



ATTORNEY'S REPORT

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Avoiding Ethical Concerns with Client Funds

Trust (or escrow) account management is a potential ethical minefield for attorneys and law firms. Weak internal controls can lead to funds being diverted, and even an innocent accounting error could result in allegations of a trust account violation.

Ultimately, a fiduciary responsibility exists for attorneys in possession of client funds and property. As part of that duty, timely and complete accounting must be provided to the client, and all funds and property to which the client is entitled must be disbursed properly.

Accounting for It All

While no specific accounting system is required by court rule, a basic trust accounting system should include at least the following essentials:

- Trust receipts journal
- Trust disbursements journal
- Trust ledger book containing 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
- The date, payee and purpose of each withdrawal

Here, the accounting system could be as basic as a manual "one-write" or "pegboard" system, where the date, payee, purpose, check number, etc., are all automatically recorded in the journal when the check is written. Or, maintaining and monitoring client trust accounts can be automated using any number of

software packages designed specifically for law office trust accounting, such as EasyTrust, i-trust and WinVantage 4.

Whatever method is used, it's good business practice to prepare a monthly reconciliation of balances in the trust ledger book, the trust receipts and disbursements journals, the bank account checkbook, and bank statements.

You'll also want to consider reporting the trust's bank and investment account transactions. Reporting is typically made to the Trustor and/or Trustees, and would only be for those accounts established for a single trust (vs. an account established to hold comingled client deposits, undisbursed litigation awards, real estate closing proceeds, etc.).

You Are Responsible

Because you are ultimately responsible for the security of these funds, the importance of strong internal controls cannot be overemphasized. Consider these steps for safeguarding client funds:

Use the correct tax ID. Obtain the client's Social Security or federal tax identification number during the initial intake process and then use the number on the bank account to avoid unexpected tax problems for the lawyer.

Limit the number of trust accounts. Avoid operational inefficiencies caused by having too many accounts. Establish criteria to determine whether new accounts should be opened (e.g., based on average account balance to be maintained, length of time balances will remain in account, etc.).

Limit the number of authorized signatories. Restrict the number of authorized signers to strengthen the approval process.

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Create a paper trail. Institute a system of check requisitioning that creates a paper trail designed to assure no client trust account checks can be negotiated without sufficient documentation.

Restrict online banking privileges. In cases where electronic banking is utilized, create a list documenting computer privileges assigned to specific employees. This list should be authorized by management or an assigned designee who does not have the ability to set up user access privileges on the system.

Require two signatures. Make certain no disbursement can be made without two signatures, or at least a contemporaneous review by a second person.

Review account reconciliations. Review all client trust fund account reconciliations at the end of each month, looking for appropriate signatures, payees, endorsements, unusual items, and large debits or credits. For the strongest controls, deliver the bank statement to the reviewing attorney unopened.

How Do You Measure Up?

Establishing proper accounting records and internal controls helps ensure that trust funds are properly safeguarded. You can have assurance you're doing your part when the following conditions are met:

You're up on your state and bar requirements. Make sure you know your responsibilities from both a bar and state law perspective.

You communicate clearly. During initial client meetings, talk with clients about trust accounting procedures and your ethical requirements. For example, let clients know upfront that settlement proceeds will not be disbursed until the settlement check has cleared.

You are properly insured. A Commercial Crime Policy may provide coverage against, among other things, employee theft, forgery or alteration, and theft of money or securities. Be sure to review policy limits annually.

You have a written trust fund policy. Have the policy reviewed by your accountants and make all employees aware of its existence. Monitor compliance and update the policy as needed.

You test your system. Have a third-party consultant test your internal policies and procedures to ensure that adequate controls are in place and duties are segregated properly.

From in-depth accounting to third-party testing, our professionals have the knowledge to help you safely manage client funds.

Handling Advance Legal Fees

Simply put, accounting for an advance fee is predicated on actual ownership of the funds. For most purposes, an advance fee remains client property until it is actually earned by the lawyer. Thus, it should be deposited in a trust account and withdrawn as it is earned. Of course, once the fees become the lawyer's property, they belong in the firm's business account.

Here's how the accounting typically works:

1. Clients pay you in advance for your fee and anticipated expenses.
2. You deposit these amounts in your trust account and record them as coming from a client trust liability account for that particular client.
3. As you earn a fee or are reimbursed for an expense, you write yourself a check from the trust account, showing the funds coming from that client trust account.

Deposit vs. Retainer

Here's where confusion reigns — much of it due to an imprecise understanding of exactly what constitutes a retainer. In its classic usage, a retainer is something of an option contract the client enters into with an attorney — basically, paying a fee for the right to employ the attorney. The retainer, in this case, is therefore earned upon receipt and does not belong in a trust account.

By contrast, an arrangement where the client pays a deposit against future fees is not a true retainer. These are funds given to the lawyer to apply against charges incurred in the future. Because this money has not yet been earned, it must be held in the trust account. Once work is performed, the attorney can transfer an amount equal to the billable hours to his or her business account.

Data Security When You're on the Go

The legal profession has certainly been at the vanguard of mobile technology. Attorneys have made the switch from briefcases full of bulky files to laptops, tablets and smart phones loaded with case notes, docket calendars and briefs.

But this increased convenience and efficiency comes at a cost. Taking your work out of the office and on the go exposes the wired attorney to a plethora of potential data security issues. These range from the annoying (a virus picked up over an offsite client's network) to the consequential and potentially severe (exposure of confidential data).

Consider the following steps for maintaining the security of your digital information.

At the Courthouse

The efficiency of mobile technology is readily apparent to any attorney who has accessed case files or entered notes in the courtroom via a laptop or smart phone. Yet, your exposure to potential breaches becomes even more pressing once you come out from behind the safety of your firm's secure network and enter a public space.

Encrypt your laptop. Encrypt your hard drive with software such as TrueCrypt (<http://truecrypt.org>), a free, easy-to-use open source encryption program.

Protect your phone. The biggest security risk with your smart phone is simply leaving it behind. Both Android and iOS have free apps that allow you to track the location of a lost phone and even take a photo from the phone's camera to help reveal its location. More advanced features allow you to remotely wipe all of the data on the phone. While this may not be ideal, it's still a viable way of protecting the firm's proprietary data.

At the Client's Facility

Working remotely at a client's place of business also exposes you to some digital dangers. It's easy for malware or viruses to target your laptop when you log into their network. Likewise, incompatible software can easily cause data corruption.

Connect yourself. You can bypass a client's WiFi system and network (which may be an inviting target to hackers) and connect directly to the Internet

with a wireless cellular phone modem adapter (aka an "aircard"). It's easy to purchase one from your Internet or cellular provider. As with any Internet-connected device, be sure to install the appropriate firewalls and antivirus software.

Keep track of flash drives. Flash drives are so tiny that they're easy to lose (or steal), and their absence may go unnoticed. Treat flash drives and other portable drives with the same precautions you would any other privileged material. You might also consider encrypting any data you store on them.

From Home

With a secure network, you can easily work on files from home after hours or on the weekend.

Create a secure portal. Whether you're developing a virtual law practice or simply communicating with clients from a home office, you'll want a secure client portal where you can interact with clients. Programs such as MyCase (<http://mycaseinc.com>) let you communicate securely with clients in a web-based setting that also allows them to access their case information.

Use secure apps. When storing and transmitting confidential data, make sure the applications you are using are secure (you'll see "https" in the URL) before proceeding. Don't enter data unless you're positive that it will be encrypted. Note that iPads and other mobile device apps do not always have this level of security. While you're at it, be sure you're using the safest available browser, such as a current version of Internet Explorer or Mozilla's Firefox with the NoScript add-on or other pop-up blocker activated.

A Word About Cloud Computing

With the flexibility to access case and client info whenever and wherever, cloud computing is fast becoming a popular choice for attorneys. To compare features, visit the Legal Cloud Computing Association at <http://legalcloudcomputingassociation.org>.

For additional security, change the security/privacy default settings in any cloud-based application immediately after you register. Finally, do not use free WiFi hotspots when using any cloud computing application remotely — use a cellular phone modem adapter or aircard instead.

Valuation Discounts and Estate Planning

America is a nation of entrepreneurs. And for many, the equity they've established in their businesses represents a substantial portion of their net worth. Unfortunately, owners of closely held businesses face a daunting challenge in the high tax rates of the federal transfer tax system.

In response, estate planning attorneys can take advantage of various valuation discounts to transfer nonvoting stock on a gift and estate tax-advantaged basis.

A common approach is to utilize a discount for lack of control (aka a minority discount). Here, the fair market value of the subject interest is reduced based on the owner's lack of control over the business (e.g., the ability to direct business policy and/or direct payment of dividends). In theory, this makes nonvoting stock in a corporation less attractive to a hypothetical buyer.

Similar is the discount for lack of marketability (DLOM), which reflects the amount that can be "written down" on the value of the business due to an inability to sell the investment for a specified price.

Case law concerning valuation discounts is constantly changing, and the IRS has consistently attacked valuation discounts applied to interests in limited partnerships and LLCs used primarily for estate planning purposes.

The good news is that in client situations where proper steps are taken to document the underlying transaction, the IRS has been largely unsuccessful in eliminating these valuation discounts. Yet, as Washington struggles with deficit reduction, estate planners should be on the lookout for legislation prohibiting discounts. For example, 2009's H.R. 436 contained wording to this effect but did not become law.

Sophisticated estate planning techniques demand sophisticated guidance. Our experienced professionals would be pleased to assist you and your clients.

Mueller Prost PC is a team of CPAs and business advisors headquartered in St. Louis. From humble beginnings on a ping-pong table in 1983, the corporation has grown into one of the leading CPA and business advisory firms in the area, operating out of two locations with more than 80 staff members. By **Advising with Vision**[®], we offer clients new and unique ways to look at their businesses. Our forward-thinking CPAs and advisors stand ready to provide depth of expertise, strategies and resources required to help clients set and achieve their goals at every stage of the business lifecycle. As a member of both the PKF North America and PKF International networks (associations of independent CPA firms), our team has the ability to leverage national and global resources when needed to benefit client engagements.

The firm offers a full range of professional tax, audit, accounting, litigation support and management advisory services to the legal community.

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