



A Comprehensive Guide to Managing Your Trust Account

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May 19, 2016

A trust account is something every attorney who settles real estate transactions must have. And while it is arguably the biggest single source of risk in your practice, in a world of ever-increasing regulatory change and doing more with less, proper oversight of the trust account is sometimes overlooked – often at great cost to the attorney. This paper provides you with a quick overview of the key concepts associated with managing your trust account.

Let's face it, trust accounts have gotten a lot of attention by ALTA, CFPB, and state bars in recent years. One of the seven pillars of ALTA's best practices is devoted entirely to trust accounts. And several state bars have recently changed their rules to strengthen trust account reconciliation requirements. But even with all the increased regulatory scrutiny over trust accounts, the most important reason to manage your trust account is, and always has been, to protect you and your client from errors or malfeasance that could result in loss of funds entrusted to you. And ultimately, the Best Practices and the new Bar rules mainly represent more formal processes around the tried and true management practices that have always worked.

Managing your trust account really boils down to seven focus areas, which we'll explore in detail.

- Bank Account Setup
- Deposits
- Checks and Withdrawals
- Data Security
- Trust Ledgers
- Insurance Coverage
- Reconciliations

*Focus Area 1: Bank Account Setup*

Modern technology, such as online banking and remote deposits, makes managing your bank account much easier and more efficient than in years past. For relatively little cost, most banks can offer you the technology to deposit money directly from your desktop, getting the money in the bank faster, and eliminating the need to walk or drive to the bank.

In addition, there are banking services available which will reduce the opportunity for fraud in your escrow account. One of the most effective of these is Positive Pay. Positive Pay is a bank service which authorizes the bank to fund only those checks you specifically authorize upon presentment. It requires you to submit an electronic file from your settlement software to the bank daily, which the bank then

compares to the checks presented. If a check is presented which does not appear on your list, the bank does not honor the check. Investors Title’s proprietary trust account service, iTracs, offers a service which can automate the daily submission of the check file to the bank, eliminating a manual, repetitive task.

You should consider whether your bank offers Positive Pay services when selecting a bank. If your bank does not offer Positive Pay, and you choose to stay with your bank, we highly recommend you utilize Reverse Positive Pay. Unlike Positive Pay, which actually *prevents* the bank from honoring a check you didn’t authorize, Reverse Positive Pay consists of comparing checks the bank *did* honor against the list of checks you know you issued from your settlement software. This can be a time-consuming task, but iTracs can help with that, too.

In addition to selecting a bank which offers Positive Pay, it is important to use a federally insured financial institution. Both Georgia and South Carolina Bar rules require that funds be maintained in a bank with a physical presence in the state. Georgia goes a step further and requires that you select a financial institution which is on the Georgia Bar’s approved list. And when you set up your account, be sure to opt to block ACH payments and international wire blocks – both increasingly popular ways for criminals to defraud your trust account. And don’t forget to identify your account as a trust account by titling it with the word “escrow” or “trust”.

Finally, any service charges assessed by your bank must be paid with attorney funds –not trust funds— either by placing a deposit in the trust account for this purpose, or by directing the bank to charge your operating account for service fees. If you choose to deposit funds in the trust account to cover service charges, it is a good idea to record them in a separate ledger.

#### Summary of Focus Area 1

<i>Recommendation</i>	<i>Source</i>
Consider online banking	iTracs tip
Consider remote deposits	iTracs tip
Use Positive Pay or Reverse Positive Pay	ALTA Best Practice #2
Select a federally insured financial institution	ALTA Best Practice #2
In SC and GA, select a bank with a physical presence in the state	South Carolina State Bar rule Georgia State Bar rule
In GA, select a bank approved by the Bar	Georgia State Bar rule
Use ACH blocks on your bank account	ALTA Best Practice #2
Use wire blocks on your account	ALTA Best Practice #2
Identify the bank account as “escrow” or “trust”	ALTA Best Practice #2
Use attorney funds to pay for bank charges	North Carolina State Bar rule

### Focus Area 2: Deposits

Incoming trust money is at greatest risk before it is deposited into your account. Therefore, it is crucial that you deposit funds as soon as possible after receipt. Taking this simple step with every deposit will greatly reduce your risk of escrow theft. Be sure to establish responsibility with your staff for incoming funds so there is no uncertainty about whose job it is to get wires and checks in the bank on a timely basis. Even though you will probably want to appoint one person to be primarily responsible for handling deposits in order to promote ownership, you should have a backup fully trained to ensure there is no interruption when the primary person is not available.

Bar rules for North Carolina, South Carolina, and Georgia require that only client funds held in trust, or funds to cover bank service charges, be deposited into the trust account. The trust account cannot be used for “stray funds” (such as rental money, replenishment funds, or tax withholdings). The one exception to this rule is that if you receive a check containing funds for two purposes (for example, the attorney’s fee plus a recording fee), and one of those purposes is for funds to be held in trust, you must deposit the entire check into the trust account and promptly remove the non-trust portion.

Finally, whether you make your bank deposit using remote deposit or at the teller window, do yourself a favor and use one deposit ticket for each client deposit. This will make your account reconciliation much easier.

Summary of Focus Area 2

<i>Recommendation</i>	<i>Source</i>
Deposit funds as soon as possible after receipt	iTracs tip
Establish clear ownership with staff for deposits	iTracs tip
Designate and train a backup for deposits	iTracs tip
Use the trust account only for trust funds and funds to cover bank charges	North Carolina State Bar rule South Carolina State Bar rule Georgia State Bar rule
Deposit checks for two purposes into your trust account, and promptly remove funds designated for non-trust purposes	North Carolina State Bar rule
Use one deposit ticket for each client deposit	iTracs tip

### Focus Area 3: Checks and Withdrawals

Unauthorized disbursements represent the highest risk to your trust account. Therefore, checks and other withdrawals from your trust account must be tightly managed.

If you use pre-numbered, pre-printed check stock, be sure to maintain a check log to account for all of your checks. At any given time, you should be able to determine from the check log if any particular check is still in stock, or if it was issued, voided, or destroyed. One way to reduce the risks associated with physical storage of check stock is to use blank check stock, and using specialized software, print the MICR encoding on the check only upon issuance. If you go this route, be sure to control access to the software containing your MICR codes.

Whether you use pre-printed check stock or blank check stock, it is important to use security features on your checks. Security features make it harder for someone to forge, tamper with, or counterfeit your checks. Nothing will stop a determined criminal, but just as is the case in protecting your home, usually the trust accounts which fall victim to this type of activity are those which appear to be easy prey. Common security features include special paper, watermarks, micro-printing, holograms, and security threads.

In your banking agreement, establish that checks above a certain dollar amount require multiple signatures, creating one more hurdle for any one individual to steal large amounts of trust funds using a single check. And be careful about allowing the use of signature stamps. Typically, they are a bad idea, because if the signature stamp is stolen or lost, you have created an opportunity for someone to fraudulently access your signature. If you do use signature stamps, make sure they remain securely stored in a locked cabinet.

As is the case with deposits, it is important, perhaps even more so, to establish clear responsibility with your staff for those involved in the disbursement process. Designate specific individuals to sign checks, and to initiate or approve outgoing wires. Establish authorization levels for each employee—the maximum amount he or she can individually approve—and review the levels at least annually. You should only authorize individuals to approve disbursements after you have fully reviewed their credit history and criminal background. And circumstances change, so it is good to get in the habit of updating background checks at least every three years. Finally, be sure to remove authorization for employees who terminate immediately so they can no longer sign checks or approve wires.

Once you've established responsibility for disbursements, you will want to make sure your designated employees are properly trained. Every employee with disbursing authority should fully understand all the relevant Bar rules and Best Practices, as well as have a general sense of proper internal controls over the disbursement function. Perhaps most importantly, make sure your staff understands how phishing scams and other common schemes that criminals use to try to steal money from trust accounts work.

Your firm should have formal policies in place which describe exactly how disbursements will be made, including answers to the following questions:

- Who is authorized to initiate wires? Who is authorized to approve wires?
- Who is authorized to approve checks?
- Do checks require multiple signatures, or only one? Does it vary by dollar amount?
- How do you verify the identity of parties requesting disbursements to reduce the risk of a criminal successfully impersonating your client?
- How do you keep your check stock secure?
- How do you spot potential phishing scams? What should be done if one is suspected?

Most state bars have rules in place which are relevant to disbursing money from trust accounts. One important rule for North Carolina, South Carolina, and Georgia, is that you cannot use trust funds to advance attorney fees; you may disburse trust funds for attorney fees only after those fees have been earned. Both the North Carolina and South Carolina State Bars prohibit making checks payable to cash or bearer, as well as cash withdrawals. If a client asks for cash, make the check out to the client, and have the client cash the check at the bank.

Finally, keep good records of all disbursements. This will make your reconciliation much easier and less time consuming, whether you do it manually or using software such as iTracs. Make sure the records in your settlement software clearly indicate from which client the funds are being disbursed, the date, the purpose, etc. And commit to entering or loading disbursements in your trust accounting software at least daily so your trust ledger balances are always current and accurate.

#### Summary of Focus Area 3

<i>Recommendation</i>	<i>Source</i>
If you use pre-printed checks, maintain a check log. Define a finite number of statuses, and insist that each check that was ever in inventory be assigned a valid status at all times	iTracs tip
Consider using blank check stock, and printing MICR information on the check when the check is being printed	iTracs tip
Use security features on your checks	iTracs tip
Require multiple signatures on large checks	iTracs tip
Think twice about using signature stamps. If you do use one, keep it secure	iTracs tip
Establish clear responsibility with your staff	iTracs tip
Establish authorization levels for each staff member, and review them annually	ALTA Best Practice #2
Make sure disbursement authorization is removed immediately from terminated employees	ALTA Best Practice #2
Conduct background checks on employees at least every three years	ALTA Best Practice #2
Develop formal, written policies regarding disbursements at your firm	iTracs tip
Do not use trust funds to advance attorney fees	North Carolina State Bar rule South Carolina State Bar rule Georgia State Bar rule
Do not make checks payable to cash or bearer	North Carolina State Bar rule South Carolina State Bar rule
Keep good records of disbursements	iTracs tip
Commit to entering transactions at least daily	iTracs tip

#### Focus Area 4: Data Security

There are two main risks with your data: One, that it gets lost or corrupted, and two, that it gets stolen. Fortunately, you can take steps to mitigate both risks.

If you aren't already making backups of your settlement software database on a regular basis, start doing so now. That is the key to ensuring your business can continue without interruption in the event of a hardware failure or some other event that impairs the data in your production database. Assign this task to a specific person, and make sure that they are adequately trained. For a relatively small fee, you can purchase software that will automate the backup process, which removes the burden from your staff and ensures that this important task is not overlooked. Whether you opt for automated backups or manual backups, you will need to determine how long to keep them. You will also need to determine where to store the backups. We recommend considering a safe, offsite location in the event your office suffers a fire or break-in.

With regard to unauthorized access to your data, or theft, the two most important variables you can control are physical access to the data and virtual access to the data. Control physical access by keeping your computers and servers in offices that are locked at night and generally inaccessible by the general public. Control virtual access by using a robust firewall, modern anti-virus software that you keep up to date, and good password standards and controls. Consider limiting the ability to install software on your computers to only a few individuals with separate administrative passwords.

Most data breaches occur through phishing scams, . a fraud scheme whereby someone tries to trick you into giving them confidential information which could be used to gain unauthorized access to data or to secure credentials which would provide access to funds. This can be done by providing the criminal confidential information outright, or by inadvertently allowing someone to install keystroke logging software on your computer. You and your staff should have a basic awareness of phishing scams, and ways to prevent them. Your best defenses against phishing scams are the following:

- Do not respond to emails asking for confidential information. If the message has an attachment, do not click on it
- Use a firewall and anti-virus software
- Require an administrative password to install software on your computers

Summary of Focus Area 4

<i>Recommendation</i>	<i>Source</i>
Make backups of your data on a regular, pre-defined schedule	iTracs tip
Assign responsibility for backups to a specific person with the proper training	iTracs tip
Consider tools to automate your backups	iTracs tip
Develop a formal policy for how long you retain backups	iTracs tip
Identify a specific secure location to store the backups	iTracs tip
Consider storing backups in an offsite location	iTracs tip
Control physical access to servers and computers	iTracs tip
Control virtual access to computers and networks	iTracs tip
Know the warning signs of a potential phishing scam, and how to avoid falling victim to one	iTracs tip

Focus Area 5: Trust Ledgers

You need some formal system to maintain your trust ledgers. There are three main options, listed below in decreasing order of control and automation.

- 1) Trust accounting software which is fully integrated with your settlement software, such as Softpro, Ramquest, or Landtech
- 2) Financial software which is typically *not* integrated with your settlement software, such as Quicken, Money, or Excel
- 3) Manual accounting using a paper-based ledger system, such as a checkbook or ledger cards for each client

If you handle even a moderate volume of real estate transactions in your practice, integrated trust accounting software will pay for itself. Not only will it save you and your staff valuable time that could be spent on billable activities, it will also reduce the risk of errors, and it will make your reconciliation process much easier. And be sure to take advantage of the integration which allows you to avoid redundant data entry between the trust accounting functionality and the settlement functionality. You should only consider option 2 or 3 if your volume of real estate closings is very low. Also note that option 3 does not appear to comply with ALTA's Best Practice Requirement of "an electronic audit trail."

Summary of Focus Area 5

<i>Recommendation</i>	<i>Source</i>
Use trust accounting software which integrates with your settlement software	iTracs tip
Avoid redundant data entry by enabling data feeds from the settlement software to the trust accounting software	iTracs tip

### Focus Area 6: Insurance Coverage

There are quite a few insurance products available which protect you from trust account risks in various ways. A synopsis of them is provided below.

<i>Type of Coverage</i>	<i>Typical Protection Offered</i>
Professional Liability (E&O)	Disbursements of client funds made in good faith, but erroneously, which cannot be recovered and are not the result of fraud
Cyber Liability	Discovery, defense, and reparation costs, as well as fine and penalties, associated with a data breach
Crime or Social Engineering	Fraudulent impersonation of a client or other person resulting in loss of client funds
Fidelity or Surety Bond	Embezzlement of client funds by an employee

You should consider whether each of the above types of coverage is necessary based on your firm's specific circumstances. Sometimes, a decision to forego certain types of insurance coverage is a prudent decision. But you should make that decision only after thoroughly evaluating your risks, the insurance products available to mitigate those risks, and the costs. Investors Title can connect you with resources available through our VIP program, which can help you determine if these products are right for you.

#### Summary of Focus Area 6

<i>Recommendation</i>	<i>Source</i>
Consider purchasing insurance to cover some of the risks associated with your trust account	iTracs tip

### Focus Area 7: Reconciliations

Reconciling your trust account on a timely basis is one of the most important, yet often most overlooked, steps in properly managing your trust account. There is no substitute for your commitment to reconcile your trust account on a regular and timely basis. It is the most important thing you can do to ensure your trust account is being managed well.

In addition to helping you identify potential errors and irregularities quickly, hopefully while you still have time to take action, regular and timely reconciliations ensure that you are always prepared for an audit, from either your underwriter or the State Bar. But remember, reconciling your account is not enough. You must also review, investigate, and clear any exceptions found during the reconciliation process. You can have an account that is fully reconciled, yet might still have significant problems and creates unnecessary risk because it contains exceptions which need attention.

Both the North Carolina State Bar and ALTA Best Practices require monthly three-way reconciliations. While a two-way reconciliation balances the bank statement to the trust software, which shows the balance of the account in total, a three-way reconciliation goes a step further and reconciles the sum of the individual client ledgers to the bank statement as well. Any differences resulting from this process



must be investigated and corrected. The benefit of a three-way reconciliation is that it ensures proper accounting for all trust funds at a client level, not just for the account in total.

As stated earlier, timely reconciliations are key to discovering potential errors and irregularities while you still have time to take action. For example, your rights are preserved with most banks only if you provide notification of errors within 30 days. The North Carolina State Bar has long required monthly 2-way reconciliations, but recently began requiring monthly 3-way reconciliations. And ALTA Best Practices require a 3-way reconciliation at least monthly, as well as a reconciliation of receipts and disbursements at least daily. Meeting these new requirements can be difficult without the proper tools. iTracs can help by automating much of the reconciliation process, enabling you to do it faster, more often, and more thoroughly.

It is important that your account reconciliation be performed by someone who does not have check signing authority in order to eliminate any potential conflict of interest. Assigning reconciliation responsibilities to a check signer who is embezzling funds provides an opportunity to perpetuate the fraud by obscuring it in the reconciliation. Using a third-party reconciliation service is one way to handle this issue. Regardless of who prepares the reconciliation, it is important that firm management review the results of the reconciliation to ensure there are no improprieties and that all exceptions are properly resolved in a timely manner. As such, it is essential that the reviewer fully understand the reconciliation requirements and each report in the reconciliation package.

Finally, ALTA Best Practices requires that results of the reconciliation be accessible electronically by the underwriters. It is unclear at this time whether providing a document in a format such as Adobe PDF via email is sufficient to satisfy this requirement, or if access to an electronic reconciliation that permits detailed analysis of transactions is required.

You should carefully consider your options when it comes to reconciling your trust account, which we've summarized below.

<i>Options</i>	<i>Characteristics</i>
Prepare reconciliation in-house	Difficult and time-consuming. Staff members may not have required expertise. Non-revenue producing activity. Difficult to maintain segregation of duties and meet other Best Practice requirements.
Outsource to a local accountant or CPA	A local accountant may be a good option, since they can easily tailor their services to your individual needs. However, the cost is often more than a third-party service that specializes in trust account reconciliations, and since most accountants handle a wide variety of assignments, they may lack specific trust account expertise, as well as deep knowledge of Bar requirements or ALTA Best Practice requirements.
Utilize a specialized third-party trust account reconciliation service	Can provide a higher level of expertise, save you time which you can then re-direct to billable services, help achieve separation of duties, and provide a platform that will enable you to comply with Bar requirements and ALTA Best Practices, typically at a total all-inclusive cost that is lower than the other two options.

#### Summary of Focus Area 7

<i>Recommendation</i>	<i>Source</i>
Review, investigate, and clear any exceptions found during the reconciliation process	iTracs tip
Prepare a 3-way reconciliation at least monthly	North Carolina State Bar rule ALTA Best Practice #2
Balance receipts and disbursements at least daily	ALTA Best Practice #2
Assign reconciliation responsibility to someone who does not have check signing responsibility	ALTA Best Practice #2
A manager in the firm should review the reconciliation for improprieties and to ensure that exceptions are resolved properly and in a timely manner	ALTA Best Practice #2
Make reconciliations electronically accessible to the underwriter	ALTA Best Practice #2

Managing your escrow account doesn't have to be difficult. Hopefully, in reading this paper, you realize that you are already taking most of these steps. And you can also see that, while the source of many of our recommendations are ALTA Best Practices or Bar rules, the recommendations are practical solutions to securing your escrow account.

Through iTracs and VIP, Investors Title has tools that can help you secure your escrow account and gain peace of mind, while maintaining compliance in a cost-effective way that doesn't negatively affect your firm's productivity. If we can be of service, please contact a member of our team today.