPA Examination of Lawyers' Trust Accounts" ("Agreed Upon Procedures") to provide information to the lawyer and the North Carolina State Bar regarding the management of the lawyer's trust account(s). As a condition of the exemption, the lawyer must make certain representations regarding the management of client and/or fiduciary funds held in trust. **This representation form and any attachments must be provided to the CPA/CPA firm prior to commencement of the examination and must be attached to the CPA report sent to the North Carolina State Bar.**

_____, hereafter "Lawyer" must attach a list of all bank accounts into which Lawyer has deposited client or other fiduciary funds, including all general, dedicated, and fiduciary trust accounts (Attachment 1), and list all lawyers affiliated with Lawyer's firm to which the exemption would apply (Attachment 2).

Lawyer's Representations

I hereby certify personally and on behalf of any lawyers affiliated with this firm, whose names are listed in Attachment 2, that the account(s) listed in Attachment 1 is/are the only trust account(s) to which such lawyer(s) has/had access during the past year, that the records and documents provided to _____, hereafter CPA, are the full and accurate records of the trust accounts and, further, with respect to transactions occurring during the past year, that the following statements are true:

- 1) The lawyer/firm does not maintain any trust accounts outside the State of North Carolina.
- 2) The lawyer/firm is aware of his/her duty to report trust/fiduciary account misappropriation.
- 3) The lawyer/firm retains required trust account records for at least the six (6) year period immediately preceding the lawyer's most recent fiscal year end.
- 4) The lawyer/firm has not used or pledged any entrusted property to obtain credit or other personal financial benefit for the lawyer or any other person other than the legal or beneficial owner of that property.
- 5) Entrusted properties belonging to a client received by the lawyer are promptly identified and labeled as the property of the client.
- 6) Entrusted property not deposited in a trust account or fiduciary account when received by lawyer/firm is placed in a place of safe keeping as soon as practical. Specifically, it is placed in:
 N/A Safe Deposit Box Office Safe Other _____
- 7) The lawyer/firm promptly notifies client of the receipt of any funds, securities or property belonging to whole or in part to client.
- 8) Where the funds received are a mix of trust funds and non-trust funds, the deposit is made to the trust account intact and the non-trust portion is withdrawn when the bank credits the account upon final settlement or payment of the instrument.

9) Written accountings are provided to client at completion of disbursement or at least annually if funds are held more than twelve (12) months.

10) If the lawyer/firm holds any property or titles to property as security for the payment of any fees or other obligations owed to the lawyer other than for fees presently owed, the lawyer has indicated that the property or titles to property are held in trust as security for the obligation and not as a completed transfer of ownership to the lawyer.

11) The lawyer/firm has not earned interest on the trust account or fiduciary account which was not distributed to client or to OLTA.

This the _____ day of _____, 20__.

Lawyer/Firm [print]

By _____
[Signature]

Sworn to and subscribed to before me this the _____ day of _____, 20__.

Notary Public

CPA Engagement Letter to Perform Agreed Upon Procedures for Lawyer

{Date}

{Address}

{Address}

{Address}

Dear {Lawyer Name}:

This letter is to explain our understanding of the arrangements for, and the nature and limitations of, the services we are to perform pursuant to the Agreed Upon Procedures for CPA Examination of Lawyers' Trust Accounts ("Agreed Upon Procedures") relative to your exemption from the random audit of lawyer trust accounts authorized by 27 NCAC 1B, Rule 0.0128(b). **Unless specifically indicated in the Agreed Upon Procedures, a reference to a lawyer's trust account(s) includes all general trusts, dedicated trusts, and fiduciary accounts in which the lawyer holds funds for others.** You are solely responsible for compliance with the State Bar's rules regarding lawyers' trust accounts. The Agreed Upon Procedures are included as Attachment A to this letter. A copy of this letter and Attachment A will be sent to the North Carolina State Bar along with our report and your representation form.

Engagement Services

Our engagement will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Because the Agreed Upon Procedures included in Attachment A do not constitute an audit made in accordance with generally accepted auditing standards, we will not express an opinion on any of the specific elements, accounts, or items referred to in our report.

At the conclusion of our engagement, we will submit a report in letter form outlining the procedures performed and our findings resulting from the procedures performed. It is our understanding that any and all exceptions noted will be reported as findings and that materiality will not be considered by _____ (hereafter (CPA/CPA firm)).

Our report will contain a statement that it is intended solely for the use of _____ (hereafter (lawyer/law firm)) and the North Carolina State Bar and should not be used for any other purpose.

The procedures that we will perform are not designed and cannot be relied upon to disclose fraud or illegal acts should any exist. However, we will inform the lawyer/law firm and the State Bar of any fraud or illegal acts that come to our attention.

Furthermore, the services are not designed to provide assurance on internal control or to identify significant deficiencies or material weaknesses. However, we will communicate to lawyer/law firm and the State Bar any significant deficiencies or material weaknesses that become known to us during the course of the engagement.

Conditions and {Lawyer/Law Firm} Responsibilities

The sufficiency of these procedures is solely the responsibility of {lawyer/law firm} and the State Bar. We make no representation regarding the sufficiency of the procedures described above either for the purpose for which these services have been requested or for any other purpose.

If circumstances arise relating to the condition of {lawyer/law firm} records, the availability of appropriate evidence, indications of a significant risk of fraudulent transactions, or misappropriation of assets, which in our professional judgment prevent us from completing the engagement, we retain the unilateral right to take any course of action permitted by professional standards including declining to issue a report, or withdrawal from the engagement.

The assistance to be supplied by your personnel (if any) will be discussed and coordinated with {lawyer/law firm}. The timeliness and accuracy of this assistance is an essential condition to the completion of our services and issuance of our report. We understand that the final agreed upon procedures report is required to be issued no later than _____.

Fees, Costs, and Access to Documentation

Our fees are based on the time required by the individuals assigned to the engagement, plus direct expenses. We anticipate that the total fees will not exceed \$ _____. Billings are due upon submission.

In the event we are requested or authorized by {lawyer/law firm} or are required by government regulation, subpoena, or other legal process to produce our documents or our personnel as witnesses with respect to our engagement, {lawyer/law firm} will, so long as we are not a party to the proceeding in which the information is sought, reimburse us for our professional time and expenses as well as the fees and expenses of our counsel incurred in responding to such requests.

This letter constitutes the complete and exclusive statement of agreement between {CPA/CPA firm} and {lawyer/law firm} superseding all proposals, oral or written, and all other communications with respect to the terms of the engagement between the parties.

If this letter defines the engagement as {lawyer/law firm} understands it, please sign and date the enclosed copy and return it to us.

Sincerely,

{CPA/CPA firm}

Enclosures

CC: Trust Account Compliance Counsel, NC State Bar

This letter defines the engagement as _____ (Lawyer/law firm) understands it.

(Signature)

(Date)

Agreed Upon Procedures for CPA Examination of Lawyers' Trust Accounts ("Agreed Upon Procedures")

The CPA/CPA firm agrees to perform the following tasks:

- Obtain an executed Lawyer's Representation Form required for exemption from random audit and be alert for any inconsistencies between the representations in the form and the results of the engagement (see next-to-last procedure to report such inconsistencies).
- Review a sample of bank statements, deposit slips, and checks for all trust account(s) to determine that they are labeled as trust account(s) or fiduciary account(s).
- Review bank statements for the trust account(s) to determine whether the lawyer is using business-sized checks containing an Auxiliary-On-Us field in the MICR line which correlates to the check number.
- Test a sample of original trust account(s) deposit slips to determine if the client name is identified and the source of funds is indicated if source is other than the client (e.g., rd party payee).
- Test a sample of amounts received (deposits) to determine if client ledgers are being maintained for each person or entity from whom or for whom trust money is received.
- Test a sample of wire/electronic transfers into or out of the trust account(s) to determine if the client/beneficiary is identified.
- Test a sample of trust account disbursements to determine that the clients (from whose ledgers the funds are drawn) are identified on the checks.
- Review a sample of disbursements to determine that payees are specific persons or entities and that checks are not to "cash" or "bearer."
- In the course of our work, be alert for and report any transactions that do not appear relevant to typical trust receipts and disbursements.
- Review trust account bank statements to determine if check images are legible copies of the front and back and no smaller than 3 1/8 / 16 inches in dimension.
- Review trust account records to confirm that the lawyer has maintained cancelled checks, bank statements, and any other documents, including NSF notices, received from the bank regarding the account for a period of at least six years immediately preceding lawyer's most recent fiscal year end.
- Review the trust account(s) to determine that bank charges are paid from the lawyer's operating account or, if not, that the lawyer has deposited a reasonable amount of funds to the trust account specifically to pay for future bank service charges and that trust account ledgers is maintained to account for these funds.
- Examine individual client ledgers or computerized report showing all client ledger balances) to determine if any have been overdrawn (i.e. have negative balances).
- Review monthly trust account bank statement reconciliations to confirm that they are being performed.
- Review quarterly reconciliations of the general trust account(s) with the client ledgers pursuant to Rule 1.15-3(d) of the Rules of Professional Conduct.

- Review monthly and quarterly reviews to confirm that they are being performed pursuant to Rule 1.15-3(i).
- Determine whether the lawyer sent the bank a written directive requiring the bank to report to the Bar when an item drawn on the lawyer's trust account(s) is presented for payment against insufficient funds pursuant to Rule 1.15-2(k) of the Rules of Professional Conduct.
- Test a sample of lawyer's accountings required to be sent annually to clients for whom funds have been held for more than one year and for all clients whose funds have been fully disbursed (zero balanced ledgers).
- Report on any inconsistencies noted between the Lawyer's Representation Form and the results of the foregoing procedures.
- Utilize the report format provided by the NC State Board of CPA Examiners to describe the work performed and to note any findings.

Report Pursuant to *Agreed Upon Procedures for CPA Examination of Lawyers' Trust Accounts*

To Lawyer/Law Firm and North Carolina State Bar:

We have performed the attached *Agreed Upon Procedures for CPA Examination of Lawyers' Trust Accounts* ("Agreed Upon Procedures") which were agreed upon by Lawyer/Law Firm and the North Carolina State Bar solely to assist the North Carolina State Bar in determining if Lawyer/Law Firm has complied with the North Carolina State Bar's rules regarding lawyers' trust accounts for the 12 month period ended [month, day, year]. Lawyer/Law Firm is responsible for compliance with the North Carolina State Bar's rules regarding lawyers' trust accounts. This engagement was performed in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described above either for the purpose for which this report has been requested or for any other purpose.

[During the performance of the agreed-upon procedures we found no instances in which Lawyer/Law Firm failed to comply with the North Carolina State Bar's rules regarding trust accounts.]

OR

[We wish to report the following to you regarding Lawyer's/Law Firm's compliance with the North Carolina State Bar's rules regarding trust accounts:]

Apart from the performance of the *Agreed Upon Procedures*, we were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on whether Lawyer/Law Firm complied with the North Carolina State Bar's rules regarding lawyers' trust accounts. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of Lawyer/Law Firm and the North Carolina State Bar relative to Lawyer/Law Firm's exemption from the random audit of lawyer trust accounts authorized by 27 NCAC 1B, Rule 20128(b).

[CPA/CPA Firm Name]

[Signature]

[Date]

APPENDIX C: JOURNAL ARTICLES

(Articles have not been edited to reflect rule changes enacted after the article's original publication)

Escheat Happens

By Suzanne Lever

Ethics counsel periodically receives calls from lawyers seeking guidance as to the proper disposition of “dormant” funds in their trust account. As it happens, this is not simply a matter of “finders keepers, losers weepers.”

At the April Ethics Committee meeting, the State Bar’s field auditor reported that for the past quarter, 28% of lawyers audited failed to properly designate and/or escheat “unidentified and/or abandoned funds as required by N.C. Gen. Stat. § 116B-53. Given that the most recent formal ethics opinion discussing escheat is from 1991, a refresher course seems in order. First of all, what exactly is “escheat” and how the heck do you pronounce it? Apparently, the word is pronounced “escheet.” (Honestly, I have been pronouncing it “es-sheet” all of these years. How embarrassing!) Escheat is one of those overachieving words that can be either a noun or a verb. According to *Black’s Law Dictionary* (8th ed. 2004), escheat is the reversion of property to the state when the property has no known owner. It is also used to refer to the actual property that has been reverted. In the old days, there was also an “escheater” who was appointed to value the property escheating to the state. Hence, it would be perfectly proper to state: “The escheater escheated the escheat.” And if the escheater happened to be less than honest (as was, reportedly, sometimes the case), you would have to proclaim that, “The escheater cheated when escheating the escheat.” (Three times fast — dare you.)

In any event, escheating refers to the power of the state to acquire abandoned or unclaimed property. Escheating becomes relevant in the legal profession when a lawyer holds funds in a general trust account and does not know the identity or the location of the owner. During the required quarterly reconciliation of trust account records, lawyers should perform a classification of all funds held.

Property is presumed “abandoned” if the owner has not communicated with the lawyer or indicated an interest in the property within its “dormancy” holding period. “The holding periods are defined in N.C. Gen. Stat. § 116B-53(c). In most cases, the dormancy period for funds in a lawyer’s trust account is five years. Pursuant to RPC § 9 (1991), a lawyer should consider four factors when determining whether the applicable dormancy period has run. The lawyer needs to establish whether during the dormancy period (1) the fund’s principal has increased; (2) the owner has accepted payment of principal or income; (3) the owner has corresponded in writing; or (4) the owner has otherwise indicated an interest in the account as evidenced by memorandum or other record on file with the lawyer. If any of the four events enumerated above have occurred, no abandonment will be deemed to have occurred and the client’s funds must remain in the lawyer’s trust. In addition, whenever any of the four events occurs, a new dormancy period begins to run. The property may only be deemed abandoned if one of the four enumerated events has occurred.

Once the lawyer has determined that the dormancy period has run, Rule 1.15(q) provides that the lawyer must make “due inquiry” of his personnel, records, and other sources of information in an effort to determine the identity and location of the owner of the property. The *Legal* investigative requirements are more specific. N.C. Gen. Stat. § 116B-59 states that a holder (the lawyer in this scenario) must make a good faith effort to locate the owner. For properties over \$50 in value, a holder must send a written notice by first-class mail to the last known address of the apparent owner as reflected in the holder’s records. Holders who fail to perform due diligence may be subject to penalties and interest as outlined in N.C. Gen. Stat. § 116B-77. If the lawyer is unsuccessful in ascertaining the identity or the location of the owner of the funds, the lawyer should contact the North Carolina State Treasury Department (nctreasurer.com/upp/Pages/default.aspx). The Unclaimed Property and Escheats Division oversees and maintains the state’s database of unclaimed property and is responsible for recovering and returning such property to all rightful owners. A helpful FAQ section can be accessed online: nctreasurer.com/upp/Resources/HolderReportingFAQs.pdf.

Trust account funds for which the dormancy period has run must be escheated to the state even if it is believed, but cannot be conclusively documented, that the funds belong to the lawyer. *But cf.* RPC 226 (when a law firm receives funds that are not identified as client funds, the firm must investigate the ownership of the funds and, if it is reasonable to conclude the funds do not belong to a client or a third party, the firm may conclude that the funds belong to the firm). Pending escheatment, the funds should be held and accounted for in the lawyer's trust account. N.C. Gen. Stat. § 16B-57(a) permits a holder of abandoned or unclaimed funds to charge a reasonable "dormancy" fee, thereby reducing the amount of funds transferred to the State Treasurer's Office, so long as (1) the holder has made a good faith effort to locate the owners of the funds; (2) there is a valid and enforceable written contract which imposes the charge; and (3) the charge is applied on a regular basis. In 2006 E.O. 15, the Ethics Committee concluded that lawyer/holders may also charge a reasonable dormancy fee against unclaimed funds with the *additional requirements* that (1) the client receives prior notice of and gives written consent to the dormancy fee; and (2) the amount of the fee is appropriate under Rule 1.5(a) of the Rules of Professional Conduct.

According to our field auditor, the abandoned funds are often the result of uncleared checks or leftover funds from real estate closings due to miscalculations of taxes or recording fees. Sometimes the amount of these dormant funds is annoyingly small. One way to avoid escheat issues on small amounts is to obtain consent for the disposition of these "leftover" funds in the original retainer agreement. An unpublished ethics advisory opinion, EA 2217 (1998), provides that a lawyer may obtain consent from a client at the beginning of the representation to waive the lawyer's obligation to return a *de minimis* amount (an aggregate amount of less than \$10) owed to the client at the conclusion of the representation.

So don't "es-cheet" yourself out of the stellar trust account audit by failing to properly handle dormant trust funds. Much of the information above is contained in the Lawyer's Trust Account Handbook, which can be quickly and easily accessed online: ncbar.gov/media/283992/lawyer-trustaccount-handbook.pdf. The handbook is always a good place to start when trust account issues arise. You may also contact our field auditor, Anne Parkin (aparkin@ncbar.gov) or our trust account compliance counsel, Peter Bolac (pbolac@ncbar.gov). You may also contact me, and I will do my best to assist you with the es-sheet process.

TOP TIPS ON TRUST ACCOUNTING: Get Active with Your Inactive Balances!

Rule 1.15-2(q) Abandoned Property

If entrusted property is unclaimed, the lawyer shall make due inquiry of his or her personnel, records and other sources of information in an effort to determine the identity and location of the owner of the property. If that effort is successful, the entrusted property shall be promptly transferred to the person or entity to whom it belongs. If the effort is unsuccessful and the provisions of G.S. § 16B-53 are satisfied, the property shall be deemed abandoned, and the lawyer shall comply with the requirements of Chapter 16B of the General Statutes concerning the escheat of abandoned property.

According to the reports submitted by our new State Bar Random Auditor, Anne Parkin, lawyers are not properly dealing with inactive balances in their trust accounts. These inactive balances are usually the result of (1) outstanding checks that have never cleared, (2) earned fees that were never removed, or (3) funds that cannot be identified due to poor record keeping. Here are some tips to deal with these three situations:

1. Outstanding Checks

A review of the past quarter's audit reports shows that lawyers are retaining funds in their trust accounts from outstanding checks dating as far back as 2003. These outstanding checks were most likely lost, thrown away, or perhaps never even mailed. There are several ways to address the problem of trust account checks that are not cashed for a significant period of time. Some lawyers print "Void After 90 Days," on trust account checks to persuade payees not to hold the checks, but that notation does not guarantee that the bank will not honor the check after 90 days. This issue should be addressed with the bank in advance. Other lawyers contact all recalcitrant payees who fail to negotiate a trust account check after a certain period of time (usually six to nine months).

Certified mail should be used if warranted by the amount of the check. If the payee cannot be located or a reply is not received within a reasonable time, the check is voided or a stop payment is placed on the check. The stop payment charge has to be paid and a stop payment is usually good for only six months. If the check is voided, it may still be negotiable. Therefore, a stop payment order may be more appropriate depending on the amount of the check. If a stop payment order is placed on a check, it is possible that the check may still be cashed, so the bank's procedures for stop payment orders should be understood in advance. After payment is stopped on a check, the funds are noted as returned on the client's ledger card. There is not a restriction on issuing a second trust account check.

While there is really no 100% safe way to deal with the issue of writing two checks, a lawyer should use his judgment based on the amount of the check, the sophistication of the payee, and his ability to communicate with the payee. If, in the lawyer's judgment, it would be impractical to issue stop payment orders to cancel the check because of the amount, a lawyer may decide that it is appropriate to simply re-issue a new check to this client. However, if the lawyer issues a second check, the lawyer will be required to reimburse the trust account if for some reason the client finds and cashes the first check. Remember, a lawyer is not permitted to mail the client cash, money orders, or cashier's checks in an effort to absolve themselves of their fiduciary responsibilities. One potential solution to the issue of outstanding checks is for the lawyer to charge a reasonable dormancy fee against the unclaimed funds. This is permitted, so long as (1) the client receives prior notice and gives written consent to the dormancy fee, (2) the amount of the fee is appropriate under Rule 1.5(a) of the Rules of Professional Conduct, and (3) the fee complies with the statutory requirements of G.S. 16B-57(a) and any other restrictions imposed by the Unclaimed Property Program of the State Treasurer's Office. For more information, and sample fee language, see 2006 Formal Ethics Opinion 5.

2. Earned Fees in Trust Account

Rule 1.15-2(f) describes the two types of personal funds that a lawyer may keep in the trust account. They are: (1) funds sufficient to open or maintain the account, and (2) funds belonging in part to a client or other third party and in part currently or conditionally to the lawyer. A part from these kinds of deposits, and a deposit to correct an error or a negative balance, a lawyer's funds should not be in the trust account. Compliance with this prohibition requires the prompt removal of earned fees. A practical reason in support of prompt removal of earned fees is that, over time, a lawyer may lose track of what money he is entitled to and what is owed to a former client. (2) To avoid commingling, lawyers should remove earned fees from their trust accounts on a consistent cycle. Whether bi-weekly or monthly, a consistent billing cycle is good evidence that the lawyer is complying with the rules against commingling.

If a lawyer believes that trust account funds are earned fees which the lawyer failed to remove, the lawyer may withdraw those funds only if he can verify and retain documentation showing that the lawyer is entitled to the funds. Mere suspicion and belief, even a very strong belief, is not enough to justify the withdrawal of the funds. If the lawyer cannot prove that he is entitled to the funds and cannot attribute the funds to a particular client, then the lawyer must follow the provisions of G.S. 16B for the escheat of abandoned property and escheat those funds to the State Treasurer's Office.

3. Unidentified Funds

Rule 1.15-2(q) is very clear on this subject. The lawyer must make a diligent attempt to determine the identity and/or location of the owner of the funds. This attempt entails examining client files, searching for address information, and reviewing old trust account records in an effort to determine and locate the owner of the funds. If, after a diligent attempt, the lawyer cannot locate or determine the owner of the funds, the funds must be deemed abandoned and paid to the State Treasurer in compliance with the requirements of G.S. 16B.

Escheating Property

Funds are to be deemed abandoned if, over the past five years, the fund's principal has not increased, the owner has not accepted payment of principal or income, the owner has not corresponded in writing and the owner has not otherwise indicated an interest in the account. If any of the events listed above have occurred during the five-year period, a new five-year period begins to run during which the lawyer is obligated to maintain the property in

the trust account. Lawyers should perform an annual review of their trust account to determine if any funds qualify for escheatment. For details on the escheat process, including forms and a Four-Step Reporting Guide, visit www.nctreasurer.com/Claim-Your-Cash/For-Holders-Of-Unclaimed-Property/Pages/default.aspx or email the Unclaimed Property Division at unclaimed.property@nctreasurer.com.

Bruno's Top Tips for Tip Top Trust Accounting

By Bruno DeMolli

(This article appeared in *Journal* 15, 3, September 2010)

Reconcile Yourself to Reconciliations

I performed random audits of trust accounts in the 9th Judicial District (Caswell and Person Counties) and the 11th Judicial District (Harnett, Johnston, and Lee Counties) last quarter. Of the 60 law firms I audited, 60% were not in compliance with the reconciliation requirements for trust accounts. Sadly, this is not an aberration.

Why do lawyers fail to reconcile?

Most lawyers fail to reconcile their trust accounts because they do not understand how to reconcile. Very typically of late, this lack of understanding is compounded by an overreliance on trust accounting software that readily produces a report called "Reconciliation Summary" or a report with a name that includes the word "reconciliation." The report with the seemingly appropriate name creates a false sense of security because, although the report may confirm that the trust account total and the balance shown on the bank statement are consistent, *the report does not satisfy the quarterly reconciliation requirements.* This article sets forth the requirements of the Rules of Professional Conduct and explains how to reconcile your trust account to the bank statement.

How do you perform a monthly and a quarterly reconciliation?

The Rule 1.15-3(d) requires both quarterly and monthly reconciliations of the trust account balance to the current bank statement for a trust account. However, there is an important distinction between the basic reconciliation that must be done monthly and the more thorough reconciliations that must be done each quarter.

Monthly Reconciliations

Rule 1.15-3(d)(2) states that each month, if the balance of the trust account as shown on the lawyer's records shall be reconciled with the current bank statement balance of the trust account." The steps required for this type of reconciliation are not unlike those necessary to balance a personal checking account.

- From the ending balance shown on the bank statement for the monthly reporting period, subtract all outstanding checks. To this amount, add all deposits that have not cleared the bank. The resulting balance is the current bank balance.¹
- Confirm that the current bank balance equals the balance for the trust account as shown on the lawyer's records for the same date that the bank statement is balanced (if using manual accounting, this balance appears on the check stubs or the account register).
Note that the "Reconciliation Summary" produced by accounting software that the reference above will typically satisfy the monthly requirement to reconcile the current bank balance to the total trust account balance.

Quarterly Reconciliations

Rule 1.15-3(d)(1) states that each quarter, *the individual client balances* shown on the ledger of the general trust account must be totaled and reconciled with the current bank statement balance for the trust account." I have added the emphasis to demonstrate the difference between monthly and quarterly reconciliations. The quarterly reconciliations require the extra step of adding up individual balances for each client as shown on the trust account ledger and making sure that this total reconciles to the bank's current balance for the month that the end of the

quarter. Quarterly reconciliations promote accurate accounting for client funds by (1) ensuring that the running balances for each client, when totaled, equal the total funds on deposit in the trust account and (2) identifying any negative balances.

There is only one additional step required for quarterly reconciliations.

- Determine the current bank balance (as explained above).
- Total the current individual balances for every client as shown on the client ledgers for the trust account. Accounting software can usually produce a report that satisfies this step. Typical names for such a report include "client trust listing," "multiple balances report (balances only)," or "custom summary report."
- Confirm that the current bank balance equals the total of current client balances.

The date for balancing the bank statement and the date client balances are totaled must be the same or the account may not reconcile. If reports are generated by computer, this means that the reports must be generated on the same date. It is recommended that the reports be printed simultaneously to avoid subsequent posting of one report and not the other, thereby affecting reconciliation.

If your trust account records are kept manually, you may use this alternative method of reconciliation:

- Add all client balances and outstanding checks. Subtract any outstanding deposits.
- The resulting balance should reconcile with the ending balance on the bank statement.

Note that trust account quarterly reconciliation records (whether manual or computer-generated) must list each client's name and current balance, the total of all client balances, and the current bank balance (with details) for the period. All reconciliation records must be retained for six years to satisfy the recordkeeping requirement in Rule 1.15-3(d). If your software does not allow you to retrieve a hard copy of the reconciliation report at a later date, a hard copy should be printed at the time of reconciliation.

Negative Balances

Negative balances, whether they are discovered in a client balance or in the current bank balance, must be promptly reimbursed or a written explanation (e.g., for an accounting error) must be included in the records for the trust account.

If you have questions about the reconciliation requirements for trust accounts, you can find more information in the *Attorney's Trust Account Handbook*, which is posted on the State Bar website (www.ncbar.gov) under the tab for Programs—Trust Accounting." You may also call the ethics lawyers on me at the State Bar (919-828-4620).

Endnote

1. Interest earned on trust accounts payable to the State Bar's Interest on Lawyers' Trust Accounts (IOLTA) program and, if emitted by the bank each month, does not need to be taken into consideration when determining the current bank balance. However, some banks emit the interest on IOLTA during the month after it is earned. When this occurs, the interest emitted from the prior month (as shown on the bank statement) is subtracted from the balance and the interest earned during the current month is added to the balance. Some banks emit the interest on IOLTA on a quarterly basis. This requires the interest earned during the third month of the quarter to be added to the statement balance and the interest emitted to be subtracted from the statement balance. It is recommended that an IOLTA ledger be maintained for both manual and software accounting when interest is not emitted in the same month that it is earned.

Top Tips on Trust Accounting: Safeguarding Funds from Embezzlement

By Peter Bolac, Trust Account Compliance Counsel

Winter 2014

The State Bar is seeing an alarming increase in the number of reported cases of employee embezzlement from law firms. Just this month, I received three calls from lawyers who had trust account funds embezzled by employees. According to the State Bar investigators, there were ten reported thefts through October of this year (an average of one each month). This is both horrifying and unacceptable. I fear that the self-reported cases are merely the tip of the iceberg in comparison to the number of thefts that have gone either unnoticed or unreported. The amounts reported stolen from trust accounts range from petty cash to hundreds of thousands of dollars, all of which the lawyer is professionally responsible for replacing in order to protect clients from harm. Perhaps the most disconcerting fact is that the thefts are perpetrated by both new and long-term employees with about the same frequency. The culprit is often the last person you would suspect, and the problem will often present itself when you least expect it.

Before you dismiss these thefts as something that only happens to bad lawyers or overstretched solo practitioners, note that many fine lawyers and large reputable firms have fallen prey to these crimes. Types of employee theft range in sophistication from the obvious to the complex.

On one end, there are employees who simply write themselves checks from the trust account, and on the other end, there are employees who develop shell companies and manipulate bank documents to cover up systematic fraud. The State Bar sees more of the former than the latter. This is concerning because simple good management of the trust account would deter and prevent this type of blatant, unsophisticated theft. The more difficult-to-catch thefts include: employees stealing cash brought into the office by clients before the cash is recorded on the ledger or deposited into an account; employees making payments to shell companies or bank accounts in real estate closings or settlements; and employees scanning bank statements into Photoshop and doctoring numbers to hide illicit activities. If you suspect that an employee is embezzling from your trust account, the first thing you should do is obtain physical control of the trust account records.

Too often we hear that an employee, upon getting word that the lawyer may be on to him, made up an excuse to take the trust account records home with him where they were ultimately "lost" or destroyed.

After securing your records, contact an independent CPA or forensic accountant to audit your trust account and look for discrepancies. Have the CPA perform proper three-way reconciliation of the account, examine check images, and look at checkbook receipts and deposit slips. Once you have retained an outside consultant to examine your records and confirmed a discrepancy, confront the employee. Often, the employee is weighed down by this crime and is ready to confess. While confrontation may be uncomfortable and the employee may become combative, defiant, or insulted by your accusations, it is your responsibility to ensure that client funds are properly safeguarded by asking difficult questions. If you cannot be sure that an employee has stolen funds, but remain suspicious, you may elect to suspend the employee with pay and have him temporarily removed from the office.

When embezzlement is discovered, the lawyer **must immediately** do the following:

- **Replenish any known deficit in the trust account** by depositing firm funds or personal funds into the trust account and documenting the deposit on the appropriate client ledgers. If the lawyer suspects that more funds may have been embezzled, the lawyer may deposit funds into the account to cover estimated deficiencies. The lawyer should create a ledger for this additional deposit and title it "firm funds to cover estimated deficiencies."
- **Report the embezzlement to the North Carolina State Bar.** While a report in writing will at some point be required, calling our office right away will allow us to help you with any questions and concerns you may have — (919) 28-4620. The lawyer is strongly encouraged to also immediately take the following actions:

- **Terminate the employee.** Do not allow the employee to take any documents from a workstation, or to access email or other computer files.

- **Call the police.** Pressing charges on a long-trusted employee may be difficult, but it is important to show that you are taking your responsibilities seriously. It is also important that the employee ends up with a record that is informative to other lawyers if the employee attempts to gain employment in the legal field again.

- **Question other employees** as to their knowledge of and/or complicity in the scheme. It may be that there was more than one employee involved in the embezzlement, or that an employee violated your trust by not revealing potentially incriminating information when it became known.

- **Consider opening a new trust account.** If you are not 100% certain of the amount that has been stolen from your trust account, consider opening a new account for all entrusted funds going forward. This way, you can operate your practice through the new trust account with fresh records and processes while simultaneously investigating the old account for deficiencies.

The NC State Bar *Lawyer's Trust Account Handbook*, available on the State Bar website (ncbar.gov/menu/publications.asp), has a chapter dedicated to safeguarding funds from embezzlement (Section IX). Some of the tips listed in that section include:

- Do not act in haste when signing checks (make sure you know what you're signing).

- Examine trust account check images for forged signatures.

- Reconcile your trust account promptly after receiving a bank statement. A lawyer should be reviewing and signing off on all reconciliations monthly and quarterly.

- Review all trust account activity regularly. Random spot checks on all trust account records and correspondence helps deter theft.

- Legal fees paid in cash are difficult to control. Office policy should require that a receipt must be given to any client who pays in cash, and the lawyer should regularly ask clients who pay in cash if they received a receipt. The numbers for receipts in the receipt book should also be examined periodically to determine if any receipts were removed or voided.

- Check with the post office to determine if anyone other than designated personnel has attempted to pick up your mail. A good thief may intercept mail that would reveal incriminating information.

- Consider having your bank statements sent to your home address.

- Question if lifestyle changes (new cars, jewelry, travel, etc.) of individuals with access to your account. Also, personal and family problems, health issues, or depression may be the cause of embezzlement.

- Beware of an employee who is overly possessive of the trust account. Implement internal controls to divide certain trust account responsibilities between multiple employees.

Often, trust account embezzlement is a crime of opportunity. If an employee knows that nobody is looking at the records, reviewing reconciliations, or performing random spot checks, then the employee will be much more likely to attempt to steal. A firm that has strong trust accounting practices will rarely have to deal with simple and obvious theft. Even with adequate supervision, however, there is often little a lawyer can do to stop an extremely motivated and diabolical employee. While acknowledging this depressing truth, a lawyer should be able to discover the theft quickly and mitigate potential harm to his or her clients with sufficient safeguards, internal

controls, and personal oversight of the trust account. If you have any questions about employee embezzlement or any other trust accounting issue, please contact Peter Bolac at (919) 828-4620 or pbolac@ncbar.gov.

It would be useful to follow this procedure for any account, but the State Bar is mostly concerned with theft of entrusted funds. Lawyers randomly selected for audit are drawn from a list generated from the State Bar's database based upon judicial district membership designations in the database.

Top Tips on Trust Accounting: Do's and Don'ts of Accepting Credit Cards

By Peter Bolac, Trust Account Compliance Counsel

DO read the relevant ethics opinions on credit cards before you decide to accept credit cards for advanced fees and costs. RPC 247 *Payment of Fees by Electronic Transfer* (1997); 97 FEO *Credit Card Chargebacks Against a Trust Account* (1998); 2009 FEO *Credit Card Account that Avoids Commingling* (2009).

DON'T just ask your friends what they use and do the same. There is a chance they are doing it wrong and are in violation of the rules.

DO know the rules on passing the costs associated with credit cards on to your clients (allowed by our ethics opinions with full advance disclosure, but may be in violation of merchant agreements or consumer protection laws). Further, lawyers must ensure that swipe fees or discount charges assessed against the trust account are properly accounted for, and not paid with client funds unless the funds were specifically collected for that purpose.

DON'T deposit unearned fees and advanced costs into your operating account. Entrusted funds should **NEVER**, under any circumstances, touch a lawyer's operating account until they are earned by the lawyer. When in doubt or when limited by circumstances such as the bank's inability to distinguish between earned and unearned charges, funds should be deposited into the trust account and earned fees should be promptly removed to the lawyer's operating account.

DO know the rules relating to protecting your trust account from chargebacks. A lawyer must attempt to negotiate an agreement with his or her bank that requires the bank to debit chargebacks against an account other than the trust account. If the bank will not agree to debit another account, the lawyer must establish a trust account for the sole purpose of receiving advance payments by credit card and transfer all payments to this account immediately to the general trust account. This will protect the funds of other clients from chargeback debits (see 97 FEO).

DON'T share credit card equipment with another firm if sharing will result in the temporary commingling of both firms' funds.

DO consider using a payment processor that is tailored for the legal community. There are many processors that cater to lawyers by agreeing to separate unearned fees (deposited into trust account) and earned fees (deposited into operating account), and protect trust funds from any debits by charging swipe fees and chargebacks to the operating account. The costs of these accounts are competitive with other providers and these companies are knowledgeable about the specific requirements in Rule 1.15. While the State Bar cannot vouch for any particular company, the North Carolina Bar Association recommends LawPay as their preferred credit card processor for lawyers (www.lawpay.com).

DON'T use PayPal to collect entrusted funds. RPC 247 says that advanced fees and expenses must be deposited "directly" into a trust account. When a lawyer accepts credit card payments through PayPal, the money is deposited into a PayPal account and the lawyer must transfer the money from the PayPal account into the trust account. Since the PayPal account is not a trust account, this process is not permitted. Lawyers are permitted, however, to use PayPal to accept earned fees that will be deposited into your operating account.

DO know that the proper way to refund unearned fees paid by electronic transfer is by a trust account check (RPC 247).

DON'T participate in a merchant agreement that grants the bank a security interest in the trust account. Rule 1.15-1(g) prohibits the use or pledge of funds in a trust account to obtain credit. A lawyer may not participate in such an agreement unless the trust account is specifically exempted from the grant of a security interest. For example, this would prohibit a lawyer from using the service **Square** unless the company is willing to alter its merchant agreement that requires the lawyer to grant "a security interest in, as well as the right of setoff against, and thereby assign, convey, deliver, pledge and transfer to us, as security for repayment of any obligations due under this Agreement, all of your right, title, and interest in and to all of your accounts with us." (<https://squareup.com/legal/ua>)

DO your homework. Having the ability to accept credit card payments from clients can be a great tool for a law practice, but make sure that you are aware of the rules and risks associated with this process.

If you have any questions relating to credit cards or any other trust accounting issue, please contact Peter Bolac at (919) 28-4620 or PBolac@ncbar.gov. Follow Peter on Twitter @TrustAccountNC for alerts on trust account scams.

Trust Account Planning for the Sole Practitioner's Withdrawal from Practice

The following is an excerpt from an article that appeared in the Spring 2001 edition of the Journal. The original article, "Law Practice Trustees: What Happens When a Sole Practitioner is Missing, Incapacitated, Deceased, or Disciplined?", was written by Larissa Erkman, State Bar Deputy Counsel.

From time to time, the State Bar is asked to seek the appointment of a trustee to wind down law practices for sole practitioners who die, become disabled, abandon their law practice or are disciplined by the suspension of their law license or disbarment. North Carolina General Statute Section 24-28(j) governs the process for appointment of law practice trustees. Section 24-28(j) provides that, upon application of the North Carolina State Bar, the courts may appoint a trustee to protect the clients of any North Carolina attorney who is "missing, suspended, disbarred, disabled, or deceased." N.C. Gen. Stat. 24-28(j).

In keeping with the General Statutes, Section 20122 of the Discipline & Disability Rules of the North Carolina State Bar specifically states:

Whenever there is no partner or other member of the North Carolina State Bar capable of protecting the interests of the attorney's clients as known to exist, the Senior Resident Judge of the Superior Court in the district of the member's most recent address on file with the North Carolina State Bar, if it is in this State, will be requested by the Secretary of the State Bar to appoint an attorney or attorneys to inventory files of the member and to take action to protect the interests of the member and his or her clients. 27 N.C. Admin. Code, 1B 20122 (1994).

Appointment of a trustee is usually not necessary if a missing, incapacitated, deceased, or disciplined attorney (hereafter, "MIDD attorney") has a partner or associate who is willing and able to protect the interests of the attorney's clients. In such case, the partner or associate ordinarily is able to handle the situation without formal court order appointing a trustee of the attorney's law practice.

The specific duties of the trustee are set out in the court's order appointing the trustee. In addition, the order appointing the trustee confers general authority to the trustee to take such actions as are necessary to accomplish the specific duties. The specific duties of a law practice trustee are (1) to immediately secure the MIDD attorney's trust account; (2) to promptly notify clients of their need to retain new counsel; and (3) to inventory files, to arrange for clients to pick up their files, to seek an order from the court allowing for the disposal of closed files.

The trustee must promptly secure the MIDD attorney's trust and/or fiduciary accounts by notifying the financial institutions where such accounts are maintained of the attorney's unavailability and securing all checkbooks and trust account records. The court order appointing the trustee gives him or her broad authority to take any steps necessary to secure the trust account, including authority to execute new directives concerning signatory authority for the account. The trustee must obtain the account records in order to identify the ownership of any funds in such accounts, so that the clients/beneficiaries may be reimbursed, or their funds forwarded as they may direct. The trustee may need to obtain records from the financial institution where the account is maintained if the trust account records are not on file in the MIDD attorney's office. The order appointing the trustee generally gives the trustee authority to disburse funds from the trust and/or fiduciary accounts. Nevertheless, the State Bar recommends that the trustee obtain another court order specifically authorizing disbursement once the trustee has determined what funds are to be disbursed and to whom. The trustee is required to account to the court for all funds and disbursements.

Along with securing the MIDD attorney's trust account, the most important task for the trustee is to determine what active client matters need immediate attention and to contact those clients to inform them of the need to retain new counsel. The State Bar recommends that all sole practitioners give careful consideration to the fact that an unexpected and tragic event may occur requiring the appointment of a law practice trustee to wind down the law practice. To the extent practicable, it is therefore prudent for sole practitioners to plan for these contingencies by: (1) maintaining current trust account records and reconciliations in accordance with the Rules of Professional Conduct; (2) leaving instructions as to where all trust records and reconciliations can be found; (3) adopting a file organization and retention policy that includes an inventory of current files with clients' addresses, as well as an inventory of closed files less than six years; and (4) adopting and implementing a closed file destruction policy in accordance with RPC 2.09 and the Rules of Professional Conduct, so that the trustee does not have to incur time and expenses inventorying closed files that have amassed over the years. These steps will not only protect clients and save time and expense for the court and the legal profession, but will also save costs to the sole practitioner or this state.

Proposed Rule Amendments to Prevent and Detect Internal Theft

By Peter Bolac, Trust Account Compliance Counsel

The following is an excerpt from an article that appeared in the May 2015 edition of the Journal.

At the April meeting of the State Bar, the Council voted to revise and republish for comment proposed amendments to Rule 2.15 of the Rules of Professional Conduct. The amendments were proposed to facilitate the prevention and early detection of employee theft from a trust account. Minor revisions were made in response to the public comment received after the January quarterly meeting, and relate to how Rule 2.15 distinguishes between trust accounts and fiduciary accounts.

The Bar only received three written comments following the publication of the proposed rule amendments in the last edition of the Journal, but there has been a fair amount of "chatter" about whether the proposed changes are overly burdensome on a lawyer's practice. While there are other substantive proposed changes to Rule 2.15 (e.g., allowing the use of credit unions, explaining the self-reporting requirement, requiring lawyers to sign reconciliations), this article focuses on three proposed rule changes: (1) monthly and quarterly reviews, (2) restriction of signature authority, and (3) trust account oversight officers (TAOO).

John Smith is a small-town lawyer with a general practice. He focuses mainly on litigation and tax matters, but also maintains an active real estate practice. He is well-regarded in his community and has no prior disciplinary issues. Mr. Smith, a solo practitioner, has always relied on the help of his staff. Under his supervision, they complete real estate closings and maintain the trust account. He trusts his staff completely. Mr. Smith knows he has to supervise his staff's handling of the trust account because Bruno made it very clear during a narrowing visit in the late 90s. During the early 00s, the real estate market begins to boom and Mr. Smith's real estate practice increases exponentially. He no longer has time to oversee every aspect of the closing process, and relies solely on his staff to handle the day-to-day deposits, disbursements, and reconciliations. He still signs most trust account checks, but has

given signatory authority to one of his employees for situations when he is not in the office. The bank statement appears to balance with the trust account balance whenever Mr. Smith asks to see a reconciliation. Everything seems to be going well until the title insurance companies begin asking why premiums have not been paid, and Mr. Smith is selected for random audit by the State Bar. Upon looking at this trust account, Mr. Smith notices that trust account checks have been paid out to employees and relatives of employees, title insurance checks have never been mailed, and the trust account is thousands of dollars short. Mr. Smith is forced to borrow money to replenish the deficit and his law practice and bar license are in jeopardy.

This is the true story.

Had John Smith regularly reviewed the images of cleared checks and a random sample of transactions, he would have noticed that checks were made out to his employees and that title insurance checks were never mailed. Further, if he was the only person in the firm with signature authority, he would have seen that the checks were made payable to improper payees. What is even more likely, however, is that if John Smith regularly reviewed images of cleared checks and a random sample of transactions, his employees would never have stolen from the trust account. A lawyer's regular review of the trust account serves as the single greatest deterrent to employee embezzlement. The embezzling employee in the above story said, when interviewed by the district attorney, that she knew she wasn't looking and she won't know if I take it or if I put it back."

Monthly and Quarterly Reviews

The proposed amendments to Rule 1.15 include the addition of monthly and quarterly trust account reviews. The monthly review requires lawyers to "review the bank statement and cancelled checks for the month covered by the bank statement." Most lawyers already perform this task during their monthly balance of the bank statement with the trust account records. The monthly review will disclose (1) forged signatures, (2) improper payees or checks to cash, and (3) unexplained gaps in check numbers indicating checks may have gone missing. The lawyer can also verify that checks from the general trust account properly identify the client from whose balance the check is drawn on the face of the check and can examine the back of cleared checks to ensure proper endorsements were made.

The quarterly review requires the lawyer to "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 revisions made this quarter add that "[T]he 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 transactions satisfies the requirement, but a larger sample may be advisable. 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. The review can be performed as an additional step in the quarterly reconciliation, and the bar will provide a sample form to use when reviewing transactions. While the random review requirement may not uncover any improper activity, it will most definitely act as a deterrent to employee malfeasance.

Restriction of Signature Authority

The proposed amendments will limit signature authority to (a) a lawyer or (b) a non-lawyer employee supervised by the lawyer who is not responsible for performing reconciliations. Every signatory, lawyer or non-lawyer, must take a one-hour trust account continuing education course (CLE) prior to exercising the signatory authority. The rule amendments will ensure that (1) the non-lawyer employee is educated about trust account rules and (2) the employee cannot issue checks without any oversight because, at a minimum, someone else is reconciling the account. The State Bar has found that limiting signature authority to lawyers is a significant barrier against employee embezzlement. The Subcommittee on Accountability for Trust Account Management initially considered whether only lawyers should be permitted to sign trust account checks, but understood that such a rule would create difficulties for many lawyers and decided to give lawyers the option of having a non-lawyer signatory. The proposed amendment should not overly burden small firm or solo attorneys because a lawyer can opt to be the only signatory and allow a non-lawyer employee to conduct the required reconciliations for the review and

signature of the lawyer.

Jane Doe is a lawyer at a highly reputable and distinguished big-city firm. Jane, a new partner, has signature authority on the trust account but doesn't handle any of the day-to-day trust account maintenance. Ms. Doe assumes that the other partners are reviewing the trust account. The only time trust accounts are mentioned at the monthly partnership meeting is when a trusted employee tells the partners that the accounts reconcile. The trust account checks started to bounce. It quickly becomes apparent that an employee has been stealing from the trust account. The State Bar investigates and requests the firm's trust account records. Each partner at the firm had assumed that another partner was actively supervising the account. In fact, no one was. The State Bar opens disciplinary files against every partner.

This is a true story.

Trust Account Oversight Officer (TAOO)

The proposed amendments to Rule 1.15 include the addition of a new subsection, Rule 1.15-4, titled *Trust Account Oversight Officer*. This rule allows, but does not require, a multi-member firm to designate, annually and in writing, one or more partners as oversight officers for any general trust account. The rule helps a firm ensure that it is properly maintaining its trust and fiduciary accounts and avoid reliance on an assumption that trust accounts are being maintained by someone else. Designation as the TAOO requires the lawyer to complete a certain amount of training to gain proficiency in the trust accounting rules and the firm's accounting system, and requires the firm to adopt a written policy detailing the firm's trust account management procedures. Again, this rule is optional for multi-member firms that want to add an extra level of oversight to their firm's trust account management.

Conclusion

It is understandable to feel overburdened by the imposition of additional oversight responsibilities. However, the additional reviews and requirements in the proposed rule amendments are not overwhelming and will go a long way to deter and detect theft from lawyer trust accounts. Safeguarding client property is your professional responsibility as a lawyer. Surely, some additional time per quarter overseeing your trust accounts is worthwhile if it helps you to avoid becoming another cautionary tale.

You are encouraged to read the full-text of the proposed rule amendments on page _____ and submit your comments to the North Carolina State Bar. The Council considers all comments, negative and positive, before any action is taken.

Random Audits

Lawyers randomly selected for audit are drawn from a list generated from the State Bar's database based upon judicial district membership designations in the database. The randomly selected judicial districts used to generate the list for the 2nd quarter of 2015 were District 3B (Carteret, Craven, and Pamlico Counties) and District 7A (Gaston County).