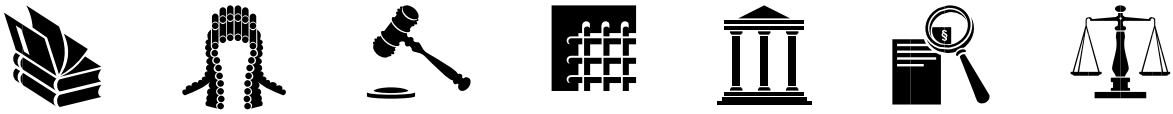
New Lawyer Program

KENTUCKY BAR ASSOCIATION

Trust Accounts 101: FAQs and Tips to Avoid Trouble



On Demand

Presented by:
The Kentucky Bar Association
Continuing Legal Education Commission

Caroline J. Carter, Laura Cole, Cassie H. Cooper, and Lori J. Reed, Editors

Published October 2025

Editor's Note: These *New Lawyer Program* handbook materials are intended to provide current and accurate information about the subject matter covered as of the original publication date. No representation or warranty is made concerning the application of legal or other principles discussed by the instructors to any specific fact situation, nor is any prediction made concerning how any particular judge or jury will interpret or apply such principles. The proper interpretation or application of the principles discussed is a matter for the considered judgment of the individual legal practitioner. The faculty and staff of the *New Lawyer Program* disclaim liability therefor. Attorneys using these materials or information otherwise conveyed during the program, in dealing with a specific legal matter, have a duty to research original and current sources of authority. In addition, opinions expressed by the authors and program presenters in these materials do not reflect the opinions of the Kentucky Bar Association, its Board of Governors, Sections, Divisions, Committees, or members.

***The Kentucky Bar Association would like to give special thanks to the volunteer authors who contributed to these program materials*.**

LAWYER TRUST ACCOUNTS 101: FAQS AND TIPS TO AVOID TROUBLE

Robbie Owen Clements*

I. INTRODUCTION

Trust account management – a subject just touched on in professional responsibility – is a very important topic for new lawyers, or any lawyers just beginning to run their own offices. Missteps in handling client funds in trust accounts can and do lead to disastrous consequences. Many of those mistakes, however, can be easily avoided with careful, vigilant management of those accounts. Understanding trust accounts begins with a thorough review of SCR 3.130(1.15), formally titled "Safekeeping property," which governs the use and maintenance of client trust accounts. Every Kentucky attorney should read the rule AND the comments and know the requirements.

II. WHAT IS A CLIENT TRUST ACCOUNT?

A client trust account is an account separate from the attorney's own funds, set up to hold client or third-party funds that the attorney comes into possession of in connection with representing a client. These accounts may also be referred to as escrow accounts. Trust accounts are also commonly referred to as IOLTA accounts, though that is not necessarily the case. All IOLTA accounts are trust accounts, but not all trust accounts are IOLTA accounts.

III. WHAT MAKES AN IOLTA ACCOUNT DIFFERENT?

IOLTA is an acronym for Interest on Lawyers' Trust Accounts. IOLTA accounts are intended to hold client funds that are 1) nominal in amount or 2) held for a short period of time. If the interest earned on the funds could be significant, it may be more appropriate to place those funds in a non-IOLTA trust account designated for that client. Under SCR 3.830, it is mandatory for any attorney who is not exempt to establish an IOLTA account. Those exemptions are specifically set out in section 14 of the rule, but generally, any attorney who handles client funds will need to have an IOLTA account. Attorneys must certify compliance with this rule annually. Interest generated from IOLTA accounts is sent directly from the banks to the IOLTA fund, which is why the IOLTA account must be maintained at a participating bank. Those funds support legal aid programs and other access to justice programs. The KBA website (https://kybar.org/) has a helpful FAQ section on IOLTA accounts and provides a toll-free number to call with any questions.

IV. WHO NEEDS A TRUST ACCOUNT?

Any attorney who holds funds for a client or third party in connection with a representation must do so in a trust account, separate from the attorney's own funds. The question the attorney must ask to determine whether the funds must be placed in a trust account is: Have

* Administrative Manager/Deputy Bar Counsel, Office of Bar Counsel.

I earned all of this money? If any portion of the funds received is for work not yet performed, costs not yet incurred, or are the property of the client or third-party, those funds must go into the trust account, at least initially, then transferred to the operating account as earned or incurred. Common situations in which the need for a trust account arise include the settlement of personal injury matters and the closing of real estate transactions. Advance cost payments must be placed in a trust account. Payments of retainers, flat fees, or any other fees for work not yet performed must also be deposited into a trust account, then transferred to an operating account when the work is complete and the fees are earned. Questions about whether you need a trust account should be directed to the Ethics Hotline for a written opinion.

V. WHY DO ATTORNEYS NEED TRUST ACCOUNTS?

Attorneys in possession of client funds have five basic duties related to those funds. Placing client funds into properly managed trust accounts enables attorneys to fulfill those duties. Those five duties include:

A. Safeguarding Client Funds

Lawyers must protect client funds that have been entrusted to them, meaning they must deposit them into trust accounts in banks that have agreed to notify the Kentucky Bar Association in the event of an overdraft. It is not enough to just keep the funds safe by, for example, placing them in the office safe. The funds must be placed in a trust account. *Chauvin v. Kentucky Bar Assn.*, 230 S.W.3d 325 (Ky. 2007).

B. Accounting for Client Funds

When requested by the client, the lawyer must account for the funds held for the client. Lawyers should always be able to provide clients with the amount of funds being held on their behalf and any expenditures that has been made from them.

C. Notifying Clients of Receipt of Funds

Lawyers must promptly notify clients upon receiving funds in which the clients have an interest.

D. Delivering Client Funds

Subject to the requirements of SCR 3.130(1.15) or other laws (*i.e.*, Medicaid liens, etc.), or to an agreement with the client, the lawyer shall promptly deliver client funds to the client. This includes refunds of fees or costs that have not been earned or incurred at the termination of representation. In the event of a dispute as to what that amount should be, the lawyer should pay the undisputed portion to the client and continue to safeguard the remaining funds until the dispute is resolved. In all cases, however, the lawyer should ensure the funds are ***actually collected in*** the trust account before disbursing them to anyone.

E. Segregating Client Funds

Trust accounts must be separate from the lawyer's personal and business accounts. The lawyer may not keep his or her own funds in these accounts and must withdraw fees as soon as they are earned.

Bottom line: trust accounts are intended to hold and protect other people's money, by keeping client or third-party money in a lawyer's possession separate from money belonging to the lawyer, and safeguarding the client or third party's money.

VI. WHAT ABOUT THE OPERATING ACCOUNT?

In addition to one or more trust accounts, firms and solo practitioners will have an operating account from which to pay the expenses of operating the office. The funds in that account are **earned** fees that are used to pay salaries and taxes, pay utility bills and rent, and generally keep the office running. Advance fees obtained with a proper written fee agreement pursuant to SCR 3130(1.5)(f), formerly referred to as "nonrefundable retainers," are also deposited in this account, though there is a possibility some or all of those funds could have to be refunded at a later date.[1]

VII. WHERE MUST TRUST ACCOUNTS BE SET UP?

Pursuant to SCR 3.130(1.15)(a), trust accounts must be kept in a bank in the state where the lawyer's office is located, absent consent from the client or third party to whom the funds in the account belong. The bank where the accounts are kept must have agreed to notify the Kentucky Bar Association in the event that any overdraft occurs on a lawyer's trust account. Not all banks have agreed to do so. It is the attorney's responsibility to ensure that the bank will notify the KBA as required by the rule. If it is an IOLTA account, the bank must be a participating bank as well. If the attorney's bank has not agreed to notify the KBA of an overdraft, or to participate in IOLTA for an IOLTA account, then the attorney must change banks. Period.

VIII. HOW LONG MUST TRUST ACCOUNT RECORDS BE KEPT?

Trust account records, including bank statements, deposit slips, canceled checks, client ledgers, receipts, and reconciliations, must be kept for five (5) years after termination of the representation. These records should be kept in a location where the lawyer can access them easily. Unlike many other jurisdictions, Kentucky is not a random audit state, meaning no one from the Office of Bar Counsel is assigned to travel to lawyers' offices to review these records; however, should an inquiry be made or a bar complaint be received, ease of access for the lawyer becomes critical. It is also a good idea to keep those records handy in case the bank makes an error in your account. Though not a common occurrence, it can happen, and

[1] Comment 11 to SCR 3.130(1.5)(f) states, "A lawyer may designate a fee arrangement as an advance fee and upon receipt deposit such funds in the lawyer's operating account. The amount of an advance fee must be reasonable in amount and comply with Rule 1.5. In the event the full amount is not ultimately earned or due to other factors, such as termination of the attorney-client relationship or is not reasonable, the funds must be returned to the client as provided in Rule 1.16(d)."

having a copy of the deposit ticket or other documentation can make the resolution of such an error much easier.

IX. WHAT HAPPENS IF A TRUST ACCOUNT IS OVERDRAWN?

As previously stated, SCR 3.130(1.15) requires lawyer trust accounts to be maintained in banks that have agreed to notify the KBA in the event of an overdraft on that account. When that notice is received, the KBA will send a letter to the lawyer requesting a written explanation of how the overdraft occurred. Required documentation will include the check that caused the overdraft and proof that the overdraft has been corrected. Bank statements may also be required. Failure by the lawyer to respond to an overdraft notification, or a response that raises questions about whether the trust account is being properly handled by the lawyer, may result in an investigation by the Inquiry Commission.

X. WHAT HAPPENS WHEN MONEY IN THE TRUST ACCOUNT BECOMES AN EARNED FEE?

If an attorney receives a retainer for work on a case, then performs work on that case, some portion of that retainer changes into an earned fee. That portion depends on the fee agreement entered into between the attorney and the client. Earned fees should be disbursed from the trust account as soon as reasonably possible after they are earned. Once earned, the funds become the property of the lawyer and cannot remain in the trust account. At a minimum, disbursements should be made on a regular basis, such as every 30 days. In the case of a retainer that is being drawn upon, best practice is to send a statement to the client showing the balance before the disbursement, the amount of that disbursement, and the remaining balance being held by the attorney.

A lawyer may choose to charge a flat fee for representation and, if collected before the service has been performed and in the absence of a proper advance fee agreement, such a fee must go into the trust account. As always, the fee remains the property of the client until earned. The agreement with the client, which best practices dictate should be in writing, should spell out when that fee is earned, whether it is based on the completion of a certain task or tasks (*i.e.* preparation of a document), the occurrence of a certain event (*i.e.* a court appearance), or the time expended by the lawyer. The fees should be withdrawn from the trust account as they are earned.

In the case of a personal injury settlement or real estate closing, funds should be transferred from the trust account to the attorney's operating account when the other funds are disbursed.

In any case, it is important to ensure that the funds deposited in the trust account have been fully collected before they are disbursed. When a check is deposited into the account, the funds may show as available, but that does not mean it is safe to immediately disburse them. Frequently, banks will hold large checks to ensure that they clear. In addition, many popular scams targeting lawyers involve payment by seemingly official checks that prove to be worthless. If the lawyer has disbursed the funds, then funds of legitimate clients being held in the trust account could be lost. Bottom line: do not disburse funds from the trust account until they have been fully collected and are in the account.

XI. CAN EARNED FEES JUST STAY IN THE TRUST ACCOUNT?

No, leaving earned fees in the trust account is commingling. Commingling occurs when a lawyer has his or her own funds in a trust account with client funds. A lawyer cannot leave earned fees in the trust account, nor can he or she deposit earned fees into it. This violates the rule even when there are no client funds in the trust account. *Merz v. Kentucky Bar Assn.*, 547 S.W.3d 764 (Ky. 2018). A lawyer can never use a trust account for holding or hiding personal funds. Likewise, commingling occurs when unearned fees are deposited in an operating account rather than a trust account. Either act is a rule violation.

Commingling is prohibited because it puts client funds at risk and violates the lawyer's duties to safeguard those funds and keep them separate from the lawyer's own. Trust accounts are typically not subject to seizure by the IRS or other creditors of the lawyer, nor are they considered part of a deceased lawyer's estate, because the money in them does not belong to the lawyer. When the lawyer puts (or leaves) personal funds in a trust account, it changes the character of that account and makes all the funds in it subject to seizure until it is determined what portion of the funds belongs to the lawyer and what portion belongs to clients.

It is also not permitted to write checks directly out of the trust account to cover personal or operating expenses, even when the funds have been earned. The proper procedure is to move earned fees from the trust account into the operating or personal account before doing anything else with them. *Curtis v. Kentucky Bar Assn.*, 959 S.W.2d 94 (Ky. 1998).

XII. HOW SHOULD CREDIT CARD PAYMENTS BE HANDLED?

Credit card payments for earned fees should be deposited directly into the operating account. The problem arises when credit cards are used to pay for retainers or advance costs, as placing those funds in the operating account, even briefly, is not permitted. According to KBA E-426, there are a couple of options for handling such payments. Either the attorney can set up two merchant accounts, one of which is a trust account, and ensure that any unearned fees or advance costs always go into that account or the attorney can have all credit card payments go into a trust account, then disburse the earned fees out to operating as soon as practicable after receiving them. If an attorney intends to accept credit card payments for unearned fees or advance costs, the attorney should consult and comply with KBA E-426.

XIII. WHAT ABOUT BANK FEES?

Although the best practice may be to have the bank draw all fees related to the trust account from the operating account, it is permissible under SCR 3.130(1.15)(d) for a lawyer to deposit some of his or her own funds into a trust account "for the sole purpose of paying bank service charges on that account, but only in an amount necessary for that purpose." There is no specific guidance on what amount would be considered reasonable to deposit for bank charges; however, any amount should be based on what the bank actually charges for things like check orders and other fees. Any amount the attorney deposits for this purpose must be tracked on its own ledger, just like funds deposited for a client.

XIV. WHAT IF THE BOOKKEEPER POCKETS SOME FUNDS?

Lawyers are not absolved from liability for trust account misconduct by delegating accounting and record keeping responsibilities to an employee or agent. Partners in a firm must make reasonable efforts to ensure measures are in effect to provide reasonable assurances that members are following the Rules of Professional Conduct. SCR 3.130(5.1). Pursuant to SCR 3.130(5.3), supervising lawyers may be held responsible for acts and omissions of employees. *Curtis v Kentucky Bar Assn.*, 959 S.W.2d 944 (Ky. 1998). All staff working with the trust account must be properly trained and supervised. Inexperience is no excuse.

To protect yourself, it is a good idea to review all bank statements as they come in for any irregularities. This does not require an attorney to be an accountant, but it does require proper oversight and understanding of your responsibilities to clients under the rules. Also, an attorney should be the signatory on the trust account. That does not, however, mean signing multiple blank checks to be used as the need arises. Don't sign the check until it has been filled out to avoid any mishandling of funds.

XV. WHAT IS THREE-WAY RECONCILIATION?

A trust account is unlike most other bank accounts, in that the funds in it belong to several different people and must be tracked accordingly. Every client must have his or her own ledger, and if there are multiple matters for a client, then each matter must have its own ledger as well. Any funds the lawyer has put into the trust account to cover bank charges must also be tracked on a ledger. Every entry for a debit or credit on the account must be made in two places – the general ledger (or checkbook register) and the specific client ledger.

When the account is reconciled (preferably monthly), the adjusted bank balance must match the general ledger/checkbook register balance, and both of those must match the total of all client ledgers. When all three are equal, the account has been reconciled – a three-way reconciliation.

XVI. WHAT ARE SOME WAYS TO AVOID TRUST ACCOUNT MISHAPS?

Obviously, reading SCR 3.130(1.15) and the comments will go a long way toward helping attorneys avoid trust account management issues. There are, however, some quick tips to remember that will help avoid missteps in handling lawyer trust accounts. A vigilant lawyer should:

A. Review the trust account bank statement when it is received;

B. Reconcile the trust account monthly (three-way reconciliation);

C. Retain trust account records for five years after the representation concludes;

D. Send clients monthly statements with trust account balances and any disbursements;

E. Properly train and supervise anyone working with a trust account as to the lawyer's ethical responsibilities regarding that account;

F. Establish clear procedures for handling the funds on receipt and for maintaining quality control;

G. Allow only lawyers to serve as signatories on a trust account;

H. Disburse funds from a trust account only after verifying the funds are fully collected and in the account; and

I. Choose clearly identifiable checks and checkbooks for trust accounts, distinct from the operating account or any other accounts held by the lawyer.