The Law Society of Manitoba

INCORPORATED 1877 | INCORPORÉ EN 1877

TRUST ACCOUNTING FUNDAMENTALS

Professional Responsibilities

March 2023

TABLE OF CONTENTS

A. INTRODUCTION

1. Objectives

After reading this module on trust accounting and working through the examples given, you will be able to:

1. **identify trust money;**
2. **explain the differences between a law firm's trust bank account and a law firm's general bank account;**
3. **identify by name and explain the purpose for the required records to be maintained for a law firm's trust bank account and general bank account;**
4. **know where to find relevant rules about trust accounting including specific deadlines for filing and when entries must be recorded;**
5. **use the checklist in the module to correctly perform a month end trust account reconciliation;**
6. **state the purpose of a specific trust investment account and identify the criteria to be considered before opening one;**
7. **enter corrections in trust ledgers and the books of original entry; and**
8. **explain the difference between the obligations of a trust account supervisor and of individual members.**

The module is designed to contain all information that someone would need to know to be able to successfully complete the examination component of the trust account supervisor approval process.

Disclaimer *– This reference material has been prepared to assist lawyers; however, lawyers should always exercise their professional judgement when using the content in practice. It is the responsibility of the lawyer to refer to the most recent legislation, practice directions and any other appropriate sources.*

2. Overview of the Trust Safety Program

The Law Society benchers have taken a proactive approach to the regulation of trust accounts by implementing the Trust Safety Program which came into effect on April 1, 2019.

Under this program all firms operating a trust account must have an **approved trust account supervisor.**

The trust account supervisor is responsible for ensuring that appropriate controls, reporting, and record keeping are in place for all trust and general bank accounts operated by the firm.

In order to become an approved trust account supervisor, you must pass two thresholds:

1. Application to the Law Society:

    a) Submit a *Trust Account Supervisor Application Form*

    b) Applications will be reviewed with three possible results:

        i. approved;
        ii. conditional approval; or
        iii. denial.

2. Pass Trust Accounting Exam:

    a) Review the Trust Accounting Fundamentals resource materials

    b) Take online exam

Why? In 2017 the benchers developed a three year strategic plan. A major component of the strategic plan is for the Law Society to **regulate proactively** to protect the public interest by ensuring that legal services are delivered by competent and ethical lawyers. The strategic plan contemplates that the Law Society will proactively assist lawyers and law firms to mitigate risk. The Trust Safety Program is one initiative that has been implemented to accomplish these goals.

3. Relevant Legislation

The *Legal Profession Act* [the *Act*], the *Law Society Rules* [the Rules] and the *Code of Professional Conduct* [the *Code*] all contain definitions and rules about a lawyer's financial obligations and accountability for accurate and timely trust accounting.

The *Act*, the Rules and the *Code* are intended to ensure that:

- all clients' money and valuable property in the possession of a law firm is properly safeguarded;
- the law firm always keeps all client money in trust separated from the general money used to operate the law firm;
- the law firm has a proper record keeping system in place which provides contemporaneous details of all trust and general transactions;
- at all times, the law firm has a complete and current permanent record for all financial transactions on each client matter;
- the law firm creates a permanent audit trail with supporting documents, which can be seen by the Law Society at any time.

Remember:

It is important to understand and follow the Law Society rules in division 4: Financial Accountability.

Rule 5-56: **Failure to comply** with any of the rules in this division without reasonable excuse may constitute professional misconduct.

B. TRUST ACCOUNT SUPERVISOR

1. Requirements for All Firms

You are not permitted to handle trust money unless you have a pooled trust account. The pooled trust account is the trust bank account into which all trust money is paid before it can be used in any way.

As of April 1, 2019, only a firm with an approved trust account supervisor can open a trust bank account [Rule 5-42(1)].

a) New Firms

Effective April 1, 2019, any new law firm that wishes to open and operate a trust bank account must first have a practising lawyer approved to be the trust account supervisor and that person must complete the education program. Successful completion of the education program requires passing an examination. Only after the approved person has passed the examination can the firm open a trust bank account.

b) Space Sharers

Under Law Society Rule 5-42(3), independent (sole) practitioners who share space and certain common expenses with other practitioners, must maintain separate trust bank accounts and cannot deposit trust monies into a trust bank account operated by any other of those practitioners or law firms.

If you are practising in such an arrangement, you must be a trust account supervisor as described herein unless arrangements are made with the Law Society to have a designated trust account supervisor.

c) Designated Trust Account Supervisor

Whether you are practising in a firm, as a sole practitioner or you are in a space sharing arrangement, you have the option to designate a practising lawyer from outside of your firm to be your trust account supervisor. This individual will have to be approved and complete the education as in the ordinary course.

However, because this person is from outside of your firm, all clients of your firm will have to be advised at the outset of the retainer that such an arrangement has been made and that contractual steps will be taken to protect their confidentiality and privilege. In addition, the firm will have to conduct conflicts checks in each matter for the protection of the clients.

2. Becoming a Trust Account Supervisor

To be approved as a trust account supervisor, a member must complete and submit the required application, pay the required application fee and meet the criteria established by the Law Society.

Refer to the *Trust Safety Program Guideline* which sets out the criteria for approval, possible results of the approval process and how you can appeal an adverse decision to the Trust Safety Appeal Committee.

It is possible for a trust account supervisor's status to be revoked. The Trust Safety Program Guideline also outlines the revocation process.

3. Responsibilities of the Trust Account Supervisor

The trust account supervisor (or the designated trust account supervisor) is responsible for the controls in relation to the operation of all law firm trust bank accounts and general accounts, the accuracy of the law firm's reporting requirements and the timeliness and accuracy of the law firm's record keeping requirements [Rule 5-42.1(1)].

The trust account supervisor is responsible for any of these tasks that have been delegated to another person.

a) Controls

The trust account supervisor is responsible to the Law Society for controls in relation to all trust and general bank accounts for the law firm. "Controls" refers to the internal mechanisms to protect clients' trust monies from defalcation and from negligent and risky handling of such monies.

Although the trust account supervisor will not be held responsible for the misconduct of other lawyers in the firm, effective policies and procedures reduce the risk of such conduct occurring. As such, the trust account supervisor is expected to establish policies and procedures for matters such as:

i. handling of all forms of trust receipts;

ii. receipt of cash;

iii. requisition and authorization of all forms of trust account withdrawals;

iv. authorization of transfers between matters;

v. storage of trust cheques;

vi. use of restricted trust accounts or specific trust investment accounts;

vii. delivery of the firm's statements of account to clients prior to applying trust money to pay the account;

viii. maintenance and storage of trust accounting records in accordance with Law Society rules; and

ix. addressing inactive trust balances.

If a defalcation or fraud by other members or staff of the law firm occurs, the Law Society expects that the trust account supervisor would examine the controls in place at the firm and address any deficiencies so as to reduce the likelihood of such conduct in the future.

Note: In addition to the controls inherent in the Law Society rules, basic internal controls include but are not limited to the following:

- If you receive cash, it must be securely stored prior to deposit at your savings institution;
- Each and every disbursement of trust money must be supported by a source document that is reviewed by the cheque maker before affixing their signature to the trust cheque;
- Keep cheque stock in a secure location;
- In computerized accounting systems, your accounting system itself typically has numerous internal controls built into it that should be used. For example, each user should have their own user name and password which is kept private and changed regularly, and different levels of users can be have different levels of access, depending upon their role. No user should be able to change or delete entries. If you have a staff member who leaves, their access to your system should be removed.

b) Reporting

The trust account supervisor is responsible to the Law Society for accurately completing all reports to the Law Society relating to the law firm's trust bank accounts and general accounts.

i. Opening a Trust Account

This starts with ensuring the Law Society is notified within 30 days of the opening of a trust account.

Caution:

Notification is required any time a new trust account is opened, whether it be within days of being approved to be a trust account supervisor or years down the road.

ii. Annual Member Report

The Annual Member Report is to be completed by all practising lawyers. Trust Account Supervisors are required to respond to additional questions that relate to:

- statistical information regarding trust accounts operated by the firm;
- information regarding any cash received by the firm during the reporting period; and
- information regarding inactive matters.

iii. Contact Person for the Law Society

In addition, the Law Society administers a number of audit programs, including new firm audits, regular spot audits, ongoing monitoring programs and check-ups, often without advance notice to the firm. When conducting these audits, law society auditors will require access to accounting records and programs and may review client files. The trust account supervisor will be the Law Society's contact person for these purposes and perhaps at other times when information is required regarding the trust account(s).

As outlined later in these materials, law firms are required to store their three most recent years of trust accounting records at their primary place of business. It is a recommended practice that the trust account supervisor ensures other staff know the location of the accounting records in case the auditor arrives and the trust account supervisor is not immediately available.

iv. Reportable Events

Reporting requirements also include notifying the Law Society when a 'reportable event' occurs. While a reportable event might be a change to where the firm banks, it might also include a circumstance where the trust account has been compromised. Every trust account supervisor is asked to use their

judgment in determining when it is appropriate to contact the audit department.

Below are examples of reportable events:

- theft (trust or general account) suspected, attempted or otherwise;
- third party fraud on the trust account (e.g., fraudulent trust cheque) suspected, attempted or otherwise;
- negative balance in a client matter (the matter is overdrawn);
- trust account overdrawn;
- any firm trust cheque returned for insufficient funds; or
- new branch office or change in trust account branch location.

v. Closing a Trust Account

The trust account supervisor is also responsible for any reporting requirements related to the closing of a trust bank account. Examples of these types of circumstances include:

a) the firm is switching their banking from one savings institution to another and the old trust bank account is being closed;

b) the current partnership is closing and is creating a new partnership with other lawyers; or

c) a sole practitioner is retiring and winding up the firm.

In each case, the Law Society will need to be notified of the closure, although the requirements regarding the closure will vary based on the circumstances.

vi. To Cease Acting as a Trust Account Supervisor

Finally, if for any reason the trust account supervisor wishes to cease acting in that capacity, he or she is required to provide thirty days written notice to both the firm and to the Law Society.

c) Reporting to Canada Deposit Insurance Corporation

If any of the firm's trust accounts are maintained in a savings institution which is insured by the Canada Deposit Insurance Corporation ("CDIC"), the trust account supervisor must ensure compliance with the reporting and disclosure obligations set forth in the *Canada Deposit Insurance Corporation Act* and the Schedule thereto [Rule 5-53].

Effective April 30, 2022, lawyers qualify as a professional trustee under a new trustee category. However, to have and thereafter maintain status as a professional trustee, CDIC has specific requirements.

The Law Society of Manitoba requires a member or law firm to have, and thereafter maintain professional trustee status for firm trust accounts. This is because the alternative status of trustee does not protect client confidentiality and has significant reporting obligations not designed or suitable for a law firm trust account, therefore placing client funds at risk.

For further information, see *Practice Direction 00-01*

d) Record Keeping

As will be examined later in these materials, there are strict record keeping requirements for the firm trust bank accounts as well as the firm general bank accounts. These include daily entries in the books of original entry and the client trust ledgers as well as properly reconciling the trust bank account on a monthly basis.

The trust account supervisor's responsibility for these requirements will vary depending on the firm's circumstances.

A sole practitioner who personally keeps the books and records will be directly responsible for ensuring that they are maintained in a timely and accurate fashion in accordance with the Law Society's requirements. This trust account supervisor will be managing the records on a daily basis and will be ensuring that they are current at all times.

A trust account supervisor in a firm that has a capable and trusted bookkeeper or accountant is permitted to delegate that function. This trust account supervisor will not be required to have daily oversight of the trust accounting activities. However, he/she will be required, at a bare minimum to understand the bookkeeping requirements and to satisfy himself/herself from time to time that they are being met. Furthermore, this trust account supervisor is required to review and understand each

monthly trust reconciliation so as to be satisfied that it is being completed within the deadlines imposed and is properly reconciled.

If the firm were to lose the services of the trusted bookkeeper or accountant, the trust account supervisor would be expected to take on greater responsibility to ensure that the records were being kept current at all times and in a compliant fashion.

Practice Tip:

If you use the services of an accountant or bookkeeper and you maintain computerized records, ensure that you have your own login and password so as to ensure that you are not "locked out" of your own records.

For firms that have a relatively new bookkeeper or accountant, the trust account supervisor is expected to be actively involved in all aspects of the record keeping until such time as the bookkeeper has demonstrated a thorough understanding of the Law Society's unique requirements and a track record for compliance.

4. Trust Account Supervisor Absences

A trust account supervisor does not need to have a replacement trust account supervisor whenever he/she is absent from the office.

For sole practitioners who wish to take a vacation, the Law Society expects that the practitioner will have organized the practice so as to allow for that absence and can continue, as has been permitted in the past, to have another lawyer approved by the CEO to act as a signing authority on the trust account in the event of an emergency of some kind. This lawyer does not necessarily have to be a trust account supervisor.

However, with any trust account supervisor, if the individual's absence will be for an extended period, there is an expectation that another trust account supervisor will be put in place to review the monthly reconciliations and to be satisfied that trust money is appropriately handled and the books and records are being managed in a compliant fashion.

C. TRUST BANK ACCOUNTS

"Trust bank account" is the umbrella term that includes all of the law firm accounts at the savings institution which contain or will contain trust money.

The three types of trust bank accounts that a law firm might have and for which a trust account supervisor is responsible are:

1. a pooled trust account which is a trust bank account opened for the benefit of a number of clients;

2. a specific trust investment account which is not a pooled trust account;

3. a restricted trust account which is a specialized pooled trust bank account.

Each type of trust bank account serves a different purpose.

There is no limit to the number of each type of trust bank account that can be opened and operated by a law firm. However, the trust account supervisor must ensure that the law firm follows the *Act*, the Rules and the Practice Directions for every trust bank account, no matter what type is opened.

1. Pooled Trust Account

If a member is going to handle trust money at any time, the law firm must have a pooled trust account to hold that trust money. The law firm does not open a separate trust bank account for each client or client matter in order to accept trust money. The law firm pools all the clients' deposits of trust money together in one trust bank account called a pooled trust account.

The interest earned on the pooled trust account is paid to the Manitoba Law Foundation in accordance with a letter of direction that is provided to the savings institution at the time the pooled account is opened.

Every member or law firm that handles trust money must have and maintain a pooled trust account.

Opening a Pooled Trust Account

The trust account supervisor is not expected to personally open every new pooled trust account for the law firm, but the law firm cannot open a new pooled trust account unless the law firm has a trust account supervisor.

The trust account supervisor is responsible for ensuring that all of the rules are followed when any new pooled trust account is opened.

To ensure that the client's money is protected and tracked, there are specific rules about the pooled trust account that must be followed and the trust account supervisor needs to be familiar with those rules in order to ensure the trust bank accounts conform with the rules.

Directions to the Savings Institution

When it's time to open a new pooled trust account, you will need to:

1. Ensure that the savings institution you wish to use can provide the services you want while meeting the Law Society's criteria for the operation of the trust bank account, as follows:

    a) The pooled trust account must be opened as a trust bank account at a savings institution. A savings institution is defined as a Manitoba branch of a chartered bank or a trust company that is authorized by law to receive money on deposit and is insured by the Canada Deposit Insurance Corporation, or a credit union or caisse populaire incorporated under *The Credit Unions and Caisses Populaires Act*.

    b) The pooled trust account must be an interest-bearing chequing account.

    c) The savings institution must provide the law firm with a monthly account statement for each pooled trust account that corresponds with the calendar month. This is necessary so that the trust account supervisor can ensure the law firm's accounting records are balanced with the savings institution records each month.

    d) The savings institution's service charges for servicing the pooled trust account must be taken by the savings institution from the law firm's general operating account and NOT from the pooled trust account.

e) The savings institution must be able to provide legible images of the front and back of all cleared cheques or the actual cleared cheques for the pooled trust account at the end of each calendar month.

f) Online access to the pooled trust account must be limited to "read only". The law firm is not permitted to have the capability to make any on-line withdrawals, payments out, or transfers from the pooled trust account**.**

g) Deposits to the pooled trust account may be made through an ATM provided the debit card is set up as a "deposit only" card. Just as with the online access, the law firm is not permitted to make withdrawals, transfers, or bill payments from the pooled trust account using a debit card and therefore, the pooled trust account and bank card must be appropriately restricted.

Once you select a savings institution that can meet the above criteria, you must take steps to ensure the minimum services (b) through e)) and any optional services (f) and g)) are provided correctly.

2. Provide a Letter of Direction to the savings institution, as required by section 50(2) of the *Act*, which directs the savings institution to remit the interest earned on that pooled trust account to the Manitoba Law Foundation. The Law Society audit department has created a standard form *Letter of Direction* to assist in meeting this obligation.

3. Designate the trust account as a professional trustee account with your savings institution if it is with a chartered bank or trust company that is insured by the Canada Deposit Insurance Corporation. See *Practice Direction 00-01 Canada Deposit Insurance Corporation Reporting.*

4. Ensure that:

a) the pooled trust account is opened in the name of the law firm (example: Red & Red LLP Pooled Trust Account);

b) the pooled trust account statement from the savings institution states that it is a trust bank account;

c) within 30 days of the opening of any new pooled trust account, the trust account supervisor notifies the Law Society that the new pooled trust account has been opened and the notice must include:

I. the date the new pooled trust account was opened,

II. the name and branch and address of the savings institution in which the new pooled trust account was opened; and

III. the account number and type of the new pooled trust account.

The Law Society will also be requesting receipt of a copy of the Letter of Direction, so it is easiest to include a copy with the notification of the new trust account;

d) trust cheques are ordered for each pooled trust account and the stock of trust cheques is securely stored at the law firm and subject to controls;

e) the cheques used to draw on the pooled trust account must be consecutively numbered; and

f) a decision is made about whether the trust cheques on the pooled trust account will require one or two authorizing signatures. Remember that at least one signature on all trust cheques must be the signature of a lawyer practising at the firm who is a member of the Law Society. Employees who are not lawyers may sign a trust cheque but only if a practising lawyer in the law firm signs in conjunction with the employee.

Practice Tip:

It is important to communicate the special nature of the trust account to the law firm's chosen savings institution. Although some savings institutions deal regularly with lawyers and understand trust bank accounts, they still can make such basic mistakes as charging bank fees to the pooled trust account instead of the general operating account.

Some law firms have a special colour for the trust cheques so that they can easily be identified and distinguished from the law firm's general operating account cheques and other trust bank account cheques.

For cheque stock, it is a good idea to have the words 'trust account' printed on the face of the cheque somewhere, so all parties who come into contact with the cheque are aware it's a trust account cheque subject to the trust account rules. It also helps prevent confusion with the member's general account cheques.

2. Specific Trust Investment Account

If you have a client who is giving you a substantial amount of trust money that will have to sit in your trust bank account for a lengthy period of time and the client wants to collect the interest on that trust money, it is possible to put the trust money or any part of it into a specific trust investment account for that client.

Specific trust investment accounts can only be opened by a member or law firm in trust for a specific client at a savings institution. If the savings institution is a bank or trust company insured by the Canada Deposit Insurance Corporation, the specific trust investment account must be designated as a professional trustee account. See *Practice Direction 00-01 Canada Deposit Insurance Corporation Reporting.*

The specific trust investment account must be interest-bearing and is limited to a daily interest savings account, a term deposit or a guaranteed investment certificate. All the interest earned on the specific trust investment account is ultimately received by the specific client.

Depending upon the nature of the practice in the law firm, it is possible that a law firm may never open a specific trust investment account.

3. Restricted Trust Account

All land titles registrations in Manitoba are electronic and are managed by Teranet Manitoba LP.

If a member or law firm will be dealing with real estate transactions and wants to use electronic funds transfers of trust money to pay the land transfer tax and registration fees through the Teranet eRegistration portal, the law firm will need to open and maintain a restricted trust account.

The law firm's restricted trust account is a specialized pooled trust bank account created for the sole purpose of accommodating the transfer of trust money for land transfer taxes and registration fees during eRegistration.

Not every firm will want or need a restricted trust account. Although the restricted trust account is a type of pooled trust bank account and therefore must meet all pooled trust account requirements including those listed in "Directions to the Savings Institution" in Section 1 above, it is not to be confused with the pooled trust account.

If you do not do any real property transaction work, you will not need a restricted trust account.

D. HANDLING OF TRUST MONEY

1. Trust Money - The Client's Money

When a member or law firm receives money in connection with their legal practice to be held for the benefit of the client, that money is trust money. All trust money must be paid into the law firm's pooled trust account and recorded in the trust accounting records before being used or disbursed in any way.

Trust money does NOT belong to the law firm or member even though it sits in a law firm's trust bank account.

Trust money belongs to the client and the client must be informed and give prior consent to any use of that trust money by the member or law firm.

Some examples of trust money include:

- the sums paid as a retainer to pay for future legal services;
- any money received in relation to a client's purchase of property;
- the proceeds of a mortgage to purchase property;
- any money received in relation to a client's sale of property;
- money paid or received to settle a legal dispute;
- money received but intended to be paid out on behalf of a client; and
- money received from an estate.

Caution:

Trust money does not belong to you. It remains the property of the client. There are specific important rules that govern how trust money must be handled by the member and the law firm.

> *"One of the top reasons lawyers are disciplined or even disbarred is trust accounting done badly or ignored. Don't become part of that statistic!"*
>
> *–Trust Accounting in One Hour for Lawyers ~Sheila M. Blackford*

To complement the basic principle that trust money is the client's money, there are a number of very specific rules:

- Only trust money that is directly related to legal services that the member or law firm is providing may be deposited to or withdrawn from a trust account [Rule 5-44(1)(a)];
- At all times there must be sufficient money in the trust bank account to meet the member's obligations to all clients with respect to trust money [Rule 5-44(1)(j)].
- A member cannot:
    - overdraw a trust bank account [Rule 5-44(1)(g)];
    - pay any personal or business related expenses from the trust bank account [Rule 5-44(1)(i); or
    - appropriate trust money or other property for fees without the express or implied authority of the client [Rule 5-55].
- Only trust money can be kept in a trust bank account [Rule 5-44(1)(l)].

2. Types of Deposits

When money from a client or on behalf of a client is received by you in any form, you must deposit the trust money to the pooled trust account "as soon as practicable", as required by Rule 5-44(1)(b).

In practice, "as soon as practicable" means within one or two days of the date of receipt.

Practice Tip:

If you get the $1000 retainer on Friday, you should deposit that $1000 into your trust account no later than Monday!

Note: If a client provides you with one cheque to pay an outstanding account and for a retainer against future fees, the cheque must be deposited into the trust bank account and then, after an appropriate hold period, the monies can be transferred to the general bank account to satisfy the account.

Trust money can be received in a variety of forms.

a) e-Transfer

If a client wants to provide trust money via Interac e-transfer, the firm may accept the money, although only if:

i. your online banking software – properly restricted to be 'read only' access – allows you to direct the receipt to your trust bank account. Trust money cannot pass, however briefly, through any account other than a trust account; and

ii. any related fees are charged only to your general bank account.

Caution:

For some savings institutions, read-only access is incompatible with receiving Interac e-transfers. If your pooled trust account is with such a savings institution, you cannot receive trust money by e-transfer.

b) Credit/Debit Cards

There are many variations in firm practices in this area.

Some firms have policies that prohibit receipt of trust money by electronic payments and instead will only accept these payment methods for the general account.

It is permissible to accept both trust and general money by credit/debit card. Those firms that do, however, must follow these requirements:

i. If there is only one terminal or merchant number set up with your electronic payment service provider, 100% of all receipts must be deposited to your pooled trust account. For payments that belong to the general account, you must receipt and record it fully in the pooled trust account, followed by a trust cheque to pay it to your general account once you have confirmed that the deposit has been received in the trust account. Service fees are sometimes deducted from the amounts being deposited, so if you are charged 2 ½ percent for every $100 deposited, most providers want to only deposit the net $97.50 for every $100. This is no different than any other bank charge that

must not be made on the pooled trust account and must instead be directed to the general account.

ii. There may be a difference between processing individual transactions and then later submitting the batch to your service provider which will ultimately result in the money being deposited to your account. So, if you have a client come in on Monday and you process a debit card transaction for $200 for him, followed by another client for $300 the following day, but you do not submit the batch to your provider until Friday, you are in violation of the requirement to deposit trust money as soon as practicable [Rule 5-44(1)(b)], as you have been holding the $200 for 4 business days and the $300 for 3 business days without depositing them to your trust account.

iii. Depending on the provider and type of card (Visa vs. AMEX, for example), there may be a delay between submission of the batch and deposit of the money in your bank account. If you need to access the money quickly for a disbursement, or if the money is destined for the general account to pay an account you already rendered, you need to ensure the money has actually been deposited to the trust account before writing that cheque.

As a general precaution, due to privacy legislation it may be difficult to follow up with your service provider to obtain details regarding the transactions afterwards (such as the name of the related cardholder). Further, most terminals create those little pieces of paper as receipts which can be easy to misplace. You must be very careful in your office procedures if you are planning to receive electronic payments to address these risks.

c) Client Direct Deposit to the Trust Account

Firms are allowed to receive trust money by a client attending a branch of the firm's savings institution and depositing money directly to the firm's trust account. While only rarely done, a firm wishing to implement this practice should know that this practice is risky, as it complicates record keeping, you cannot physically assess the authenticity of the cheque or draft, and you must still ensure compliance with the cash limit rules even though it is being deposited directly to your trust account by the client. If you decide to allow it despite these drawbacks, you must:

a) Communicate clear instructions to the client before depositing the money:

   i. There will be a delay before the firm can make use of the funds, as the firm will need to follow up with the savings institution for each receipt (see below for more information);

   ii. Cash over $7,500 in a single transaction or in the aggregate cannot be deposited to the trust account and any excess must be returned to the client in cash;

   iii. The client must advise the firm immediately after the deposit has been made, preferably providing a copy of the deposit slip. Otherwise, it may be difficult to trace which client provided the money after-the-fact, particularly if more than one client has made a retainer deposit of the same dollar amount at a similar time.

b) This deposit method will not shorten the time of any waiting period to disburse funds that would otherwise apply. Confirm available funds before disbursing;

c) Follow up with the savings institution to trace the deposit and confirm the nature of the funds deposited (cash, cheque, bank draft, etc.), appropriately identify the payor of the funds, and recommend obtaining a copy of the instrument;

d) Return to the client in cash, with appropriate receipting, any cash in excess of the $7,500 limit received; and

e) Ensure the accounting records clearly identify the unique nature of this deposit, identifying it as a 'remote client-initiated deposit' or something similar.

d) Remote Deposit Capture

Remote deposit capture is a technology used by some firms to deposit money to a trust or general bank account without leaving their office.

For those who wish to adopt this technology, there are a number of requirements:

   i. The system must use a specialized scanner approved or available through your savings institution. Scanning or taking a photo with a portable device such as a tablet or cell phone is not allowed;

ii. The system must use a secure platform for connecting between the law firm and the savings institution;

iii. For the pooled or restricted trust account, any fees must be charged directly to the general account and not deducted from the deposit;

iv. All supporting documentation must be printed and maintained in hard copy format or saved in a universally readable format; and

v. All remote deposits must be directed to the appropriate account – pooled, restricted, or general account.

3. Withdrawals

Generally, the only way to pay money from the trust account is by using a cheque made payable to the person to whom the money is to be paid [Rule 5-44(1)(c)]. There are only a few narrow exceptions regarding cash refunds, wire transfers and bank drafts which are discussed below.

a) Trust Cheques

The cheque used to withdraw money from the pooled trust account must have pre-printed numbers on the cheque stock, and the cheques are to be used in sequential order [Rule 5-44(1)(c)].

In addition, a trust cheque must be fully completed *before* it is signed, and cannot be post-dated [Rule 5-44(1)(f)].

Under no circumstances should a blank trust cheque be signed.

b) Wire Transfers

Wire transfers are NOT the same as e-transfers. Wire transfers are done between financial institutions. e-Transfers can be done by anyone with that option on their account and with any computer or smartphone. Interac is a common company that facilitates e-transfers. You are not permitted to make an e-transfer out of the pooled trust account.

There may be situations where use of a wire transfer would be better than a cheque to withdraw money from the pooled trust account. This is one of the rare exceptions to the rules requiring cheques. Although advantageous, their use also raises some concerns about the security of the money, so there are specific steps that must be taken by the member both prior to and subsequent to execution of a wire transfer.

See *Practice Direction 03-02 Wire Transfers – Requirements and Fraud Prevention*.

Members wanting to send a wire transfer must first read the Practice Direction and then log into the member's portal on the Law Society's website.

When logging in, the member will be asked to confirm the various steps outlined in the Practice Direction have been taken.

Assuming all steps are followed, a confirming response will be received by the member (and by the audit department as well), after which the wire transfer may proceed.

Members who need to perform wire transfers on a regular basis due to the nature of their practice can contact the audit department of the Law Society to discuss the possibility of special authorization to perform wire transfers without prior contact with the Law Society for each one executed.

Caution:

Wire transfers, both received and sent, are particularly vulnerable to fraud. Ensure that you are aware of the types of fraud attempts and how to *prevent* them.

c) Bank Drafts

There are some cases where it may seem better to use a bank draft instead of a trust cheque to send trust money. Sending estate money to a beneficiary located outside of Canada is a common example of the desire to use a bank draft or a wire transfer. A bank draft, when used, must be purchased with a trust cheque at your savings institution. However, there are a number of special considerations when using a bank draft, including:

a) Money is immediately withdrawn from the trust account when a draft is purchased, compared to a cheque where the money does not leave your bank account until the cheque is received and cashed.

b) Once the draft is purchased, it becomes more like cash than a cheque. The draft generally cannot be cancelled without the return of the original bank draft or potentially with a bond of indemnity which would transfer

responsibility for the original draft back to the firm if it is ever presented for payment at a bank after a replacement has been issued. By contrast, you can generally place a stop payment on a cheque, with the terms of such a process varying among savings institutions.

c) Drafts which remain uncashed after 10 years are generally paid over by the savings institution to the Bank of Canada, whereas stale cheques can be cancelled, a stop payment issued, and the money remains under the control of the law firm.

In situations where a draft is still the preferred method of payment, the Law Society requires firms to clearly indicate in the accounting records that a draft was purchased and the name of the end recipient of the draft (as opposed to just showing the name of the savings institution that converted the trust cheque to a draft). A copy of the draft should also be kept in both the client file and the monthly accounting records.

The Law Society also recommends advising the end recipient of the importance of securing and promptly negotiating the draft. Firms should also safeguard the delivery of the draft in some manner, such as by courier, registered mail or some other secure method where a signature is required by the recipient.

4. Confirming Funds are Available – "Hold Periods"

Prior to disbursing any trust money on any matter, you must ensure sufficient money is held in trust for the matter. While this starts by checking the balance in the client trust ledger, it doesn't end there.

The Law Society requires that the availability of funds be confirmed by:

- checking the client trust ledger;
- where electronic funds are being received, checking the pooled trust account to ensure the funds have been deposited;
- establishing and adhering to law firm policy for appropriate methods of payments from clients and any related hold periods. Hold periods should be determined by firms through consultation with their savings institutions; and
- investigating any 'red flags' that may occur at any point in the confirmation process.

Practice Tip:

Personal cheques always have a recommended hold period, often four or more days.

You will want to confirm that funds are available **any time** money is being paid from a client trust ledger, whether it is by issuing a trust cheque (or in those rarer cases, sending a wire transfer, or purchasing a bank draft), or even a transfer of funds between client ledgers (transfers are discussed in the next section).

5. Payments to Teranet Manitoba

Specific bookkeeping obligations arise when payments are made to Teranet Manitoba for real property transactions.

In addition to bookkeeping obligations, client file report requirements arise for many payments to Teranet regardless of what payment method is used to pay the related Teranet fees. In particular, the law firm must use the client file report received from Teranet which confirms the use of the money provided by the firm, compare that to the accounting records in the law firm and reconcile any discrepancies [Rule 5-47(4)]. In addition, as a source document for your trust account, you must file a printed or electronic copy of the client file report in the client file, saving it in a universally readable format if it is saved electronically [Rule 5-43(1)].

If you are planning to make payments to Teranet using trust or general account money, you should review the Law Society's *eRegistration requirements* and *FAQs*.

6. Transferring Funds Between Client Ledgers

While receipts of trust money or writing a trust cheque are routine transactions on a pooled trust account, there is a third type of transaction that may happen. There may be occasions on which the law firm needs to be able to transfer money from one client trust ledger to another client trust ledger. While these are permitted, it is essential to ensure that the proper bookkeeping accompanies these transfers. Please refer to the section on Record Keeping for a detailed explanation of those requirements.

7. Cash Transactions

To combat money laundering, lawyers are not permitted to receive cash in excess of $7,500 in respect of any one client matter. Unless it falls within one of the exceptions, if any party attempts to deliver cash in excess of that amount, lawyers are required to return the cash to the party. The party can be directed to attend at a financial institution, deposit the funds and obtain a bank draft.

It is important to note that the $7,500 limit is an aggregate amount. So, if a client were to provide $5,000 cash toward a purchase of an asset and later arrives with an additional $3,000, the lawyer could accept only $2,500 of the latter sum. Any additional sums received from the client or from any party on that matter would have to be by cheque or some other means other than cash.

There are exceptions. The $7,500 restriction does not apply when the cash is received in connection with the provision of legal services:

- from a financial institution or public body;
- from a peace officer, law enforcement agency or other agent of the Crown acting in an official capacity; or
- to pay a fine, penalty or bail.

Note:

Cash transactions have specific record keeping requirements. These will be outlined in the Record Keeping section.

A further exception relates to professional fees, disbursements or expenses. A lawyer can accept cash in excess of $7,500 for one of those purposes, provided that any refund out of such receipts is also made in cash. For example, a lawyer would be entitled to accept a $50,000 cash retainer from a client. If, however, the client's legal matter does not materialize and the file is concluded after the lawyer has billed $4,000 in fees, the balance of $46,000 must be returned in cash to the client.

Did You Know?

Some firms have a policy of not accepting cash from clients. That is a business decision. If you do decide to accept cash, you must ensure the specific requirements regarding cash are adhered to for each and every transaction.

E. RECORD KEEPING

1. Choosing an Accounting System

It is the trust account supervisor's responsibility to ensure that a proper and effective record-keeping system is in place. This includes maintaining up-to-date trust records and preparing the required reconciliations on a monthly basis.

The first decision you will need to make is whether you wish to use a manual or electronic accounting system. Many members who still use a manual system seem to feel that they should be using computers instead. They shouldn't feel that way.

Each system has its advantages and disadvantages.

A manual system is well suited to a member who doesn't have a significant volume of trust transactions. It is also inexpensive and may be easily adapted to meet the member's needs, while still complying with the rules. Simple basic journals and ledgers may be purchased at any office supply store, or some practitioners even use the audit department's *templates*. A new practitioner may wish to hire an accountant/bookkeeper to help set up the required bookkeeping system. It is also useful to talk to other members with similar practices to see what system has worked well for them. You may also contact an auditor of the Law Society of Manitoba for direction.

Those finding the manual system time consuming may wish to switch to an electronic (computerized) system.

An electronic system can provide a wide range of timely information which is not quickly obtained when using a manual system. Other benefits include ease of recording transactions, eliminating certain types of errors, and various controls which are built into some of the systems. However, the system is more expensive to acquire and maintain.

An additional option would be a 'semi' electronic system where a spreadsheet program such as Excel is used. While the fluent user of the program can set up various spreadsheets for the records and usually eliminate addition errors, it lacks some of the controls built into specially designed accounting software.

Caution:

When converting accounting systems, you must preserve the records from the prior accounting system. When converting from a manual system to an electronic system, you must retain the manual records in accordance with the Society's record storage requirements. This should be not be any different than your usual record storage practices.

However, additional steps at the time of conversion are required if you are converting from one software to another. In particular, you must preserve the full history for the current matters that have balances in trust from the prior system by either:

- importing historical data into the new software. This is more than just the balances at the time of conversion, it is all of the underlying transactions that led up to the balance when converting. For example, if a matter being converted had $775 in trust at the time of conversion and had historical transactions of a $1,000 retainer receipt and a $225 payment for filing a statement of claim, the two historical transactions of the receipt and the payment must be imported into the new system, not just the $775 balance; or

- entering only the current balance in the new software for each matter and printing a copy of each client trust ledger with a current balance. This can be either a paper copy or electronic copy saved in a universally readable format. Following the above example, this would document the $1,000 retainer and the $225 payment, which would be used together with the data in the new software for later transactions to form a complete history for the matter.

It is also a good idea to maintain one license of your prior software for a period of time to allow for ease of looking back for earlier records if anything was missed at the time of conversion.

2. Required Records

The two most fundamental accounting records that are needed for each and every transaction on a trust bank account are the book(s) of original entry and the individual client trust ledgers for each client matter [Rule 5-43(1)]. These records may be referred to by other names if you use an electronic accounting software.

You will use the book(s) of original entry to record each trust transaction and the individual client trust ledgers to record each trust transaction related to that client matter. They are key records.

a) Book(s) of Original Entry

A book of original entry is defined in Rule 5-41 as a book or books used to capture each and every financial transaction that takes place in the law firm for all client matters, in chronological order and in full detail. The term "book of original entry" is not a commonly used term in accounting, and this record is commonly referred to as the journal in accounting language as well as in some accounting software for law firms.

The plural, 'books' of original entry means it is possible that a member may use a number of books together as the permanent records.

The number of books of original entry you use is up to you.

Practice Tip:

Some members have a separate book used for recording receipts, another book for recording disbursements, and another book for recording transfers among accounts.

According to Rule 5-43(6), if your book of original entry is hand written then each entry must be recorded in **ink**.

All entries are recorded in the book of original entry at the time the transaction is done – no backdating allowed. No erasures, deletions or corrections are permitted to be made on an existing entry. So, to correct an error (such as cancelling a trust cheque) do not change the original entry. Instead, make a new entry using the current date, in a negative dollar amount. The new "reversing" entry cancels the original entry.

Every time you have a transaction, you must record it right away, as Rule 5-43(7) requires the trust records to be current at all times.

Examples of entries that will be recorded in a book of original entry include a receipt from a client, a trust cheque you are writing to another lawyer, or a transfer you need to make between client matters.

Remember:

Your pooled trust account cheque stock is pre-numbered and must be used in sequence. Even a cheque that has been accidentally damaged and rendered unusable, should be recorded as a void cheque in the book of original entry. Write "VOID" across the cheque and keep it with your accounting records. Do not throw it out or shred it.

Rule 5-41 requires you to record the "form in which the trust money is received" in your book of original entry. If someone gives you money, you 'receive' it. Examples of the form of money you may receive include cash, cheque, bank draft, wire transfer or an interac e-transfer. This is the 'form' of receipt, and you must record the form of receipt in your book of original entry for each and every receipt of trust money.

You can find a sample of a book of original entry completed for sample fact scenarios *here*.

Note: The book of original entry and the client trust ledgers must record the payor of each receipt. A payor is the person or entity paying and should not be confused with:

- The client, in cases where a third party is the payor. For example, if a retainer in a criminal law matter is paid by the defendant's parents, your records must reflect that the money was received from *parents' name* for *client name*. Both parties must be recorded;
- The bank when a bank draft is received. Although the bank is the payor when mortgage proceeds are received, it is not the payor when a retainer or cash to mortgage is received. So, while the payor for the bank draft can be the bank, it often is not; and
- The source of funds, as required by *the client identification and verification rules*.

b) Client Trust Ledgers

Keeping track of the trust money specific to the client matter.

A book of original entry will track everything that happens in the pooled trust account for all clients together. However, you still need to track the transaction for each client matter separately from all other matters, even if the matter is for the same client [Rule 5-43(1)].

For this, you use client trust ledgers.

In the client trust ledger (as well as in the book of original entry), you must record the full details of a transaction as it happens, keep the transactions in chronological order, and ink must be used if entries are hand written [Rules 5-41, 5-43(6) and (7)].

You may not make erasures for corrections or adjustments.

In addition to tracking every transaction, the client trust ledger must also show the running balance of the client's share of the pooled trust account after each transaction is recorded [Rule 5-41].

Under Law Society Rule 5-44(1)(h), you are not allowed to overdraw a client's trust ledger because you cannot use money from the pooled trust account that belongs to other clients to make up one client's shortfall. You must always check the client trust ledger before disbursing any money on behalf of the client to be sure that there is enough money in that client ledger to cover the payment you want to make.

Practice Tip:

While the rules require that the "form in which the trust money is received" must be recorded in the book of original entry, it is a good practice to also record it in the client trust ledger, so that whenever you receive cash, you can easily check in a central location if cash has already been received on the matter before accepting the money. This will help you comply with Rule 5-45.

You can find sample fact scenarios with a number of completed client trust ledgers *here*.

c) Transferring Funds Between Client Ledgers

One of the unique accounting needs in a law firm relates to making transfers between client trust ledgers. Sometimes, money needs to be transferred from one client trust ledger to another client trust ledger.

Transfers are generally not a daily occurrence, especially in a new practice.

From a bookkeeping perspective, the transfers must be recorded in both the book of original entry, as well as the affected client trust ledgers [Rule 5-41]. Remember that full details must be recorded.

Transfers can be between two different matters for the same client, or two different clients. Although the bookkeeping effect is the same, the requirements that precede the transfer differ, as set out below.

i. Transfers between two different matters for the same client

No money held in one client trust ledger may be transferred to another client trust ledger to pay a statement of account without the client's prior informed consent in writing or verbal consent confirmed in writing.

Example 1:

Assume you act for Client X who is both selling one house and buying another house. You will have a client trust ledger for each matter. Client trust ledger A for the sale and client trust ledger B for the purchase are both in the name of the same Client X.

Further assume that you have completed the legal work for the purchase of the house and you have delivered a statement of account to Client X for that matter, and it is recorded in client trust ledger B. Assume there is no balance left in client trust ledger B, but there is a trust account balance left in client trust ledger A.

Before you can transfer the money in client trust ledger A to pay for the fees and disbursements owing by the same client in client trust ledger B, you must obtain the express consent of Client X in accordance with Practice Direction 88-02. Consent must be fully informed and voluntary, as defined in the Code of Professional Conduct.

ii. Transfers between two different clients

For transfers between one client's client trust ledger and a different client's client trust ledger, you must have prior authorization of the client and it must be in writing or confirmed in writing.

Example 2:

Assume one client trust ledger is for Client C who is purchasing some land from Client D. Client D will have a separate client trust ledger. Client C and Client D have been informed about the potential for conflict and have given written consent to you to act for both of them in the real estate transaction. Since the client trust ledgers are for different clients, no transfer of money can be made from the client trust ledger for Client C to the client trust ledger for Client D without the prior written consent of Client C; or the prior verbal consent of Client C followed by written confirmation of Client C's consent, as required by Rule 5-44(1)(k).

Remember:

For either type of transfer, you should keep the authorization as a supporting document.

Caution:

It is a **common error** for trust transfers to be recorded only in the client ledgers. Remember that each trust transfer must also be recorded in the book of original entry.

d) Duplicate Receipt Book

Many members use a duplicate receipt book whenever money is received from a client. A duplicate receipt book allows a copy to be given to the client for their records, and a copy to remain in the duplicate receipt book for the member's accounting purposes.

If a client pays with a cheque or bank draft, you have the option of using a receipt book or not, as it is not required by the rules for non-cash receipts. It is a good business practice to give a receipt for a cheque too; it helps you keep track of all trust money. Based on the unique nature of bank drafts discussed earlier, it is also a good practice to receipt bank drafts.

e) Receipts for Cash

However, if a client provides you with cash, a duplicate receipt book **must** be used. Each receipt must identify or contain the following regarding the cash that is received [Rule 5-45(2)]:

i. the date;

ii. the payor name;

iii. the amount;

iv. the client name;

v. the file number;

vi. two signatures – one from the person receiving the money on behalf of the firm AND one from the person providing the money.

It is also important to note that both the payor **AND** the client name are required. While this is often the same person, law firm staff must be alert to also document the name of the payor in circumstances where it is different than the client.

f) Supporting Documentation

When you opened your pooled trust account, you would have made arrangements with your savings institution to get a statement every month with a full record of all activity on the pooled trust account. This includes cheque images of the front and back of each pooled trust cheque that the bank processes for payment. These are essential records for the trust account that must be obtained or received from your savings institution at least monthly.

In addition to the book of original entry, client trust ledgers, and monthly reconciliations, you must maintain supporting documentation for all pooled, restricted and specific investment trust accounts, as well as the general account [Rules 5-43(1) and 5-48(1)].

Such supporting documentation includes, but is not limited to, deposit slips, bank statements/passbooks, receipt books, statements of account issued by the firm, third party invoices/receipts and negotiated/cleared cheques (either as originals or cheque images).

3. Illustrations

(Handling of Trust Monies and Record Keeping)

a) Steps to Follow when Receiving Trust Money

For illustration purposes, assume you are using a manual accounting system. While the steps are similar for computerized accounting systems, how you set up a client or create the client trust ledger would be different for the two types of systems.

Example 1:

You are meeting with your first client, and at the end of the meeting, the client writes a cheque payable to your firm to retain you to act. What do you do?

Trust money received: You will need a duplicate receipt book, the book of original entry, a client trust ledger & deposit record.

STEP 1: Give the client a receipt for the money from your **duplicate receipt book**. Even though it is a cheque, it is good practice to get used to giving every client a written receipt from your duplicate receipt book any time you receive money from the client. Some lawyers regularly meet with clients at places other than the office. If this is you or a member of your firm, you should be carrying a small receipt book separate than the one at the main office. A duplicate receipt book protects you and protects the client.

REMEMBER: if the client gives you CASH as the retainer, you MUST give the client a written receipt from your duplicate receipt book, specific information needs to be recorded on the receipt **AND** both you and the client must sign the receipt.

STEP 2: **Record in the book of original entry** that you received the money, that the money was received by cheque, who gave the money to you, what client and matter the money is for, the date you received the money, that you gave a duplicate receipt and the file number if one exists.

STEP 3: **Create a new client trust ledger** for the new client and record the receipt of the money including all the same details you included in the book of original entry.

STEP 4: **Deposit the money to your pooled trust account** as soon as is practicable (within one or two business days) and get a **deposit record from the bank/savings institution.** For most firms, this is accomplished using a deposit book to list the details about what is included in the deposit and the bank teller stamps the deposit book when it is processed.

Example 2:

You need to file a statement of claim for the above client, and wish to use the client's money in the pooled trust account for the filing fee disbursement. What are the steps to be able to make a payment out of the pooled trust account?

b) Steps to Follow when Paying Monies Out of Trust

STEP 1: Check that the pooled trust account has sufficient money held for the client. In order to find out if this client has enough money in the pooled trust account to pay for the disbursement, you must confirm the funds are available, as described in the prior section, as you cannot overdraw any client's client trust ledger.

STEP 2: If you have completed Step 1 and the result is that there are confirmed available funds to cover the cheque, prepare the trust cheque. The trust cheque must be completed with the current date, the amount, the payee [here the Minister of Finance for the statement of claim filing] and the client file number BEFORE it can be signed. A trust cheque must be signed by at least one lawyer in the firm.

STEP 3: Record all the particulars in your book of original entry related to the fact that you wrote a trust cheque on the pooled trust account including the purpose (to pay for the expense of the filing fee for a statement of claim) the payee (payable to the Minister of Finance), the date, the file number for that client matter. Full information for the withdrawal of the trust money must be recorded.

STEP 4: Record all the particulars in your client trust ledger for that client matter related to the fact that you wrote a trust cheque on the pooled trust account including the purpose (to pay for the expense of the filing fee for a statement of claim) the payee (payable to the Minister of Finance), the date, the file number for that client matter. This is because full information for the withdrawal of the trust money must be recorded in the client trust ledger as well as the book of original entry.

c) Steps to Follow When Transferring Between Client Trust Ledgers

STEP 1: Obtain the client's authorization to transfer the monies and document it.

STEP 2: Confirm that there are funds available as described in the prior section.

STEP 3: Record the transfer in the book of original entry. Full details about the transfer must be recorded, usually as a separate line for each matter affected by the transfer.

STEP 4: Record the transfer details in both affected client trust ledgers. Full details about the transfer must be recorded.

You can find example transactions for a newly opened law firm, together with a fully completed book of original entry and client ledgers *here*.

4. Record Storage

a) Three Years of Current Records

Sometimes storage of multiple years of accounting records becomes cumbersome. Should you want to keep these records in a place other than your office, keep in mind that you must maintain the most recent three years at your chief place of practice in Manitoba, unless otherwise authorized by the Law Society [Rule 5-54(2)].

b) Ten Years of Historical Records

As for older records, all trust books, records and accounts (including supporting documentation) must be kept for no less than ten years [Rule 5-54(1)(a)].

c) Electronic Storage

Provided that the requirements outlined below are met, the following are acceptable alternatives to paper storage of records [Rules 5-43(2), 5-43(5) and 5-54(1)(b)]:

Book of Original Entry	Save in a universally readable format immediately after each month end
Monthly Trust Reconciliation (and related supporting documents)	Save in a universally readable format no later than the last day of the subsequent month
Client ledger upon closure of file	Electronic copy in a universally readable format on the electronic file
Monthly bank statements and cheque images (trust and general bank accounts)	Save in a universally readable format no later than the last day of the subsequent month end[1]
Purging of electronic records	Save in a universally readable format

** [1] It is important to note that monthly bank statements and cheque images saved electronically must reside on the law firm's electronic storage system. It is not acceptable to rely on your savings institution's online banking system as the sole storage location.

Please note the following requirements:

i. Files must be in universally readable format

What does 'universally readable format' mean? It means that the Law Society is not requiring a particular format be used (such as PDF), but whatever format is being used must be viewable easily on other computers. So, saving a PC Law data file that must use PC Law to read the report is not a universally readable format, whereas printing or saving a PC Law report to PDF format is considered universally readable.

ii. Minimum 10 year retention period of both electronic and paper records

Backup requirements: a backup copy of the electronic records must be updated at least monthly and stored in a secure manner in an off-site location.

iii. Legibility

As documents stored electronically must be of sufficient resolution or quality to be legible, all documents should be reviewed at the time of electronic storage to ensure legibility of information.

Firms choosing to electronically store documents should be aware that legibility can be impacted by factors that include shading on reports (such as PC Law or others), use of gel pens or colour paper stock.

iv. Storage and Access

The electronic records must be organized and stored in a systematic fashion.

The electronic records must be provided upon request to the Law Society, which may include providing an auditor with read-only access to the electronic storage system while at your office, providing the documents in soft copy (such as on a flash drive), or printing a hard copy.

Practice Tip:

A back up copy of the electronic records must also be made, at least monthly, and stored securely off-site. While these are the minimum requirements, many members choose to back-up more frequently, as it can be costly and time consuming to recreate accounting records after the data is lost. It is also a good idea to test the back up regularly to ensure it is functioning as you expect. Some members have needed to rely upon their back up copy due to a system failure, only to discover it wasn't working properly and therefore of little to no value at all.

F. MONTHLY TRUST RECONCILIATIONS

1. Overview

Each month, for each trust bank account operated by your firm, you must compare your trust accounting records for the month with the trust account statement from your savings institution for that same month and figure out whether your records match the savings institution's statement [Rule 5-43(2)]. If the records do not match, you need to figure out why.

Think of a reconciliation as the systematic comparison of the transactions in the book of original entry and the total of the balances in the client trust ledgers with transactions on the bank statement for the trust account. The report explains the reasons for any differences among the three balances by recording 'reconciling items' to show that the balances are the same as the bank statement balance when the reconciling items are included.

You must balance exactly, to the penny.

Doing this each month is one way you might discover errors and omissions, outstanding cheques or missing deposits, and anomalies in the account such as improper withdrawals. Not only does this comply with the rules, it is easier to find and fix an error if you only have one month's worth of records and supporting documents to check.

You have until the end of the next month to figure all that out [Rule 5-43(2)], and once you do, you must keep a permanent copy of the trust reconciliation report for that month with all the supporting documents.

Even if there has been no activity in the account or the balance is **zero**, you must do a monthly trust reconciliation for every trust account of the law firm.

More detailed explanation of a Monthly Trust Reconciliation

A trust reconciliation is sometimes called 'a three-way reconciliation', because the three main records are compared to each other every month. This means that:

a) the trust account bank statement,

b) the book of original entry, and

c) the total balance of all the client trust ledgers

must be reviewed to ensure that all three have the same balances, and if not, that the reconciling items are identified.

Trust Bank Account Balance	=	**Book of Original Entry**	=	**Total of Client Trust Ledgers**

Because the book of original entry tracks every transaction in the pooled trust account, it seems logical to think the statement from your savings institution showing the balance in the trust account would always be the same balance as the book of original entry at any given time. However, there are many reasons for the balances to be different.

Example:

Consider a cheque for $4,000 that is written on October 20th on the pooled trust account, but is not cashed before the end of the October.

Your book of original entry must show the $4,000 cheque as a withdrawal right away on October 20th, **but** the statement from your savings institution for October will not show the withdrawal of $4,000 since the $4,000 cheque was not cashed yet.

In that situation, the October 31st balance for both your book of original entry and your savings institution's statement will not be the same.

Your reconciliation report will record the full details (issue date, cheque #, payee, dollar amount) of the outstanding cheque to be cashed to explain why the book of original entry balance and the statement balance are different.

The basic steps for completing a monthly trust reconciliation are explained in the following example:

Example:

Early in June you either get a copy of the May statement from your savings institution by mail or on June 1st you go online with your "read only" online access and obtain the May statement for your trust bank accounts.

Record the statement's month end balance for May on the report you are creating for your reconciliation (such as a Trust Account Bank Reconciliation Report) as your next step in the reconciliation.

You list and then total all the individual client trust ledger balances and record that total on your report, and then you record the May 31st balance from your books of original entry on your report as well.

You compare the three balances. The three balances do not match exactly.

You must review your records and supporting documents to discover why the balances do not match exactly.

You also review your monthly trust reconciliation report for April to see if there are any reconciling items that remain outstanding at the end of May.

You must complete the investigation and review and explain each difference by entering "reconciling item(s)" into your Trust Account Bank Reconciliation Report so that the balance for your trust records matches exactly the balance in the bank statement once the reconciling items are included.

All of that must be completed no later than June 30th.

Full details of every reconciling item must be listed separately on the monthly trust reconciliation.

2. Completing a Pooled Trust Account Monthly Reconciliation

Here are the steps to follow

STEP 1: **Monthly statement.** When you get your monthly trust account statement from the savings institution, immediately review it. All transactions should look reasonable – there should be no surprises! However, if you see a charge or fee that should not be there, make a note of it. It not only will be a reconciling item, but it will require action to investigate and correct.

You also need to account for all enclosures with your statement, since occasionally a cheque clears the bank but the original cheque / cheque image is not included with your statement. Make note of it. You will need to contact your savings institution to ensure you receive the missing record.

STEP 2: **Supporting documents.** Gather your book(s) of original entry and your client trust ledgers, or the equivalent electronic reports from your accounting system. You will also need the reconciliation from the prior month, so ensure you have that on hand too.

You are going to compare all the entries on monthly statement with the entries in your book(s) of original entry. Remember that the deposit and withdrawal dates on the savings institution records will be the date that the deposit or withdrawal cleared so the dates are unlikely to match the dates you will have recorded as the date you deposited the money or the date you wrote the trust cheque.

STEP 3: **Create the reconciliation(s).** Using the above records, you will be preparing a report that lists all reconciling items to show that the balances of the book(s) of original entry, the client trust ledgers and the ending balance of your monthly statement are identical when the reconciling items are included.

Some firms prefer to separately compare only the book of original entry and the monthly statement, with the end result usually called a bank reconciliation. This bank reconciliation would then be a component of another report commonly called a cover sheet

or three-way reconciliation, where the bank reconciliation balance is compared with the client trust ledgers and the book of original entry. As long as the three balances are compared and reconciled, it does not matter if the bank reconciliation is separately prepared or not.

STEP 4: **Systematic comparison.** You will now need to systematically compare the transactions in your book of original entry with your monthly statement.

Are there any transactions on your statement that are not in your book of original entry? Perhaps there is a bank fee that was erroneously charged to your trust account. This is a reconciling item and an action item that requires investigation and correction.

How about transactions in your book of original entry that are not on your monthly statement? These are always reconciling items, but only sometimes require investigation and correction. For example, a cheque that was written at the end of the current month that was not yet cashed by the recipient is an outstanding cheque that usually requires no investigation or correction. If a deposit was recorded in the book of original entry on the last day of the month and your deposit records show that it was deposited on the first day of the subsequent month, no further investigation is needed.

STEP 5: **Entry errors?** If you still don't balance after you've completed your systematic comparison, start looking for entry errors.

Transposed numbers are a common error and might appear in your records or in the bank records. For example, assume the cheque you wrote and recorded in your book of original entry was for $197, but the savings institution recorded it as $179 in their records. The $18 difference is a reconciling item and you must contact your savings institution to resolve the error.

Errors in entering the number are also common errors. For example, assume your client provided a cheque for $100, but you recorded the receipt as $1000 in error in the law firm accounting records. The $900 difference must be recorded as a reconciling item for the month in question, and correcting entries are required.

In manual accounting systems, sometimes the book(s) of original entry balance does not match the total client trust ledger balances. If that is the case, a common error is that the amount recorded in the book(s) of original entry does not match the amount that should have also been recorded in the one relevant client trust ledger. You will have to compare all entries to find the error(s), and any errors found are reconciling items that require correcting entries.

STEP 6: **Complete the reconciliation review checklist.** There is more than merely completing the reconciliation itself that should be done monthly. For example, the client trust listing should be reviewed to ensure there are no overdrawn matters, and that inactive matters are being addressed on a timely basis. It is also a good time to review the records to ensure that appropriate receipts were issued for any cash received. These are the types of items listed on the Law Society's *Reconciliation Review Checklist*, available on the Law Society website. It is recommended that all firms complete this checklist monthly.

STEP 7: **Save and store.** Save the newly created report and checklist with all supporting documents in your records, and ensure that you finish the report by the deadline (the end of the month following the month you are reconciling).

For firms with more than one trust account:

1. Should you have more than one pooled trust account, each account must be reconciled separately.

2. You must do a monthly trust reconciliation for any specific trust investment accounts.

3. You must do a monthly trust reconciliation for any restricted trust accounts.

You can find a bookkeeping illustration of a monthly trust reconciliation of a pooled trust account *here*.

Remember that Rule 5-43(2) requires that the monthly reconciliation must be completed "*no later than the end of the following month*", so for example, the reconciliation report for the month of October must be completed on or before November 30th.

3. Reconciling Items

Once you have completed the monthly trust reconciliation comparison of your trust accounting records with your savings institution's monthly statement, you may have no reconciling items, or a variety of different types of them. Each reconciling item must be listed on the reconciliation in full detail.

These are some basic guidelines for identifying items that may need reconciling and how to address with those reconciling items which require follow up.

Remember:

Reconciling items that require action on your part need to be listed on the reconciliation in full detail and action must be taken in a timely fashion to investigate and/or correct the difference.

a) Outstanding Cheques

Outstanding cheques occur when you have recorded the cheque in your book of original entry but the recipient has not cashed it yet, so it is not on your savings institution's monthly statement.

Outstanding cheques can often resolve themselves without any additional work on your part. However, you should always review them each month to see if any are unusual, such as:

- Cheques for large dollar amounts that are still outstanding at the end of a month can be unusual, as large cheques are generally cashed quickly. If they are still outstanding, a bit of further investigation may be needed to ensure the intended recipient actually received the cheque;
- Cheques that have been issued three or more months ago and still remain outstanding should be investigated to try to ensure they are cashed before they become stale-dated;
- Cheques that are more than six months old are considered to be stale-dated. Although the return policy of savings institutions vary, some may refuse payment on the cheques once they are six months old. The original cheque would then need to be cancelled and a new cheque issued, recording all the

associated trust accounting entries for each transaction. Depending upon the dollar amount and risk associated with the first one, you will also need to consider placing a stop payment on the original cheque if it cannot be located.

b) Outstanding Deposits

Outstanding deposits usually require no action on your part. This is true if they result from a receipt being recorded in your book of original entry at the end of the month but the corresponding deposit was not made to your savings institution until the beginning of the next month. Assuming the deposit was already brought in on the first or second banking day of the month, the deposit will have resolved itself.

However, if you have a reconciliation that shows an outstanding deposit that does not meet the above criteria, you must investigate and resolve it (i.e. why is the money not in the trust bank account?)

c) Correcting Errors

Other reconciling items **always require action**. Some examples include:

- The cheque you wrote and recorded was for $197, but the savings institution incorrectly recorded it as $179 in their records. The $18 difference is a reconciling item and you will need to contact your savings institution to resolve the error.

- You ran out of trust cheque stock recently and ordered more. Your savings institution erroneously charged the fee for cheque printing to the trust bank account instead of your general bank account. This $35 fee is a reconciling item for which you also should contact your savings institution to resolve.

- Your client provided a cheque for $100, but you recorded the receipt as $101 in error in the law firm accounting records. The $1 difference must be recorded as a reconciling item for the month in question. Correcting entries must be recorded in the book of original entry and the applicable client trust ledger to reverse the original entry that was for the wrong amount, and re-record an entry in the correct amount. The specifics of how you correct it will depend on your accounting system. However, all corrections should be recorded in your system using the current date – the date you are making the correction. Some members think the adjustment should use the same date as the original entry. This is called backdating and must not be used. Make sure your description for each correcting entry explains what happened so that there is full information.

- If you are using a manual accounting system, sometimes the reconciling item is not related to the trust bank account at all, but is a recording error on your part. For example, sometimes the amount recorded in the book of original entry doesn't match the amount recorded in the client trust ledger. This too is a reconciling item to be shown on your reconciliation, and corrected in whichever of the two records had the error. Remember – no backdating!

Remember:

The dollar value of the reconciling difference or reconciling item is irrelevant. The trust account, by its very nature, must be reconciled to the penny, with each and every adjustment identified in full detail and corrected on a timely basis.

4. Stale-Dated Cheques and Stop Payments

You should be alert to the fact that a stale-dated cheque can actually still clear your bank account. Even when you have asked your savings institution to stop payment on a particular cheque, there is a risk that the cheque will clear your account. This is because your savings institution may decide to honour the cheque despite its age, often requiring the law firm to identify a problem very quickly. If you have a stale-dated cheque that you wish to cancel and re-issue, it is best to read your account agreement carefully.

Did You Know?

Bank drafts, money orders, certified items and government cheques are never stale-dated.

G. SPECIFIC TRUST INVESTMENT ACCOUNT

The basic requirements outlined above for pooled trust accounts and trust accounts generally also apply to specific trust investment accounts. For example, you need a book of original entry, client trust ledgers, and a monthly trust reconciliation for a specific trust investment account.

However, there are also specialized requirements in Rules 5-46(1) and (2) that apply only to a specific trust investment account:

1. All trust money must first be recorded in the records of and deposited into a pooled trust account, even if the entire amount is to be invested.

2. When you open the specific trust investment account, the pooled trust cheque written to initiate it is written to *your law firm's name, in trust for your client's name.*

3. You then update your specific trust investment account records (book of original entry and client trust ledger) for the receipt of the investment, and provide the pooled trust cheque to your savings institution to invest in a daily interest savings account, a term deposit, or a guarantee investment certificate [Rule 5-41].

4. Interest earned on the investment will need to be recorded in the book of original entry and client trust ledger for the specific trust investment account.

5. When the time comes to redeem the investment, you must deposit the redeemed investment proceeds in the firm's pooled trust account, even if it is to be paid immediately to the client. Again, the accounting records for both the specific trust investment account and the pooled trust account must be updated to reflect the redemption in one and the receipt of money in the other, respectively.

Like any other trust account, you will need to perform a monthly trust reconciliation for your specific trust investment account [Rule 5-43(2)].

Although it may be appealing to every client to open a specific trust investment account, the broad guideline for the lawyer to follow is that the cost to the client of opening and administering the specific trust investment account should not exceed the interest earned on it for the client.

Before opening a specific trust investment account both you and the client should consider:

- the administrative costs of opening an account and completing the required bookkeeping;
- the length of time the money is to be retained;
- the sum of money involved; and
- the interest rate payable on the account.

You, as the lawyer, should also consider the Law Society's *Practice Direction 84-01: Interest on Client Trust Funds*.

Caution:

A common error is to make the cheque payable to the savings institution where the investment will be held. Using the proper payee instead recognizes that control stays with the member the money is merely being moved to another trust account of the firm.

1. Completing a Monthly Reconciliation

The steps to complete a monthly reconciliation for a specific trust investment account are largely similar to completing one for the pooled trust account. However, due to the unique nature of specific trust investment accounts, here are some additional factors to keep in mind:

- If you have more than one specific trust investment account with a balance during the month at the same savings institution, the monthly reconciliation report can include all the specific trust investment accounts in one report.
- The type of monthly statement you receive will depend both on the type of investment, as well as which savings institution you are using. Furthermore, for guaranteed investment certificates with some institutions, you may not automatically receive a monthly statement for transactions. However, you still need to have some form of confirmation of the investment at the end of the month. In some cases, law

firm staff request that a teller print the information when they attend to their savings institution on the first banking day subsequent to month end.

- There is a separate *reconciliation review checklist* for specific trust investment accounts that can be used that reflects the unique nature of these reconciliations.

You can find a bookkeeping illustration of a monthly trust reconciliation of a specific trust investment account *here*.

H. RESTRICTED TRUST ACCOUNT

The restricted trust account is a separate trust bank account from the other two types of trust bank accounts.

The restricted trust account was created in order to accommodate electronic transfer through the Teranet Manitoba LP ("Teranet") e-Registration system for Manitoba land titles transactions. Through a restricted trust account, a law firm may allow direct withdrawals to be made from it by Teranet when the proper procedures are followed and when the trust money is for the payment of land transfer tax and registration fees.

Some of the unique aspects of a restricted trust account include:

1. The only money that can be deposited into the restricted trust account is for the payment of land transfer tax and registration fees at Teranet [Rule 5-47(1)].

2. Before being deposited into the restricted trust account, trust money must FIRST be deposited into the pooled trust account, updating the usual accounting records. Only after this process is completed in the pooled trust account can available funds be confirmed and a pooled trust cheque be written so that trust money can be deposited into the restricted trust account [Rules 5-44(1) and 5-47(1)].

3. If more money than is required for the matter is deposited into the restricted trust account, a trust cheque from the restricted trust account must be issued so that the excess money is paid immediately back to the pooled trust account from where the money originally came [5-47(2)].

As a trust bank account, all the basic requirements outlined earlier for pooled trust accounts and trust accounts generally also apply to a restricted trust account. For example, you need a book of original entry, client trust ledgers, and a monthly trust reconciliation for a restricted trust account [Rules 5-43(1) and (2)]. There are also specialized requirements regarding transaction numbering and supporting documentations for the Teranet withdrawals, as explained in detail in the Law Society's *eRegistration requirements*.

Due to the unique nature of a restricted trust account, there is a unique *checklist* for completing the monthly trust reconciliation.

Only the restricted trust account permits withdrawal by a third party and that third party is only Teranet Manitoba LP

I. GENERAL BANK ACCOUNT

When a firm is first opening a pooled trust account, a general bank account will also need to be opened. A general bank account is needed because it is used for depositing money related to the practice of law that is not trust money and for paying business expenses such as rent, staff salaries, etc. All of the bills associated with the operation of the practice are paid from the general bank account. Although you don't have to, many members choose to use the same savings institution for their general bank account as they do for their trust bank account.

It is basically the member's business account. Once you have rendered legal services to your client and delivered a bill (a statement of account) to the client, payments of that statement of account are deposited into your general bank account.

Practice Tip:

From a practical perspective, it is a good idea to order different coloured cheques for the general bank account and trust bank account. This helps reduce the chance of error when writing cheques – less possibility of writing a trust cheque on general bank account cheque stock, or vice versa.

1. Required Records

There are two main accounting record requirements for your general account; a general book of original entry and an accounts receivable ledger. There is also a requirement that you keep all supporting records for the account, which includes bank statements, deposit slips, statements of account and similar documents.

a) Book(s) of Original Entry

The book of original entry for your general account has a number of the same requirements as a trust account book of original entry. It can be electronic or paper. There is no prescribed form for a book of original entry for general or trust accounts.

However,

- the book of original entry must contain the full details of all transactions entered into it;
- you must record the 'form' of receipt (cash, cheque, e-transfer or wire transfer etc.);
- every time you have a transaction, you must record it right away on that date; and
- you cannot backdate or make changes in entries once they are made. If you have to correct an entry, you must make a new entry or entries to correct the original entry and you must date the new entry or entries with the current date. Ink must be used if it is a hand written book of original entry.

Practice Tip:

The rules do not currently require you to perform a monthly reconciliation for the general account. However, it is a very good business practice to do so. Many institutions have a time limit for making adjustments, and if you check monthly for errors, it is usually easier to find the source of the error than if you wait until an error finds you! It is also a way to ensure compliance with the requirement for full details for all transactions.

b) Accounts Receivable Ledger

When you complete work and provide your client with a statement of account, and there is any amount owing to you, even if there is a plan that the client will make regular payments over time on the account, this creates a receivable for your law firm.

You are required to record receivables on a systematic basis, tracking the amount of the statement of account, any payment(s) made so far on it, and the remaining balance.

J. RESPONSIBLE BILLING PRACTICES

Rule 5-57 requires that you must only charge or accept a fee, disbursement, or expense, including interest, that is fair and reasonable and that has been disclosed to the client. As such, when billing for services that you have provided or for disbursements that you have incurred, there are responsible practices that should be followed.

First, you cannot prepare and provide a statement of account to a client without first having provided significant legal services unless the statement of account is for disbursements only. See *Practice Direction – 89-03 – Appropriate Billing Practices*.

Secondly, if money in the trust account is going to be used to pay the statement of account, the client must be provided with a copy of the Statement of Account before or at the time the trust cheque to the member is written [Rule 5-44(1)(d)].

Typically, when a retainer is of short duration and the matter is concluded quickly, only one statement of account will be rendered at the conclusion of the matter. An example of this is a criminal matter where you are retained solely to make a bail application.

If the matter is lengthy, you may choose to send a statement of account before the matter is completed and, in some situations, you may choose to send regular interim statements of account - such as with a protracted piece of civil litigation.

Caution: COMMON ERRORS IN BILLING ON REAL ESTATE TRANSACTIONS

For real estate transactions in particular, do not fall into one of the two common errors that have been observed. First, the estimate of funds required that is prepared at the beginning of the transaction is not a substitute for preparing a statement of account. No fees or disbursements can be paid to your general bank account without first issuing a statement of account.

Secondly, do not bill too early. Legal services are not considered to be concluded until a substantial portion of the money has been disbursed. In most purchase transactions, this is after the transfer has cleared land titles and after the mortgage funds are requested and ultimately paid to the vendor's lawyer. Where you are acting for the vendor, legal services are usually considered to be concluded after the vendor's encumbrances have been paid out.

Caution: ESTATES

There are a number of specific King's Bench rules regarding the fees that can be charged in estate matters, the consent requirements for the various parties involved in an estate, and the information that should be provided on any statement of account rendered. If you are acting on an estate matter, you should be thoroughly familiar with these rules.

K. COMPLETED MATTERS

You've completed the matter for your client, and now just need to do the final steps before you can close the file and store it. As part of your closing procedures you should:

- ensure that you have reported to your client by sending a letter, returning any original client documents, reminding the client of any future important deadlines or matters the client must watch for, and include at that time your final statement of account;
- disburse all remaining trust money for the matter to the appropriate parties on a timely basis; and
- place a copy of the client trust ledger on the file when it is closed [Rule 5-54(1)(b)].

L. INACTIVE MATTERS

As part of reviewing the monthly trust reconciliation, the client trust listing should be reviewed to identify matters for which there has been no trust activity for some time – a warning sign that the matter may be becoming inactive. There are a number of professional obligations in the Law Society rules and the *Code of Professional Conduct* that arise when a matter becomes inactive. Your obligations will vary based on whether or not the matter is concluded and if you still have contact with the client.

If the matter has been concluded and you still have money in trust for the client, prepare your final statement of account for unbilled fees and disbursements and send it to your client. If there is a reasonable expectation that the client will receive the statement of account, then you can write a trust cheque to your general bank account to pay it. Refund any extra money to the client. Send your report to the client and close the client trust ledger and the file. Do not let these matters linger, as Rule 5-44(1)(m) requires trust money to be paid out expeditiously once a legal matter is concluded.

In addition, Rule 3.2-1 of the *Code* sets out a lawyer's duty to provide courteous, thorough and prompt service to the client. Under related Commentaries [4] and [5](m), the lawyer also has a duty to:

- ensure that matters are attended to within a reasonable time frame;
- provide an interim report where one might reasonably be expected; and
- provide a prompt and complete report when the work is finished.

The lawyer must maintain contact with the client from time to time whether the matter has been inactive at the client's own choosing or due to other reasons such as the lawyer's delay or other pending proceedings. This contact and interim reporting to the client should include details of any monies that have remained in trust for the client. It would be prudent for the lawyer to request that the client confirm his or her instructions about how to proceed with the matter and to advise of any change to his or her contact information.

Pursuant to Rule 3.2-2C of the *Code* and related Commentary [6], if the lawyer has lost contact with the client or the lawyer cannot obtain instructions from the client and the matter has not been concluded, the lawyer must take reasonable steps to locate the client. If those efforts fail, the lawyer should consider withdrawing in accordance with Rule 3.7 of the *Code*.

For any matters for which a client cannot be located, whether or not the matter has been concluded, the lawyer may be permitted to remit trust money to the Law Society pursuant to Section 51(1) of *The Legal Profession Act* if:

- the lawyer has lost contact with the client;
- all reasonable efforts to locate the client have failed; and
- three years have passed without trust activity.

However, prior to making the remittance, you must first have taken additional steps to locate the client over and above trying the last contact information in law firm records. Steps to consider include an internet, King's Bench, or land titles search. You should also document the details of additional steps taken.

If you are still unable to locate the client, there is a *form* on the Law Society website which can be used when making the remittance, and your correspondence should be addressed to the audit department.

You should also bear in mind that matters with outstanding trust conditions or estates with personal representatives or beneficiaries that cannot be located after reasonable effort on your part have unique considerations and may involve additional steps. For such matters, it may be best to contact a member of the audit department to discuss the situation prior to making any remittance.

Caution:

Stale-dated cheques can become essentially a second storage area in your trust account records for inactive matters. Stale-dated cheques must also be addressed on a timely basis.

M. WHEN A LAWYER LEAVES A FIRM

For all lawyers, professional obligations arise when a lawyer leaves a firm, and Rule 3.7-7A of the *Code of Professional Conduct* has numerous requirements to ensure clients are given reasonable notice and reasonable steps are taken to obtain the instructions of each affected client as to who they will retain.

When trust money is involved, the trust account supervisor needs to ensure there are proper controls in place at the firm in these situations. Considerations include the following:

- The trust account supervisor should ensure that the list of files of the departing lawyer includes trust balances and any valuable property and that each file is accounted for in the transition. It is a common error for firms to not include inactive matters at this time, which still need to be considered and addressed in some fashion.

- An orderly transition of any file leaving the firm involves first obtaining the written authorization from the client to transfer the trust money or any valuable property with the file to the departing lawyer or to other new counsel. Thereafter, each transitioning file should be reviewed to determine the status of the file at the time of transition, and often includes rendering statements of account for fees and disbursements to date. For those clients with trust money, the lawyer must first consider if there are any related trust conditions that may prevent the use of the trust money to pay an account for fees and disbursements and/or that may prevent transfer of the trust money to the departing lawyer or to other new counsel. If there are such trust conditions, they must be varied before the trust money can be used or transferred out of the firm's trust account. Commentary [5] of Rule 7.2-11 of the *Code* requires that trust conditions can only be varied with the consents of both the lawyer/person who imposed the trust condition and the lawyer who accepted the trust condition. If there are no trust conditions restricting the use of the trust funds, the trust funds were not otherwise provided to be used for a specific purpose such as to pay for an expert report or for court transcripts, and there is no other claim to the trust funds, the lawyer may firstly apply any funds to any outstanding accounts in accordance with Rule 5-44(1)(d), where an account has been delivered to the client for fees and disbursements. Any remaining trust money could be returned to the client; or lastly, transition with the file to the departing lawyer or new counsel.

- For any file leaving the firm, a copy of the client trust ledger is part of the financial record of the file and must accompany the file.

- Consider whether you should make and retain copies of any file documents that pertain to the receipt or payment of trust funds, prior to the file being given to the client or sent with the lawyer or to new council, at the firms' cost.

- A review should also be done in conjunction with the departing lawyer to identify any balances for unlocatable clients and determine what actions have been taken to date to locate the clients. If there have been no trust transactions for more than 3 years and the clients cannot be located, after a reasonable search has been done given the dollar amount in trust, these balances may be sent to the Law Society as a Section 51 remittance with the proper *paperwork*.

- Under no circumstances should the files be taken by or given to the departing lawyer until guidance and authorization has been received with respect to the client trust funds as well as the file. The file and trust funds should be transferred together. Having said this, there may be situations where the client's direction and authorization cannot be obtained but the client will be prejudiced unless work is immediately done on the file. In such circumstances, the firm and the departing lawyer will need to cooperate with one another to ensure that the work is done and the client's interests are protected while still recognizing that the firm must maintain control of the file. If the departing lawyer is in the best position to do the work, the firm may be able to maintain control of the file through the use of trust conditions that would permit the departing lawyer to have access to the file for a limited purpose, provided that once the work has been completed the file is returned to the firm until such time as the authorization to transfer the file and trust funds has been received.

N. ACTING IN DUAL CAPACITY

When a member is acting solely in a representative capacity (i.e., the member is not providing legal services), Rule 5-49(1) requires that all associated funds must be held outside of trust, in a separate estate account.

At times a lawyer will act in a dual capacity, such as when a lawyer is the personal representative of an estate and also providing legal services on the matter. In such a case, the lawyer is required by *Practice Direction 92-01* to treat all funds deriving from the estate as client trust funds and handled in accordance with the financial accountability rules.

However, when the legal services have been concluded, any remaining funds can no longer be held in the trust account and should be removed to a separate estate account, in accordance with Rule 5-49.

O. MEDIATION AND ARBITRATION FEES

While mediation and arbitration services can be provided by a lawyer, they are not legal services. In accordance with Law Society Rule 5-44(1)(a), when a lawyer is only providing such services, no related money may be deposited to the firm trust account. In addition, a lawyer who provides such services would need to be very clear upon being retained that these services are not legal services and as such any retainer money received will not be deposited to the firm trust account.

It should also be noted that as a firm's general bank account is also only to receive money related to a firm's legal practice (Rule 5-48(1)), the money cannot be deposited to a general bank account either. In such a case a separate bank account for the mediation and arbitration business should be used.

However, at times the same lawyer will provide both mediation/arbitration services and legal services and in such a case it becomes more difficult to discern what can or should be done. For example, a legal agreement may be drafted at the conclusion of a mediation, and the lawyer may receive a retainer for the agreement drafting. Such a retainer meets the definitions of both trust money and professional fees in the financial accountability rules, and as such must be deposited to the firm's trust account.

So, if the services are purely mediation/arbitration, any related retainer cannot be deposited to the firm trust account and the client should be so advised in writing at the inception of the matter.

If there is a blend of services that include legal services, the portion of any retainer that relates to legal services should be deposited to the firm trust account. Again, the client should be advised in writing at the inception.

P. OTHER VALUABLE PROPERTY

From time to time, a member may be requested to hold their clients' valuable property in trust for them. Because the property belongs to the client and is valuable, Law Society Rule 5-43(4) requires the member or law firm to maintain a record of the valuable property held in trust. The client's valuable property that must be listed in a record is property which has value and can be transferred or negotiated by a member, such as jewelry, a stamp collection or a painting.

The member or law firm will need proper documentation to record the particulars of the property.

The audit department of the Law Society has prepared a blank *template* of a form to record particulars of a client's other valuable property.

Note that there is space on the form for both the depositor and the person who accepts the valuable property to sign as a record of the receipt. As well, there is space for the ultimate recipient of the property and the releasing staff person to sign when the property is released.

In addition, the member should take the appropriate steps to ensure the property is properly safeguarded (example: in a safety deposit box or vault) and recommend the client insure against its loss.

Q. FRAUD AWARENESS

How do you best protect against fraud the trust money that clients have entrusted to your firm? Educate yourself and others in your firm – lawyer and support staff alike – about the fraud risks and then creating and maintaining an environment of internal controls that helps prevent fraud.

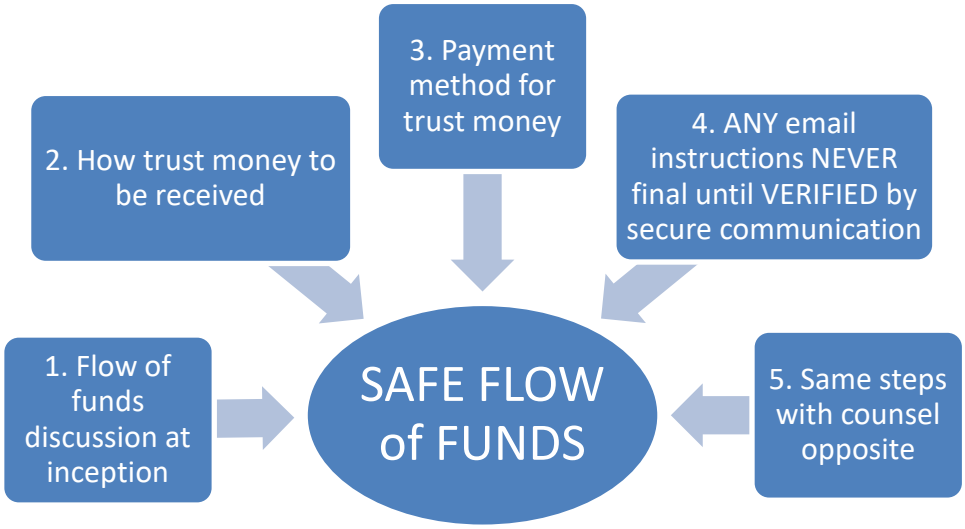
Remember that this means protecting the channels by which you may receive trust money, or disburse it. For example:

- If your client is providing a cheque or bank draft, scrutinize it, does it look right?
- If you are acting on a collections matter and the opposing party provides the funds right away, does that make sense?
- If your client is pressuring you to disburse trust money in a hurry without following your firm's established protocols, is that a warning sign?
- Are you being asked to change payout instructions late in the matter, inconsistent with the original instructions from your client?
- Do payment instructions make sense in the context of the matter? For example, if your client has recently moved to Alberta, why would they ask you to send funds out of Canada?

You should also know that beyond internal controls, you should always question the unusual when something doesn't feel right. These questions should be investigated and resolved before accepting or disbursing trust money.

Be constantly diligent, as new fraud methods are relentlessly being developed and existing methods are being changed. Not all frauds will have the same red flags, but there are warning signs if you listen to them. Trust your instincts. Don't forget basic security practices such as keeping passwords confidential, regularly changing passwords, and keeping your software up to date. Learn about social engineering scams that can often arrive by email and trick recipients into entering passwords or inadvertently allowing ransomware to be installed on your network.

In addition to having strong internal controls and adopting good cyber hygiene, you can SIGNIFICANTLY REDUCE the risk of all kinds threats to trust money by following the **Safe Flow of Funds** guideline *every single time* you handle trust money:



1. **Flow of funds discussion:** Establish the flow of funds together with your client as early as possible. This is for funds to be received or disbursed.
2. **Receipt of trust money**: Tell your client how you are to receive money in this matter, that your instructions will not change and to be automatically suspicious of such an event, calling you ONLY at the phone number they already have for you – NOT using any number accompanying the changed instruction!
3. **Payment of trust money:** Obtain written payment instructions at that same meeting if you can, but that's not always possible and remember there will be extra steps to verify any information received later.
4. **Payment instructions via email:** If you EVER receive ANY payment instructions by email or fax– even *initial* instructions - have a two-part policy:
   i) they are NEVER considered to be final instructions until they are VERIFIED; and
   ii) they can only be verified by using contact information *other than* those that accompany the instructions.

   If this is your client providing payment instructions, confirm by PHONE on a call *you* initiate using the contact information you gathered at the *start* of the matter. If it's another law firm, call the firm using the contact information from the Law Society's website directory (*Lawyer Lookup* in Manitoba, with similar directories in other jurisdictions). Under NO circumstances should you confirm by email or call using contact information provided with the instructions.
5. **Counsel Opposite:** Take the same precautions for money flowing from or to counsel opposite. Would-be thieves impersonate anybody involved in a transaction, including staff at another law firm.

Know that fraud risks exist both inside and outside of your firm. Proper controls, implemented consistently, and an appropriate level of oversight on an ongoing basis will help reduce these risks. Ensure new staff are trained properly. Check from time to time to make sure the controls are still working properly or are updated to reflect new practices.

For further information about good cyber hygiene, see the Cyber Security *resource library*.

R. FOR YOUR REFERENCE

GLOSSARY OF TERMS

Accounts Receivable - A receivable is created when you send a statement of account to your client but have not yet received full payment. The amount owing is called a receivable.

Books of Original Entry - A book (or books) recording in chronological order the full details of all payments from trust, all transfers between individual client trust ledgers, all trust receipts and the form in which the trust money is received. [Rule 5-41]

Cancelled Cheque - A cheque that was originally recorded in the accounting records that now needs to be reversed/cancelled due to an error.

Cheque Images - A copy of the front and back of the cleared cheque included with a monthly statement from a savings institution.

Cleared Cheque - Any cheque written on a bank account that has been cashed.

Client Trust Ledger (also known as 'Client Ledger' or 'Ledger') - A separate record maintained for each client and matter, recording in chronological order, the full details of all trust transactions for that client, and the balance in the client's account. [Rule 5-41]

Confirmed Available Funds - Ensuring that the funds for a specific client matter have been deposited to the trust bank account **and** have been cleared through the banking system prior to disbursing money on that matter from a trust bank account.

Disbursements - amounts paid or required to be paid to a third party by a member or law firm on a client's behalf in connection with the provision of legal services to the client by the member or law firm which will be reimbursed by the client [Rule 5-41].

e-Transfer or Interac e-Transfer of Funds - A method of receiving money electronically from another bank account.

Electronic Payment Service Provider- Organizations that provide firms with the capabilities and equipment to accept debit and credit card payments.

Expenses - costs incurred by a member or law firm in connection with the provision of legal services to a client which will be reimbursed by the client including such items as photocopying, travel, courier/postage and paralegal costs [Rule 5-41].

Financial Institution – means:

a) a bank that is regulated by the *Bank Act*,

b) an authorized foreign bank within the meaning of section 2 of the *Bank Act* in respect of its business in Canada,

c) a cooperative credit society, savings and credit union or caisse populaire that is regulated by a provincial or territorial Act,

d) an association that is regulated by the *Cooperative Credit Associations Act* (Canada),

e) a financial services cooperative,

f) a credit union central,

g) a company that is regulated by the *Trust and Loan Companies Act* (Canada),

h) a trust company or loan company that is regulated by a provincial or territorial Act,

i) a department or an entity that is an agent of Her Majesty in right of Canada or of a province or territory when it accepts deposit liabilities in the course of providing financial services to the public, or

j) a subsidiary of the financial institution whose financial statements are consolidated with those of the financial institution [Rule 5-41].

Financial Services Cooperative – a financial services cooperative that is regulated by an *Act respecting financial services cooperatives*, CQLR, c. C-67.3, or *An Act respecting the Mouvement Desjardins*, S.Q. 2000, c. 77, other than a caisse populaire;

Funds - Cash, currency, securities and negotiable instruments or other financial instruments that indicate the person's title or right to interest in them. [Rule 5-41]

Money - Cash, cheques, drafts, credit card transactions, post office orders, express and bank money orders, and electronic transfer of deposits at financial institutions. [Rule 5-41]

Monthly Trust Reconciliation (or Three Way Reconciliation) - A comparison prepared each month by the member or law firm showing the reasons for any differences between the books of original entry, the client trust ledgers and the bank's records. [Rule 5-41]

NSF Cheque (Non-Sufficient Funds) - A cheque which was presented for payment to a bank, but there were insufficient funds in the related bank account to complete the payment.

Outstanding Cheque - A cheque issued from a bank account that has not yet been cashed.

Outstanding Deposit - A deposit recorded in the law firm accounting records but not yet appearing in the savings institution's bank account statement.

Pooled Trust Account - An interest-bearing chequing account opened at a savings institution by a member for the benefit of a number of clients. [Rule 5-41]

Professional Fees – Amounts billed or to be billed to a client for legal services provided or to be provided by a member or law firm.

Public Body – means:

a) a department or agent of Her Majesty in Right of Canada or of a province or territory,

b) an incorporated city, town, village, metropolitan authority, township, district, county, rural municipality or other incorporated municipal body in Canada or an agent in Canada of any of them,

c) a local board of a municipality incorporated by or under an Act of a province or territory of Canada including any local board as defined in *The Municipal Act* or similar body incorporated under the law of another province or territory,

d) an organization that operates a public hospital authority and that is designated by the Minister of National Revenue as a hospital under the *Excise Tax Act* (Canada) or an agent of the organization,

e) a body incorporated by or under an Act of a province or territory of Canada for a public purpose, or

f) a subsidiary of a public body whose financial statements are consolidated with those of the public body [Rule 5-41]

Reconciling Item - Any difference between the law firm's trust account records and the trust bank account monthly statement balance for the same month.

Remote Deposit Capture - Remote deposit capture is a way to deposit cheques received without delivering the cheques to the financial institution.

Reportable Event - Circumstances where a trust account supervisor should contact the audit department of the Law Society to advise the auditors (and provide details) of the situation (such as a client matter being overdrawn).

Restricted Trust Account - A pooled trust bank account used only for the purpose of transferring funds electronically to pay Teranet Manitoba LP on account of land transfer tax and registration fees on real property transactions. [Rule 5-41]

Savings Institution - A Manitoba branch of a chartered bank or a trust company that is authorized by law to receive money on deposit and is insured by the Canada Deposit Insurance Corporation, **or** a credit union or caisse populaire incorporated under *The Credit Unions and Caisses Populaires Act*. [Rule 5-41]

Specific Trust Investment Account - A separate interest-bearing account opened by a member or law firm in trust for a specific client at a savings institution, and is limited to a daily interest savings account, a term deposit or a guaranteed investment certificate. [Rule 5-41]

Stale or Stale-Dated Cheque - A cheque that was issued six (6) months ago or more that has not yet been cashed.

Statement of Account - An invoice or bill sent to a client for legal services rendered and/or for disbursements.

Stop Payment - A service you can request from your savings institution when a cheque has been issued, but not yet cashed, and you want to prevent it from being cashed.

Supporting Documentation - Documents that support transactions recorded in your accounting records and can include documents from a third party (e.g., bank statement, invoices) and law firm records (e.g., receipt books, deposit slips).

Trust Account Supervisor - A practising member who has been approved to operate a trust bank account. [Rule 5-41].

Trust Money - All money received by a member or law firm in connection with the legal practice that belongs in whole or in part to a client or is received on a client's behalf or to the direction or order of a client. It also includes money received by a member or law firm on account of professional fees for services not yet rendered or on account of disbursements or expenses not yet paid, or for which a statement of account has not been rendered. [Rule 5-41].

Trust Safety Appeals Committee - The committee responsible for considering appeals of decisions to deny or to approve with conditions a member's application to become a trust account supervisor and appeals of decisions to revoke a member's status as a trust account supervisor. [Rule 5-41]

Trust Transaction - Any accounting transaction where trust money is received, disbursed or transferred.

Trust Transfer - Moving ("transferring") trust money from one client trust ledger to another client trust ledger.

Valuable Property - Anything of value, other than trust money, that can be negotiated or transferred by a member or law firm. [Rule 5-41]

Void Cheque - Any cheque that is unusable and cannot be accepted for payment (usually indicated by writing "VOID" across the cheque).

Wire Transfer - Wire transfers are movement of money from one bank account to another and are done by financial institutions.

RESOURCES

- *Law Society Financial Accountability Rules*
- *Law Society Practice Directions*
- *Trust Safety Program Guideline*
- Forms:
  i. *Letter of Direction*
  ii. *Unlocatable Client* (*Legal Profession Act* s. 51 remittance)
- *Accounting Record Templates*
- *Reconciliations Review Checklists*
- *Accounting Record Examples*
- *eRegistration through Teranet Manitoba LP for the Manitoba Property Registry, Law Society Requirements* and *FAQs*