

# COAG National Legal Profession Reform

## Discussion Paper: Trust money and trust accounting

### **Purpose**

The purpose of this Paper is to outline the Taskforce's preferred approach to regulation of trust money and trust accounting to give effect to the objectives of the National Legal Profession reforms.

This Paper sets out proposed Regulatory Objectives and Principles for inclusion in the national law, and upon which a uniform national regulatory framework for trust money and trust accounts is intended to be based. The Paper also identifies areas for improvement and simplification under a national regulatory framework.

The Paper is confined to trust money and trust accounting issues as they affect legal practice. This Paper does not consider matters relating to the authorisation by regulatory authorities of particular Authorised Deposit-taking Institutions, or the means by which interest and similar payments arising from general trust monies are transferred and utilised for public purposes.

### **Background**

A law practice that receives general trust money is required to establish and maintain a general trust account at an Authorised Deposit-taking Institution. In most jurisdictions, a law practice that maintains a general trust account is also required to transfer a proportion of that general trust money either directly to a statutory deposit account or to a regulatory authority. This money may be reclaimed by the law practice on an at-call basis.

Interest that arises on general trust accounts maintained by law practices, as well as on statutory deposit accounts maintained by regulators is paid to a regulatory authority. The treatment of general trust money transferred to regulators, and of the interest arising on trust money will be dealt with in a separate paper.

### **Regulatory objectives**

The Taskforce considers that regulation should achieve the following objectives under a uniform national regulatory framework:

1. To ensure trust money is held by law practices in a way that protects the interests of persons for or on whose behalf it is held.
2. To ensure that the principals of a law practice are jointly and severally liable for compliance by the law practice of its obligations under this part of the legislation.

### **Powers of the Board**

The Taskforce proposes that:

1. The National Legal Services Board may develop National Rules on trust money and trust accounts to ensure that trust money is managed by law practices in a way that protects the interests of the persons for whom the money is held.
2. The National Law and National Rules may include requirements for the receipt, handling and disbursement of trust money, trust accounting procedures, administration, software, auditing, inspection, reporting, external examination of trust records and accounts and external intervention in the management of trust money and trust accounts.

The Board may supervise law practices in their dealings with trust money and trust accounts through investigations, external examinations and external interventions.

### **Proposed Regulatory Principles**

The Taskforce proposes that the National Law will clearly set out the principles for regulating trust money and trust accounts. These principles will form the basis upon which National Rules will be developed by the National Legal Services Board:

#### **Principle 1: Receipt of trust money**

Money entrusted to a law practice in the course of, or in connection with the provision of legal services by the practice, is trust money of the clients of the law practice.

A law practice shall not receive trust money unless a principal of the law practice holds an Australian Practising Certificate authorising the receipt of trust money.

#### **Principle 2: Holding and dealing with trust money**

When a law practice receives trust money, the law practice must hold that money exclusively for the person for whom it was received, and only that law practice or an associate(s) of that law practice authorised to do so, may deal with the trust money.

A law practice or authorised associate(s) of a law practice must deal with trust money in compliance with this Act, the Regulations and the National Rules.

Where the Regulations or the National Rules require trust money to be deposited into a trust account, that trust account must be maintained by the law practice with an Authorised Deposit-taking Institution.

#### **Principle 3: Obligation to report irregularities**

Persons (including entities) receiving, handling or dealing with trust money who become aware of, or reasonably suspect, an irregularity in trust money accounting must report that possible irregularity to the Board as soon as practicable. This includes associates of a law practice and Authorised Deposit-taking Institutions.

#### **Principle 4: Failure to comply**

Failure to comply with the requirements of this Part or the corresponding Regulations or National Rules will incur a penalty. Failure by an Australian Legal Practitioner may also constitute unsatisfactory professional conduct or professional misconduct.

#### **Principle 5: External examination**

A law practice must ensure that an external examination is made of its trust records in accordance with the National Law and National Rules.

## **Principle 6: Investigation and intervention powers**

The Board is responsible for the following:

- Investigations of the affairs of a law practice—which may involve the conduct of routine investigations on a regular or other basis; or investigations in relation to particular concerns regarding trust money, trust accounting, trust property or any other aspect of the affairs of a law practice;
- External examinations of a law practice’s trust records where it is not satisfied that the law practice has had its trust records examined in accordance with the National Law and National Rules; and
- External intervention in the business and professional affairs of law practices for the purpose of protecting the interests of the general public, clients and lawyers, so far as their interests are not inconsistent with those of the general public and clients.

The National Rules may make provision for these matters provided they are not inconsistent with the National Law.

### **Proposed legislative provisions**

The Taskforce proposes that, in addition to the Legislative Principles outlined above, the National Law should contain a streamlined form of the Model Bill provisions dealing with trust money and trust accounts—except as outlined below or where the drafter considers that the provisions are of such a nature that they could be moved into National Rules.

### **Specific issues to be addressed by a uniform national approach**

#### ***Consistency of situations when trust account provisions do not apply***

Currently, each State and Territory may prescribe that the trust money and trust account provisions of the relevant *Legal Profession Act* do not apply to certain law practices or classes of law practice either generally or in prescribed circumstances; or to certain kinds of trust money either generally or in prescribed circumstances.

By way of example, the NSW regulations:

- prescribe that the trust account provisions do not apply to the Crown Solicitor;
- prescribe that money received by a barrister in advance of legal fees to be billed to the client is not subject to the trust account provisions; and
- authorise the Law Society Council to exempt a law practice from complying with the trust money and trust account provisions, subject to any conditions it may decide to impose.

The Taskforce proposes that the Board may develop National Rules determining that the trust account provisions do not apply to certain law practices or classes of law practice either generally or in prescribed circumstances; or to certain kinds of trust money either generally or in prescribed circumstances.

#### ***Whether money is “trust money” for the purposes of the Act***

Money may or may not be trust money to which the legislation applies. There is a uniform statutory definition of trust money in the Model laws and each *Legal Profession Act*. That definition is as follows:

**trust money** means money entrusted to a 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.

Current legislation anticipates that situations will arise where it is not readily apparent whether or not money received by a law practice is trust money or is trust money of a certain kind for regulatory purposes. The Taskforce considers it desirable that these doubts be resolved quickly and definitively. Accordingly it is envisaged that the Board will be empowered to make a determination as to whether or not money is trust money. As with the Model Bill provision, this would have effect subject to a decision of a court or administrative review body made in relation to the money concerned.

#### ***Responsibility for compliance with trust money and trust account provisions***

The Model Bill and *Legal Profession Acts* presently contain a number of essential rules fixing responsibility for complying with trust money and trust accounting obligations:

- The principals of a law practice are joint and severally liable for compliance with the Act and regulations relating to trust money and trust accounts.
- A legal practitioner associate who maintains a trust account in relation to a law practice is also subject to the same provisions of the Act and regulations as a principal of the law practice.
- Particular actions properly taken by a legal practitioner associate in managing a trust account, discharge the corresponding obligation of the law practice.
  - Regulations may be made to prevent a legal practitioner associate undertaking some actions in relation to management of trust money and trust accounts
- Former law practices and former principals and associates remain liable for conduct occurring during the period they were law practices, principals and associates, subject to any necessary modifications.

The Taskforce considers the national regulatory framework must continue to make provision for:

- Each principal of a law practice being jointly and severally liable for compliance with the national law and any national rules relating to trust money and trust accounting.
- Each legal practitioner associate who maintains a trust account in relation to a law practice being required to comply with the National Law and any National Rules relating to trust money and trust accounting to the same extent as a principal of the law practice.

- Former law practices and former principals and associates remaining liable for conduct occurring during the period of former practice, to the extent they would be liable if they had not ceased to be a law practice, principal or associate.

### ***Jurisdictional differences***

Much of the primary legislation fixing regulatory obligations on law practices was designated as core uniform in the Model Bill and adopted as such by each of the seven enacting jurisdictions. However, a number of jurisdictional differences remain.

1. The manner in which a law practice may withdraw money from a general trust account. The general rule established by the Model Bill prohibits a law practice from withdrawing trust money from a general trust account other than by cheque or electronic funds transfer. The Queensland legislation permits a law practice to withdraw trust money from a general trust account using electronic funds transfer only if specifically authorised to do so by the regulatory authority. As this requirement is inconsistent with the legislation in all other jurisdictions that have enacted the Model Bill, the Taskforce does not propose to adopt it.
2. The Model Bill contains a non core provision that a barrister is not, in the course of practising as a barrister, to receive trust money. Most jurisdictions have adopted this provision. However, several jurisdictions allow a barrister to receive money in advance on account of legal costs for legal services. The Taskforce proposes that this arrangement be included in the new regulatory framework.

The Taskforce envisages that National Rules may be made to, for example, determine the manner in which a barrister must account for trust money on account of legal costs in advance of the provision of the legal services.

### ***Accounting procedures***

Extensive accounting procedures are prescribed by regulations made under the various *Legal Profession Acts*. These regulations deal with matters such as: recording receipts and payments in trust accounts receipts cash books and payments cash books; entries that must be recorded in trust ledger accounts and other records; who may authorise transactions in trust ledgers and journal transfers; the frequency with which trust accounts, ledgers and journals must be reconciled; and maintaining written records to sufficiently enable the accuracy of particulars recorded by a computer program to be verified.

The Taskforce proposes that the National Law should allow for National Rules to be developed to deal with matters such as accounting procedures for trust money and trust accounts. This should simplify procedures for law practices operating in several jurisdictions. However, any provisions dealing with offences or regulatory powers should be included in the National Law.

Where a law practice uses a computerised accounting system, regulations set out a number of mandatory functional requirements and limitations that must be included in that system. In addition, regulations set out specific accounting information that must also be held in printed form.

The Taskforce considers that law practices should be encouraged to invest in computerised accounting systems. The Taskforce also considers that the national regulatory framework should be developed to facilitate electronic lodgement of documents and reporting of information for regulatory purposes. To assist this, the Board should be authorised to:

- Develop National Rules regarding minimum functionality and limitations in accounting software for law practices, including data standards for regulatory reporting purposes; and
- Approve particular commercial (i.e. off-the-shelf) accounting software products as meeting relevant provisions in the National Rules.

### ***Offences against trust money and trust accounting provisions.***

The Taskforce notes there are over 30 prescribed offences contained within the trust money and trust accounting provisions of the Model Bill and Legal Profession Acts. The majority of these offences carry a monetary penalty.

The Taskforce is undertaking an analysis of all of the offences and penalties under the Model Bill and *Legal Profession Acts* with a view to the possible streamlining and consolidation of the offences and penalties under a uniform national framework.

### ***Reporting obligations.***

Law practices are subject to extensive reporting obligations about trust money and trust accounts, set out in both primary legislation and regulations. They include:

- notifying a regulator of the fact that a general trust account has been established;
- giving written notice of details of each account at an Authorised Deposit-taking Institution which holds entrusted money;
- giving written notice of the fact of authorising or terminating the authority of an associate or an Australian legal practitioner to sign cheques that cause money to be withdrawn or transferred from a general trust account (including identity and relationship to the law practice);
- giving written notice of associates and Australian legal practitioners as at 30 June each year who are authorised to sign cheques or cause withdrawals or transfers from general trust accounts;
- giving written notice of the closure of general trust account;
- giving written notice of the appointment and termination of an external examiner;
- giving written notice, when required by regulator, of whether or not trust money has been received or held and if so, the classes of trust money.

The Taskforce notes that mandatory reporting requirements have been developed as a means of facilitating independent oversight of trust accounting by law practices. However, they also add to the compliance burdens and costs of conducting legal practice. The Taskforce recognises the importance of independent oversight in the interests of consumer protection, but notes these reporting requirements could be simplified. The Taskforce proposes that the National Law should allow for the development of National Rules in this area (however, as noted above, any provisions dealing with offences or regulatory powers should be included in the National Law).

### ***External examinations of trust accounting records.***

Currently, every law practice that receives or holds trust money must have its trust records externally examined at least once each financial year by an external examiner (unless specifically exempted from the requirement to do so). If a law practice fails to do so, or the examination is not done in a way that satisfies the requirements, the regulatory authority may appoint an external examiner to undertake the work.

The Taskforce considers an external examination framework is a useful mechanism of independent oversight of trust accounting practices and records, regardless of the amount of trust money held, the volume of transactions undertaken during a year, or other systems of control that a law practice may have in place to ensure compliance with those trust accounting and record keeping obligations. However, the Taskforce also recognises the compliance cost involved and considers that simplification of the external examination framework may be possible.

The Taskforce proposes that the National Law should provide the framework for external examinations, which would be based on the Model Bill provisions, and would be supported by the National Rules. As noted above, any provisions dealing with offences or regulatory powers should be included in the National Law. In addition, the Taskforce proposes greater use of client verification as part of these examinations (see the discussion below).

***Regulator initiated examinations, investigations and interventions.***

Presently, a Regulatory Authority may appoint “suitable qualified persons” to investigate the affairs or specified affairs of a law practice. Investigators may be appointed to conduct either routine inspections and investigations, or to conduct investigations into specific allegations or suspicions about irregularities in the management and accounting for trust money or trust property.

A Regulatory Authority may also appoint a range of persons to intervene in the business and professional affairs of a law practice. These interventions can involve: the appointment of a supervisor of trust money; the appointment of a manager of a law practice; and the appointment of a receiver to a law practice. A separate Taskforce paper deals with External Interventions.

In relation to investigations, the Taskforce proposes that a simplified version of the Model Bill provisions be adopted (provided that any provisions dealing with offences or regulatory powers are included in the National Law).

In addition, the Taskforce notes that there appears to be little evidence that random trust account inspections are of assistance in identifying major defalcations in relation to trust accounts and trust money. Accordingly, it may be preferable to focus more on the regime for external examinations of trust accounts as a more useful mechanism of independent oversight of compliance with the regime, and consumer protection.

***Client statements.***

Presently, regulations require a law practice to disclose - by means of Statements - trust account and trust ledger account transactions and dealings conducted on behalf of each client who has entrusted money to a law practice.

Regular client verification is a control in providing assurance to clients that a law practice is appropriately managing money held in trust, and for early detection of potential errors or deliberate defalcations. This is particularly important for clients who might be described as “retail” or “non-sophisticated” clients.

The Taskforce considers the National Law should continue to require a law practice to provide client statements of trust account and trust ledger transactions, with National Rules overcoming existing jurisdictional differences by setting out uniform requirements as to the

format, content, timing and manner in which these Statements are to be provided. The Taskforce also considers there should continue to be an option for “sophisticated clients” to agree alternative reporting arrangements.

### ***Reporting of trust account irregularities.***

The Model Bill contains provisions that require:

- a legal practitioner associate of a law practice to give written notice to a Regulatory Authority of any irregularities in any of the practice’s trust accounts or trust ledger accounts;
- an Australian legal practitioner not associated with the law practice to provide written notice to a Regulatory Authority where the practitioner believes on reasonable grounds that there is an irregularity in connection with the receipt, recording and disbursement of trust money received by that law practice; and
- an Authorised Deposit-taking Institution at which a trust account is maintained to notify a Regulatory Authority of any deficiency in the trust account or any suspected offences in relation to the trust account.

The Taskforce considers the National Law should continue to impose these reporting obligations, with National Rules overcoming existing jurisdictional differences by setting out uniform requirements as to the format, content, timing and manner in which these Reports are to be provided

### ***Professional Conduct and Practice Rules.***

Conduct consisting of a contravention of the Act, regulations, and Legal Profession Rules declared by the Model Bill to be conduct capable of constituting unsatisfactory professional conduct or professional misconduct.

Some jurisdictions (for example New South Wales) presently include in legal profession rules, some specific rules relating to trust accounting practices (‘legal practice rules’). A range of sanctions may be imposed for a breach of the legal profession rules including, ultimately, an order by a Disciplinary Tribunal recommending the Supreme Court order the legal practitioner’s name be struck of the roll.

The Taskforce considers that the National Law should maintain the policy that a breach of trust money and trust accounting obligations should continue to be conduct capable of constituting unsatisfactory professional conduct or professional misconduct. The Taskforce does not, however, consider that there is a need into the future for legal practice rules to be included within legal profession (conduct) rules, on the basis that National Rules relating to trust money and trust accounting would provide a single, nationally uniform set of practice rules for this area of regulation.

### ***Jurisdictional linkages and single national trust accounts***

The current regulatory framework contains elaborate rules to determine the jurisdiction in which trust money was received for regulatory purposes. The general rules are as follows:

- If the money is received in the same jurisdiction where the law practice has an office – the law of the jurisdiction in which the office is located applies.
- If the money is received in another jurisdiction in which the law practice also has an office – the law of that other jurisdiction applies.

- If the money is received in a jurisdiction where the law practice does not have an office, the law of the jurisdiction where the law practice does have an office applies, unless the law of another jurisdiction applies provided the law practice doesn't have offices in other jurisdictions.

The Taskforce notes that jurisdictional linkages between the place where trust money is received and the place where a law practice has an office imposes significant compliance costs and burdens upon law practices that practise on a multi-jurisdictional basis. Presently, these costs and burdens are compounded by jurisdictional differences in the accounting procedures for trust money and trust records embodied in regulations made in each jurisdiction.

The Taskforce is considering options for enabling a law practice that operates in several jurisdictions to maintain a trust accounting system (including a single set of national trust accounts) in one jurisdiction only. This subject will be dealt with in more detail in a separate Paper.

#### ***Australian registered foreign lawyers***

The Model Bill provides that provisions relating to trust money and trust accounts (as well as any legal profession rules) apply to Australian-registered foreign lawyers in the same way as they apply to law practices and Australian legal practitioners. This general rule is subject to any regulations that may be made concerning the application of the provisions, including any modifications of particular provisions.

The Taskforce considers the same approaches should be adopted under the National Law and National Rules.

---