

What you don't know about trust accounts can hurt you

The Minnesota Supreme Court has publicly disciplined several attorneys this year for trust account errors. I have previously written on this topic,¹ and because it's important and the consequences are so serious, I would appreciate your attention once again if you are in private practice. This time I'd like to tell you the tale of three firms.

Firm A

Imagine you are in practice with a partner. You do not have a bookkeeper, but use Quickbooks, so entering client transactions and keeping track of client money is pretty straightforward. You each handle your own client transactions, but you've agreed your partner will handle the monthly reconciliation of the check register to the bank statements. You also periodically review the bank statements and client subsidiary ledgers to make sure everything looks okay. You have worked this way for several years, and do not believe there are any issues.

One day, the bank pays a fraudulent



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check drawn on your trust account, and you receive an overdraft notice. The OLPR receives notice of this overdraft as well, asks for an explanation and requests three months of trust account records, which you promptly provide. The first thing we notice is there are no monthly trial balance reports or three-way reconciliation reports, and there appears to be a shortage when we compare what it looks like the trust account should contain with what actu-

ally is in the trust account (even setting aside the fraudulent check transaction, which the bank immediately reversed).

The OLPR converts its inquiry into a disciplinary investigation, and asks for more monthly records. Neither you nor your partner actually know what a monthly trial balance report is, nor do you understand how a three-way reconciliation process differs from the check register/bank statement reconciliation process you use. Several months of very distracting and time-consuming back and forth take place, and you learn your trust account has pretty much always had a shortage, which sometimes reached several thousand dollars. This happened not because anyone was stealing client funds, but because you and your partner, over time, had mistakenly made disbursements from the trust account in excess of client funds in the account. These over-disbursements were not caught in the monthly reconciliation process. Because of this, you and your partner have been negligently misappropriating client funds (using one client's funds to pay another client's obligations), in addition to not maintaining the required books and records, for a long period of time. This continued even after you hired an accountant to help make sure everything was on track, because the accountant was allowing negative client balances in individual client matters to reduce the overall trial balance, and thereby under-calculating shortages in the account.

Firm B

This tale is very similar to Firm A's situation, but this time you employ a bookkeeper to whom you and your partner have delegated responsibility for both your trust account and your business account. Your bookkeeper is excellent, has worked at a law firm previously, and you are so thankful that you do not have to worry about the accounts. You keep a close eye on disbursements (as only you and your partner can issue trust account and business account checks), you both generally monitor your client subsidiary ledgers, and you review the monthly reconciliation reports provided.

What you did not realize was that your bookkeeper did not know that trust accounting in Minnesota is different from standard accounting, and he too was failing to maintain monthly trial balance reports and to conduct a monthly three-way reconciliation process. Until the OLPR reviewed the matter, you also did not realize that sometimes credit card payments for advance fees were not being transferred to your trust account but rather were mistakenly left in your business account, even though the advances were noted on the subsidiary ledgers. Once the account was fully audited, it turned out that there were sometimes long and sometimes short periods of shortages that varied in amounts, as well as periods of co-mingling (periods where firm funds remained in the account because they were not withdrawn within a reasonable time of being earned), in addition to a failure to safekeep client funds that arose from leaving them in the business account.

Firm C

The tale of Firm C is a bit different. You are the only partner but you employ several associates and a large team of support staff to manage your successful collection practice. You have a long-term office manager to whom you have delegated all accounting responsibilities, and whom you trust implicitly. You are so successful that you do not have to closely monitor the accounts, and you take comfort in the fact that, in addition to your own trustworthy staff, your sophisticated clientele closely monitors its own accounts. What you do not know is that your trusted office manager frequently moves money between accounts to meet firm expenses, often withdrawing money from trust to make sure that financial obligations of the firm are being met. You also did not know that client funds from third parties were being deposited into non-trust accounts and subsequently spent. Nor did you realize that the office manager was also taking funds to pay for her own and her family's personal expenses, which funds were sometimes stolen from trust accounts and sometimes from your business accounts.

This behavior continued for a couple of years until there was a liquidity crisis—apparently your first clue that a potential issue existed. The OLPR audit showed that over a substantial period of time, more than \$2 million had been misappropriated. You close your firm and liquidate its assets to ensure that clients are made whole.

All of these scenarios have resulted or are in the process of resulting in varying degrees of public discipline. I cannot stress enough that handling other people's money is a serious responsibility, taken seriously by this Office and the Court, and you as the attorney are responsible for failures, even if you have delegated primary responsibility to others. Rule 1.15 and Appendix 1 to the Minnesota Rules of Professional Conduct describe in detail your responsibilities regarding trust accounts. The rule and appendix set forth an accounting system and monthly reconciliation process designed to catch errors (because mistakes happen) and timely correct them to ensure that you are safeguarding and appropriately accounting for client or third-party funds. It is not mysterious or difficult—but you must attend to it every month, whether you are doing it yourself or delegating the task to others. There are a lot of ways that errors in trust accounts can lead to serious discipline, and you do not want it to happen to you.

Help exists

In conjunction with the State Law Library, we will be presenting a free trust account CLE on October 31, 2018, from Noon to 1:30pm, at the Minnesota Judicial Center. More information can be found at the Law Library's website, www.mn.gov/law-library, under the Services tab. This presentation offers a remote attendance option and will be videotaped and made available through the library's on-demand portal. The OLPR has numerous resources on our website, www.lprb.mncourts.gov, under Lawyer Resources as well. While everyone is busy and few among us are trained in money management, attorneys who handle client or third party funds are almost guaranteed to regret not taking the time to ensure their trust accounts are being maintained properly. ▲

Notes

¹ "Spring Trust Account Cleanup," Bench & Bar (April 2018), and "Is Your Trust Account in Order?" Bench & Bar (September 2016), available at www.lprb.mncourts.gov/articles.