A Practical Guide to Attorney Trust Accounts and Recordkeeping

New York Lawyers' Fund for Client Protection

October 1999

Dear Colleague:

We are pleased to contribute this revised version of A Practical Guide as a public service for the bar of New York, law office staffs, and law students.

It is intended as a plain-English guide to current disciplinary and court rules, statutes and bar association ethics opinions relating to attorney trust accounts, and accounting standards for law offices.

A Practical Guide was first published in April 1988, with the help of the Committee on Professional Ethics of the New York County Lawyers' Association. This new version is prompted by recent changes in court rules and statutes.

Like all practical guides, it is intended to provide a straightforward summary of the applicable rules and standards when a lawyer holds client money and escrow funds. It is not, of course, a substitute for the black-letter provisions of the New York Lawyer's Code of Professional Responsibility.

We hope you find A Practical Guide to be informative and helpful in your practice.

What are a lawyer's ethical obligations regarding client funds?

A lawyer in possession of client funds and property is a fiduciary.[1] The lawyer must safeguard and segregate those assets from the lawyer's personal, business or other assets.

A lawyer is also obligated to notify a client when client funds or property are received by the lawyer. The lawyer must provide timely and complete accountings to the client, and disburse promptly all funds and property to which the client is entitled. A client's non-cash property should be clearly identified as trust property and be secured in the lawyer's safe or safe deposit box.

These fiduciary obligations apply equally to money and property of non-clients which come into a lawyer's possession in the practice of law.

What is an attorney trust account?

It's a "special" bank account, usually a checking account or its equivalent, for client money and other escrow funds that a lawyer holds in the practice of law. A lawyer can have one account, or several, depending on need. Each must be maintained separately from the lawyer's personal and business accounts, and other fiduciary accounts, like those maintained for estates, guardianships, and trusts.

An attorney trust account must be maintained in a banking institution located within New York State; that is, a "state or national bank, trust company, savings bank, savings and loan association or credit union." Out-of-state banks may be used only with the prior and specific written approval of the client or other beneficial owner of the funds. In all cases, lawyers can only use banks that have agreed to furnish "dishonored check notices" pursuant to statewide court rules.[2]

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[1] Disciplinary Rule 9-102 of the Lawyer's Code of Professional Responsibility, 22 NYCRR 1200.46. The Appellate Divisions' Disciplinary Rules are published in 22 NYCRR Part 1200; McKinney's Judiciary Law (Appendix); and McKinney 's New York Rules of Court.

[2] DR-9-102(b)(1), 22NYCRR1200.46(b)(1). The Dishonored Check Reporting Rules, effective January 1, 1993, are reported at 22 NYCRR Part 1300.

These rules also require that lawyers designate these bank accounts as either **Attorney Trust Account, Attorney Special Account,** or **Attorney Escrow Account,** with pre-numbered checks and deposit slips imprinted with that title.[3]

What is the purpose of an attorney trust account?

To safeguard clients' funds from loss, and to avoid the appearance of impropriety by the lawyer-fiduciary. The account is used solely for funds belonging to clients and other persons incident to a lawyer's practice of law.

Funds belonging partly to a client and partly to the lawyer, presently or potentially, must also be deposited in the attorney trust account. The lawyer's portion may be withdrawn when due, unless the client disputes the withdrawal. In that event, the funds must remain intact until the lawyer and client resolve their dispute.

Withdrawals from the attorney trust account must be made to named payees, and not to cash. And only members of the New York bar can be signatories on the bank account.

What about bank service charges?

A lawyer may deposit personal funds into the attorney trust account that are necessary to maintain the account, including bank service charges.

Should interest-bearing accounts be used?

Lawyers, as fiduciaries, should endeavor to make client funds productive for their clients. By statute, every lawyer has complete discretion to determine whether client and escrow funds should be deposited in interest-bearing bank accounts.[4]

For funds nominal in amount, or which will be held only briefly by a lawyer or law firm, the statute authorizes their deposit in so-called IOLA bank accounts.

But lawyers may also establish interest-bearing accounts for individual clients. For all client funds,

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[3] DR 9-102(b) (2); 22 NYCRR 1200.46(b)(2).

[4] Judiciary Law, §497.

lawyers may use pooled accounts in banks which have the capability to credit interest to individual client sub-accounts. A lawyer or law firm may also do the calculations necessary to allocate interest to individual clients or other beneficial owners.

What is IOLA?

IOLA is the acronym for the Interest On Lawyer Account fund and program.[5] IOLA is a state agency which uses interest on attorney trust accounts to fund non-profit organizations which provide civil legal services for the poor, and programs to improve the administration of justice.

The IOLA account is designed for nominal and short-term client deposits: a sum of money, for example, that would not generate more than $150 in interest for the client-owner.

A lawyer's participation in IOLA has no income tax consequences for the lawyer, or for the client. In addition, IOLA assumes the cost of bank service charges and fees on the account.

IOLA's offices are at 36 West 44th St., Suite 711, New York, New York 10036. Telephone (212) 944-9640, or 1-800-222-IOLA.

How should large trust deposits be handled?

When a client's funds and the anticipated holding period are sufficient to generate meaningful interest, a lawyer may have a fiduciary obligation to invest the client's funds in an interest-bearing bank account.[6]

In that case, prudence suggests that a lawyer consult with the client or other beneficial owner. And when dealing with large deposits and escrows, lawyers and clients should be mindful of federal bank deposit insurance limits.

There may also be income tax implications to consider. Using the law client's social security or federal tax identification member on the bank account can avoid tax problems for the lawyer.

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5 State Finance Law, §97-v; Judiciary Law, §497.

6 See, NYSBA, Comm. on Prof. Ethics, Ops. 554 (1983), 575 (1986); Assoc. Bar, NYC, Comm. on Prof. & Jud. Ethics, Op. 86-5 (1986).

May a lawyer retain the interest on an attorney trust account?

No. A lawyer, as a fiduciary, cannot profit on the administration of an attorney trust account. While a lawyer is permitted to charge a reasonable fee for administering a client's account, all earned interest belongs to the client. A lawyer's fee cannot be pegged to the interest earned.[7]

What happens if a trust account check bounces?

A bounced check on an attorney trust account is a signal that law client funds may be in jeopardy. Banks in New York State report dishonored checks on attorney trust accounts to the Lawyers' Fund for Client Protection; for referral by the Lawyers' Fund to the proper attorney grievance committee for such inquiry as the committee deems appropriate.

These bank notices are required by the Appellate Divisions' Dishonored Check Reporting Rules.[8] A "dishonored" instrument is a check which the lawyer's bank refuses to pay because of insufficient funds in the lawyer's special, trust, or escrow account.

The Lawyers' Fund holds each dishonored check notice for 10 days to permit the filing bank to withdraw a report that was sent in error. However, the curing of an insufficiency of funds by a lawyer or law firm will not constitute reason for the withdrawal of a dishonored check notice.

Are there special banking rules for down payments?

Yes. A buyer's down payment, entrusted with a seller's attorney pending a closing, generally remains the property of the buyer until title passes. The lawyer-escrow agent is serving as a fiduciary, and must safeguard and segregate the buyer's down payment in a special trust account.

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[7] NYSBA, Ops. 532 (1981), 582 (1987); NYC, Op. 81-68 (1981).

[8] DR 9-102(b)(1), 22 NYCRR 1200.46(b)(1). The Dishonored Check Reporting Rules, effective January 1, 1993, are reported at 22 NYCRR Part 1300.

The purchase contract should make provision for depositing the down payment in a bank account, the disposition of interest, and other escrow responsibilities.

A 1991 statute codifies the fiduciary obligations of lawyers and realtors who accept down payments in residential purchases and sales, including condominium units and cooperative apartments.[9]

This statute requires that the purchase contract identify: (l) the escrow agent; and (2) the bank where the down payment will be deposited pending the closing.

There are also special rules, promulgated by the New York State Department of Law, where escrow accounts are established in connection with the conversion of buildings into condominiums and cooperatives.[10]

Are other bank accounts needed?

Yes. A practitioner needs a business account as a depository for legal fees, and to pay operating expenses. A typical designation is **Attorney Business Account.** Lawyers also need special bank accounts when they serve as fiduciaries for estates, trusts, guardianships, and the like.

Where are advance legal fees deposited?

This depends upon the lawyer's fee agreement with the client. If the advance fee becomes the lawyer's property when it is paid by the client, the fee should be deposited in the business account, and not in the attorney trust account.

If, on the other hand, the advance fee remains client property until it is earned by the lawyer, it should be deposited in the attorney trust account, and withdrawn by the lawyer or law firm as it is earned.[11]

In either event, a lawyer has a professional obligation to refund unearned legal fees to a client whenever the lawyer completes or withdraws from a representation, or the lawyer is discharged by the client.[12]

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9 General Business Law, Article 36-C, §§778,778-a.

10 See, General Business Law, §352-e(2-b).

11 See, NYSBA, Op. 570 (1985).

12 DR 2-110(a)(3); 22 NYCRR 1200.15(a)(3).

And advances from clients for court fees and expenses?

This also depends upon the lawyer's fee agreement with the client. If the money advanced by the client is to remain client property until it is used for specific litigation expenses, it should be segregated and safeguarded in the attorney trust account, or in a similar special account.

How are unclaimed client funds handled?

If a lawyer cannot locate a client or another person who is owed funds from the attorney trust account, the lawyer is required to seek a judicial order to fix the lawyer's fees and disbursements, and to deposit the client's share with the Lawyers' Fund for Client Protection.[13]

What happens when a sole signatory dies?

The Supreme Court has authority to appoint a successor signatory for the attorney trust account. The procedures are set forth in court rules adopted in 1994.[14]

What accounting books are required?

No specific accounting system is required by court rule, but a basic trust accounting system for a law firm consists of a trust receipts journal, a trust disbursements journal, and a trust ledger book containing the individual ledger accounts for recording each financial transaction affecting that client's funds.

At a minimum, each client's ledger account should reflect the date, source, and a description of each item of deposit, as well as the date, payee, and purpose of each withdrawal.

Many practitioners find that the so-called "one-write" or "pegboard" manual systems provide an efficient and economical method of trust accounting.[15] There are also computer software packages for law office trust accounting.

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[13] DR 9-102(f); 22 NYCRR 1200.46(f) .

[14] DR 9-102(g); 22 NYCRR 1200.46(g) .

[15] Vendors include Eastern Systems, Inc., Safeguard Business Systems, Inc., and McBee One-Write Bookkeeping Systems.

Whether it be an attorney trust account or the lawyer's operating account, each should be maintained daily and accurately to avoid error. All documents like duplicate deposit slips, bank statements, canceled checks, checkbooks and check stubs must be preserved for seven years.

Internal office controls are essential. It is good business practice to prepare a monthly reconciliation of the balances in the trust ledger book, the trust receipts and disbursements journals, the bank account checkbook, and bank statements.

What bookkeeping records must be maintained?

Every lawyer and law firm must preserve,[16] for seven years after the events they record:

— books of account affecting all attorney trust and office operating accounts; and

— checkbooks and check stubs, bank statements, pre-numbered canceled checks and duplicate deposit slips.

Also, copies of:

— client retainer and fee agreements;

— statements to clients showing disbursements of their funds;

— records showing payments to other lawyers or non-employees for services rendered; and

— retainer and closing statements filed with the Office of Court Administration.

"Copies" means original records, photo copies or other images that cannot be altered without detection.

In the event a law firm dissolves, appropriate arrangements must be made for the maintenance of the firm's records, either by a former partner or the successor law firm. In the absence of an agreement, the local Appellate Division has the authority to impose an arrangement.[17]

How are these rules enforced?

A violation of a Disciplinary Rule constitutes grounds for professional discipline under section

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[16] DR 9-102(d); 22 NYCRR 1200.46(d).

[17] DR 9-102(h); 22 NYCRR 1200.46(h).

90 of the Judiciary Law. Also, the accounts and records required of lawyers and law firms by court rule may be subpoenaed in disciplinary proceedings.

Lawyers are also required to certify their familiarity and compliance with Disciplinary Rule 9-102 in the biennial registration form that is filed with the Office of Court Administration.

What losses are covered by the Lawyers' Fund?

The New York Lawyers' Fund for Client Protection (previously the Clients' Security Fund) is financed by a $100 share of each lawyer's $300 biennial registration fee. The Lawyers' Fund receives no money from the IOLA program.

The Lawyers' Fund, established in 1982, is ministered pro bono publico by a Board of Trustees appointed by the State Court of Appeals.[18] The Trustees provide upwards of $8 million in reimbursement each year to victims of dishonest conduct in the practice of law.

The Lawyers' Fund is authorized to reimburse law clients for money or property that is misappropriated by a member of the New York bar, in the practice of law. Awards are made after a lawyer's disbarment, and in situations where the lawyer is unable to make restitution. The Fund's current limit on reimbursement is $200,000 for each client loss.

To qualify for reimbursement, the loss must involve the misuse of law clients' money or property in the practice of law. The Trustees cannot settle fee disputes, nor compensate clients for a lawyer's malpractice or neglect.

Typical losses reimbursed include the theft of estate and trust assets, down payments and the proceeds in real property transactions, debt collection proceeds, personal injury settlements, and money embezzled from clients in investment transactions.

The Lawyers' Fund is located at 119 Washington Avenue, Albany, New York 12210. Telephone (518) 434-1935, or 1-800-442-FUND. Visit our Internet site at www.nylawfund.org.

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18 Judiciary Law, §468-b; State Finance Law, §97-t.