Trust Accounting under the *Legal Profession Act 2007*

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Introduction

The *Legal Profession Bill 2007*, currently before Parliament, is expected to come into effect from 1 January 2009. It is important that practitioners who have not already done so begin making the necessary changes to ensure compliance as at 1 January 2009.[2]

The purpose of this paper is to provide legal practitioners with a practical overview of the changes to the ways in which trust moneys are classified and accounted for by law practices. I hope it will also reassure legal practitioners that although the provisions of the new Act seem complex and intimidating, some of the changes merely codify standards and practices presently in use. Nevertheless, legal practitioners need to be aware that there are important changes to the terminology and classifications of trust moneys, and that the new Act imposes significant penalties for non-compliance with its new provisions.

At present there are no new regulations, but it can be assumed that they should be similar to those produced under the National Practice Model Laws and would be similar to those currently used in other States.

Overview of Part 9 of the New Act: Trust Money and Trust Accounts

The provisions governing trust moneys are set out in Part 9 of the new Act. These provisions reflect a move by the legal profession nationwide to establish a more uniform approach to regulating trust moneys.

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[2] For the sake of convenience I will refer to the provisions of the *Legal Practice Act 2003* as "the current Act" and the provisions of the *Legal Profession Act 2007* as the "new Act".

Section 204 of the new Act articulates the goal of Part 9: to protect trust moneys within a structure that is fundamentally uniform across Australian jurisdictions, for the purpose of minimising compliance requirements for law practices operating in more than one Australian jurisdiction, and facilitating cooperation between legal regulatory authorities in different Australian jurisdictions.

Many of the provisions in Part 9 of the new Act are "core" provisions, meaning they are intended to be uniform across all Australian jurisdictions.

Part 9 of the new Act is divided into the following 6 divisions:

- Division 1: Preliminary
- Division 2: Trust Accounts and Trust Money
- Division 3: Investigations
- Division 4: External Examinations
- Division 5: Provisions Relating to Authorised Deposit-Taking Institutions (ADI's)
- Division 6: Miscellaneous

The 47 sections comprising these 6 divisions replaces the 12 sections comprising Part 10 of the current Act. The new Act creates a much more detailed framework of requirements than previously in place. Although this may at first seem overwhelming, the new structure provides a more comprehensive set of guidelines, which should provide legal practitioners with more direction as to their obligations concerning trust moneys. It also brings WA into line with the trust accounting obligations in other Australian jurisdictions, which will be beneficial for law practices with divisions in other States.

In familiarising themselves with the new system, legal practitioners should remember that although the new Act is more prescriptive and uses new terminology, the essential requirements remain the same: to provide protection for trust moneys and to record all transactions affecting trust moneys.

Division 1: Preliminary

In line with the goal of establishing a more uniform approach to regulating trust moneys in Australian jurisdictions, Division 1 commences with a statement of the purposes of Part 9 of the new Act, before identifying the parameters of the application of Part 9. Division 1 differentiates trust money from other types of money entrusted to and/or held by law practices (such as money held in connection with the provision of financial services) and provides the key definitions required for the application of Part 9.

The most profound change imposed by the new Act is the introduction of new terminology for differing classifications of trust moneys. Section 205 defines "trust money as:

> *"money entrusted to the law practice in the course of or in connection with the provision of legal services by the practice, and includes —*
>
> *(a) money received by the practice on account of legal costs in advance of providing the services; and*
> *(b) controlled money received by the practice; and*
> *(c) transit money received by the practice; and*
> *(d) money received by the practice that is the subject of a power, exercisable by the practice or an associate of the practice, to deal with the money for or on behalf of another person."*

The current Act defines trust money in more general terms. However, despite the new names, many law practices will find that their present trust accounting system already accommodates these new classifications. Nevertheless, when receiving trust moneys from clients, practitioners will now need to classify the type of trust money received.

Section 205 provides further definitions of each sub-category of trust money. “Controlled money” is defined by section 205 as:

> *“money received or held by a law practice in respect of which the practice has a written direction to deposit the money in an account (other than a general trust account) over which the practice has or will have exclusive control”*

Controlled money includes trust moneys held by legal practitioners on behalf of clients which are subject to specific investment instructions. Presently these moneys are known as investment accounts and should not be confused with moneys referred to in section 206(2). Controlled money must be deposited into a “controlled money account”, which is defined by section 205 as “*an account maintained by a law practice with an ADI [authorised deposit-taking institution] for the holding of controlled money received by the practice*”. The specific requirements for dealing with controlled money are discussed below under Division 2.

Section 205 defines “transit money” as:

> *“money received by a law practice subject to instructions to pay or deliver it to a third party, other than an associate of the practice”*

Transit money would include cheques made payable to a third party provided to the practitioner for the purpose of being forwarded on to the recipient. For example, in the context of a personal injury practice, a cheque made payable by the client to a medical practitioner as payment for a medical report would be classified as transit money if it was sent to the practitioner for the purpose of being forwarded on to the doctor. Transit money, by its nature, is not paid into an “account”. Nevertheless, there are specific requirements for dealing with transit money which are discussed below under Division 2. Although the current Act is silent with respect to transit money, practitioners have always been encouraged to maintain a record of these cheques or to keep copies of the cheque and notes as to their disposition.

Trust money which does not meet the definition of controlled money or transit money is simply "general" trust money. This money is required to be deposited into a "general trust account", which is defined by section 205 as "*an account maintained in this jurisdiction by a law practice with an ADI for the holding of trust money received by the practice, other than controlled money or transit money*". The general account will be used for the day to day transactions occurring in a legal practice and the requirements for dealing with these funds are discussed below under Division 2. In essence, the documentation for dealing with such funds has not changed.

Section 205 also provides a comprehensive definition of "trust records", which includes:

> *"(a) receipts;*
> *(b) cheque butts or cheque requisitions;*
> *(c) records of authorities to withdraw by electronic funds transfer;*
> *(d) deposit records (including deposit slips and duplicate deposit slips);*
> *(e) trust account ADI statements;*
> *(f) trust account receipts and payments cash books;*
> *(g) trust ledger accounts;"*
> *(h) records of monthly trial balances;*
> *(i) records of monthly reconciliations;*
> *(j) trust transfer journals;*
> *(k) statements of account as required to be furnished under the regulations;*
> *(l) registers required to be kept under the regulations;*
> *(m) monthly statements required to be kept under the regulations;*
> *(n) files relating to trust transactions or bills of costs or both;*
> *(o) written directions, authorities or other documents required to be kept under this Act;*
> *(p) supporting information required to be kept under the regulations in relation to powers to deal with trust money."*

Under the current Act, legal practitioners are required by section 140 to maintain "books of account" but the type of records falling within this definition are not specified. In this sense, the new Act provides further clarification as to the parameters of the record keeping process.

As mentioned above, Division 1 also delineates what is <u>not</u> trust money. Section 206 provides that money held by a law practice in connection with the provision of financial services which require an Australian financial services licence is <u>not</u> trust money. Likewise, money held for or in connection with a managed investment scheme or mortgage financing is <u>not</u> trust money.

On the other hand, money held for investment purposes is trust money "*if it is held as part of and in relation to a legal practice*", and the investment is for the ancillary purpose of maintaining or enhancing the value of the money pending completion of the matter in respect of which the moneys is so held.

In the event of a dispute as to whether money is "trust money" or not, section 207 permits the Board to make a determination as to whether the money constitutes trust money.

Section 208 of the new Act, in anticipation of the prevalence of interstate practices practising in this jurisdiction, has been included to provide guidance as to when WA law applies to trust moneys (as opposed to the corresponding provisions in other States).

Section 209 of the new Act provides for the Board to enter into protocols with other States with corresponding regulatory authorities in respect of trust account matters. These protocols provide for "*determining the jurisdiction where a law practice receives trust money; sharing of information*". The protocols must be "*embodied or identified in the regulations*" for it to take effect. There is no corresponding provision in the current Act.

Section 210 of the new Act defines when moneys are "received" by a law practice. Trust moneys may be "received" electronically, by credit card transaction or telegraphic transfer. The current Act does not specifically define when trust moneys are received. Section 211 of the new Act defines what steps must be performed by a legal practitioner associate to discharge his or her obligations under Part 9 on behalf of a law practice.

Section 212 provides that the obligations imposed by Part 9 on a law practice are also imposed on the principals of that practice jointly and severally. Discharge of the legal practice's obligations discharges the corresponding obligations on all of the practitioners.

Section 213 of the new Act states that Part 9 applies to former law practices, and principals and associates of law practices in respect of their conduct while they were in such practice.

DIVISION 2 – TRUST ACCOUNTS AND TRUST MONEY

This division sets out the requirements for the maintenance of trust accounts and dealings with trust moneys, including how these moneys are to be recorded and held, as well as defines who is the appropriate person to do so.

Division 2 also introduces penalties for non-compliance of as much as $5,000 for each violation. This division is highly prescriptive about what is required in the maintenance, holding and withdrawal of funds. It is vital that the practice makes an accurate allocation of trust funds into the right category, i.e. controlled money, transit money, trust money subject to a specific power, or general trust funds.

Sections 214,215,216 and 217 of the new Act deal specifically with trust moneys placed into the general trust account. In most cases there is a penalty of a fine for non-compliance.

Sections 218 and 219 of the new Act deal with controlled money. Again, there is generally a penalty of a fine for non-compliance.

Section 220 of the new Act deals with transit money and requires the timely delivery of these funds. It provides that the law practice must account for the money in the way prescribed in the regulations. Section 220 also provides for fines for non-compliance. The current Act simply provides in section 141 (2) that:

> "*where a legal practitioner receives a cheque from a person for the use or benefit of a person other than the legal practitioner -*
>
> *(a) the legal practitioner must cause an adequate record of the receipt and disposition of the cheque to be made;*"

The introduction by the new Act of the definition of transit money in Division 1 and the requirements in Division 2 clarifies what is presently required in the keeping of records. The proposed regulations may stipulate specific recording requirements which are currently not stated.

Section 221 of the new Act provides that trust money subject to a specific power must only be dealt with in accordance with that power and that money must be accounted for as prescribed by the regulations. There are fines for non-compliance.

Sections 137 and 141 of the current Act deal with the above issues but in a less prescriptive manner. Section 137 provides that every legal practitioner practising in this State who receives trust moneys must deposit these funds into a trust account. This is a general account, or an account maintained for persons from whom or for whose use or benefit the moneys are received. These funds must be retained until they are dealt with as directed or they are otherwise dealt with according to law. Section 141 presently governs dealings with receipt of cheques received from a person for the use or benefit of a person other than the legal practitioner (i.e. what is now called "transit money"). This section requires adequate recording of the receipt and disposition of the cheque, that a direction in writing be provided, and that these records be held for at least 7 years.

Section 222 of the new Act also governs the receipt of trust money in the form of cash. Cash funds must be deposited to either the general trust account or a controlled trust account, irrespective of any direction by an appropriate person in respect of transit funds, or trust money that is the subject of a specific power. Once the funds are deposited they can be dealt with as directed. The penalty for non-compliance is a fine of $10,000. Section 222 also defines who is an "appropriate person":

> *""appropriate person" in relation to trust money, means a person who is legally entitled to give the law practice concerned directions in respect of dealings with the trust money."*

Section 223 of the new Act specifically states that trust money cannot be used for payment of debts of the practice or for the satisfaction of a judgment. This provision does not apply to money to which a law practice or associate is entitled. Section 137 of the current Act contains similar provisions regarding trust money.

Section 224 of the new Act deals with the intermixing of money. It provides that:

> "*a law practice must not, otherwise than as permitted by subsection (2), mix trust money with other money. (2) A law practice is permitted to mix trust money with other money to the extent only that is authorised by the Board and in accordance with any conditions imposed by the Board in relation to the authorisation"*.

The current Act is silent on this issue but it has been the Board's practice to disallow intermixing of moneys.

Subject to the provisions of Part 10 of the new Act governing costs disclosure and assessment, section 225 of the new Act specifies a number of ways in which a law practice may deal with general trust funds and controlled money. These include:

- Exercising a lien for legal costs reasonably due and owing to the practice;

- Withdrawing funds to pay outstanding invoices owing to the practice (subject to compliance with relevant procedures and requirements provided for in the Act); and
- Where money remains unclaimed after payment of the practice's invoices, deal with the balance as required by the *Unclaimed Money Act 1990*.

Section 226 of the new Act provides that a deficiency in any trust account or trust ledger account may constitute and offence. Likewise, failure to pay or deliver trust moneys may be an offence. This section provides as follows:

> "*(1) An Australian legal practitioner commits an offence if the practitioner, without reasonable excuse, causes —*
>
> > *(a) a deficiency in any trust account or trust ledger account; or*
> >
> > *(b) a failure to pay or deliver any trust money.*
>
> *(2) A reference in subsection (1) to an account includes a reference to an account of the practitioner or of the practice of which the practitioner is an associate.*
>
> *(3) In subsection (1) —*
> ***"cause"*** *includes to be responsible for;*
> ***"deficiency"*** *in a trust account or trust ledger account includes the non-inclusion or exclusion of the whole or any part of an amount that is required to be included in the account."*

The penalty for non-compliance may incur a hefty fine of $25,000.

Section 227 of the new Act now compels a legal practitioner to report certain irregularities and/or suspected irregularities to the Board. This duty applies to all legal practitioner associates of a law practice. This duty is further extended by section 227 (2)

to an Australian legal practitioner to report any irregularities *"in connection with the receipt, recording or disbursement of any trust money received by a law practice of which the practitioner is not a legal practitioner associates"*. Reporting must be given by written notice and done so as soon as practicable. The fact that the practitioner may be incriminated does not excuse him /her from complying with this section. Protection is provided to a legal practitioner against liability for any loss or damage suffered by another person as a result of the practitioner's compliance with this section. The penalty for non-compliance is a fine of $5,000.

Section 228 of the new Act deals with the keeping of trust records. A law practice must keep, "*in the form of a permanent record, trust records in relation to trust money received by the practice"*. The definition of what is a permanent record is supplied within this section and states that:

> ***""permanent record"****, in relation to a trust record, means printed or, on request, capable of being printed, in English on paper or other material."*

It further states that "*the law practice must keep the trust records* -

> *(a) in accordance with the regulations; and*
> *(b) in a way that at all times discloses the true position in relation to trust money received for or on behalf of any person; and*
> *(c) in a way that enables the trust records to be conveniently and properly investigated or externally examined; and*
> *(d) for a period determined in accordance with the regulations".*

These provisions are similar to section 140 of the current Act but there is now a $5,000 fine for non –compliance.

Section 229 of the new Act deals with receiving trust money under false names. A law practice must not knowingly receive or record trust moneys under a false name. If a client is commonly known by more than one name, then all such names must be recorded. This section is intended to address the issue of money laundering. The penalty for non-compliance is a fine of $10,000. The current Act does not deal with this issue but most legal practices are aware of the need to open a client trust ledger in the client's correct name or to make note of the names that they are commonly known by if it is more than one name.

DIVISION 3 - INVESTIGATIONS

This Division deals with the appointment of investigators, and conducting of investigations. It provides various powers for investigators to enter practices, and to recover costs in respect of their inspections of the practice. It is a requirement that the investigator's report remains confidential.

DIVISION 4 – EXTERNAL EXAMINERS

This Division provides for the designation and appointment of external examiners. An external examiner can be either a auditor, employee or an agent of the Board. Pursuant to section 236 the Board may appoint an associate of a law practice as an external examiner. Section 237 states that a law practice must have its trust records externally examined by an external examiner appointed in accordance with the regulations at least once in each financial year.

Section 238 of the new Act deals with the examination of affairs of a law practice in connection with the examination of trust records. This section enables an external examiner to, if warranted, examine other aspects of the practice in so far as they are relevant to trust money.

This is not covered in the trust section of our current Act but is provided in other areas of our current Act.

Section 239 of the new Act deals with the final examination of trust records. This section applies if a law practice –

> "(a) ceases to be authorised to receive trust money; or
> (b) ceases to engage in legal practice in this jurisdiction."

This section stipulates the period to be examined and that the report must be lodged with the Board within 60 days after the end of the period to which the examination relates. The penalty for non-compliance is a fine of $10,000. The current Act does not deal with this issue but it has been the Board's practice to obtain a final examination report to confirm that trust funds have been appropriately dealt with and the closure of the trust account.

Section 242 of the new Act provides that a law practice whose trust accounts have been externally examined must pay the costs of the examination. Section 142 of the current Act provides a similar liability.

DIVISION 5 – provisions relating to ADIs

This Division deals with approved deposit institutions ("ADIs") and their obligations and liabilities. These are similar to the restrictions in section 139 of our current Act.

Section 244 requires ADIs to provide reports, records and information to the Board. There are fines for non-compliance.

DIVISON 6 – Miscellaneous

Section 245 of the new Act deals with the restrictions on receipt of trust money. Firstly, a law practice may not receive trust money unless a principal holds an Australian practising certificate authorising the receipt of trust money. For incorporated law practices, at least one legal practitioner director must hold such a practising certificate. The penalty for non-compliance is a fine of $25,000.

Furthermore, section 246 of the new Act provides restrictions on receipt of trust money by interstate legal practitioners.

Section 247 of the new Act deals with the application of this Part to incorporated legal practices and multi-disciplinary partnerships. This section provides that the same obligations imposed on law practices by this Part also apply to incorporated legal practices and multi-disciplinary partnerships in respect of legal services. The regulations may, however, provide that specific provisions of this Part do not apply to incorporated legal practices and multi-disciplinary partnerships, or apply with specific modifications.

Section 248 of the new Act requires disclosure to clients when funds received or held will not be treated as trust moneys. This disclosure must be given in writing to the person at the time or as soon as practicable after the determination is made. The regulations may make provision as to the form and manner that this disclosure is to be made.

Section 249 of the new Act also requires law practices or legal practitioner associates to advise the Board of the details of each account maintained at any ADI in which money entrusted is held. This applies whether or not the money is trust money and whether or not section 206 or 207 applies to the money. The penalty for non-compliance is a fine of $5,000.

Section 250 of the new Act deals with the regulations. The regulations may make provisions for or with respect to any matter to which this Part relates.

Appendix A ***Trust Accounts – Part 9 New Act – Part 10 Act***

The present Act has 12 sections dealing with trust accounts, whereas the New Act contains 47 sections.

Act	New Act	Description
	204	Purpose
3 / 136	205	Definitions
	206	Money involved in financial services or investments
	207	Determinations about status of money
136	208	Application of Part to law practices and trust money
	209	Trust money protocols
	210	When money is received
	211	Discharge by legal practitioner associate of obligations of law Practice
	212	Liability of principals of law practice
	213	Former practices, principals and associates
	214	Maintenance of general trust account
137	215	Certain trust money to be deposited in general trust account
137/141	216	Holding, disbursing and accounting for trust money
	217	Manner of withdrawal of trust money from general trust account
	218	Controlled money
	219	Manner of withdrawal of controlled money from controlled money account
141 (2)	220	Transit money
	221	Trust money subject to specific powers
	222	Trust money received in the form of cash
137	223	Protection of trust money
	224	Intermixing money
138	225	Dealing with trust money: legal costs and unclaimed money
	226	Deficiency in trust account
	227	Reporting certain irregularities and suspected irregularities

140	228	Keeping trust records
	229	False names
142	230	Appointment of investigators
143	231	Investigations
	232	Application of Part 15
144	233	Investigator's report and confidentiality
	234	When costs of investigation are debt
147	235	Designation of external examiners
	236	Designation and appointment of associates as external examiners
147	237	Trust records to be externally examined
	238	Examination of affairs in connection with examination of trust records
147	239	Final examination of trust records
	240	Carrying out examination
	241	External examiner's report and confidentiality
142	242	Law practice liable for costs of examination
139	243	ADI not subject to certain obligations and liabilities
	244	Reports, records and information
	245	Restrictions on receipt of trust money
	246	Restrictions on receipt of trust money by interstate legal practitioners
136	247	Application of Part to incorporated legal practices and multi-disciplinary partnerships
	248	Disclosure to clients – moneys not received or held as trust money
	249	Disclosure of accounts used to hold money entrusted to law practice or legal practitioner associate
	250	Regulations
145		Action on examiner's report
146		Legal practitioners to make payments towards Guarantee Fund