

Trust bank accounts

Certain industries require the owner of the business to open trust bank accounts into which monies belonging to their clients are deposited. Lawyers, solicitors, estate agents and stockbrokers immediately come to mind.

Lawyers and solicitors accept advance payments for services to be performed and also amounts to be paid to third parties in the performance of their duties. These duties include the purchase and sale of fixed property, shares and many other asset classes. The legal profession usually requires them to only draw down client deposits once they have performed the relevant task and only on the issue of an appropriate invoice.

Estate agents are similarly required to deposit client monies into a trust fund or place the money with a lawyer or solicitor pending transfer of title of the property they have undertaken to sell or purchase on behalf of the client.

Stockbrokers are also required to separate their clients' funds from their own funds. Stock exchange systems are very sophisticated and they may provide for the client transactions to be performed on their inhouse computer. When this is the case they usually provide for the client's cash balance to be swept into a trust bank account at the end of each day. This is accomplished by totalling the balance to the credit of each client in respect of each broker, and transferring that amount to the trust account. The money is returned the following day. This permits the stock exchange to monitor the solvency of each stockbroker and ensure that they meet the capital requirements to continue in business.

Certain trading platforms are operated outside the control of the stock exchange although the transactions are effected through the stock exchange trading computer system. These platforms are required to provide security and guarantees to cover gross amount owing to the stock exchange at the end of each day.

Example no 1

A solicitor during the course of a week's business activities records the transactions listed below in the conduct of his business. The solicitor Mr Zing is a sole trader and employs two other persons. Record the transactions below via journal entries: -

- 1 An amount of \$ 600 000 is transferred into his trust bank account by Mr Pink to cover the cost of purchasing a house for \$ 570 000. The amount in excess of the purchase price is to discharge any fees and costs involved in the transaction.

- 2 Mr Gil consults with Mr Zing in connection with impending legal action regarding his dog attacking a person passing by his house. He transfers \$ 100 000 dollars into his trust account to cover legal costs and providing for settlement of the looming claim for damages.
- 3 Mr Zing raises invoice no 60 for \$ 600 to cover his time spent researching similar cases and the time spent in his initial consultation with Mr Gil
- 4 Mr Zing transfers \$ 600 from the trust account to his business account to cover invoice no 60
- 5 Mr Zing makes a payment of \$ 14 000 to the deeds office to cover transfer duties in respect of the purchase of Mr Pink's house. This is paid from the trust account
- 6 Mr Zing makes a payment to the local authority in respect of outstanding rates and municipal charges relating to Mr Pinks new house in amount \$ 5 000. This payment is made from the trust account.
- 7 Mr Zing reaches an out of court settlement with the solicitor of the party injured in the incident concerning Mr Gil's dog. He makes an eft payment to Solman & Co being the solicitor of the claimant in amount \$ 35 000 in full and final settlement. This payment is made from the trust account.
- 8 Mr Zing raises invoice no 61 for \$ 20 000 in respect of services in dealing with the the claim against Mr Gil.
- 9 Mr Zing transfers \$ 20 000 from the trust account to his business account to cover invoice no 61.
- 10 Mr Zing recovers \$ 3 500 from the seller of Mr Pink's house in respect of the seller's portion of the rates and municipal charges

- 11 Mr Zing makes an eft refund from his trust account to Mr Gil in amount \$ 44 400 being the remaining balance after conclusion of the damages claim.

Mr Zing

Journal entries

	Dr	Cr
	\$	\$
Trust bank account	600000	
To Trust client account Mr Pink		-600000
Being direct deposit into the trust account		
.....		
Trust bank account	100000	
To Trust client account Mr Gil		-100000
Being direct deposit into the trust account		
.....		
Debtor-Mr Gil	600	
To Fees receivable		-600
Being invoice no 60 for services rendered		
.....		
Trust client account Mr Gil	600	
To Trust bank account		-600
Being invoice no 60 paid from trust bank account		
.....		
Business bank account	600	
To Debtor Mr Gil		-600

Being payment from trust account to business account	
.....	
Trust client account Mr Pink	14000
To Trust bank account	-14000
Being payment to deeds office from trust bank account	
.....	
Trust client account Mr Pink	5000
To Trust bank account	-5000
Being payment of rates and municipal charges in respect of Mr Pink's house	
.....	
Trust client account Mr Gil	35000
To Trust bank account	-35000
Being agreed settlement payment from trust bank account	
.....	
Debtor-Mr Gil	20000
To Fees receivable	-20000
Being invoice no 61 for services rendered	
.....	
Trust client account Mr Gil	20000
To Trust bank account	-20000
Being invoice no 61 paid from trust bank account	
.....	
Business bank account	20000
To Debtor Mr Gil	-20000

Being payment from trust account to business account

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Trust bank account	3500
To Trust client account Mr Pink	-3500

Being recovery of portion of rates and municipal charges
from seller of Mr Pink's house

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Trust client account Mr Gil	44400
To Trust bank account	-44400

Being refund of remaining balance of Mr Gil's trust account
after settlement of claim and expenses

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The payment from the trust account to the business account requires two separate journal entries because the equal and opposite entry has to be generated from two different bank accounts. In practice the entries would be passed as the book-keeper processed the bank account statements. It is unlikely that these would be successive entries as recorded above because the book-keeper would complete the one bank statement before attending to the bank statement of the second bank account.

It is essential that the bank balance is equal to, or exceeds the total of the total of the client trust accounts. Advances to one trust creditor may not be financed out of the credit balances of another trust account creditor.

The bank charges relating to the trust bank account are usually debited in the business bank account as this is a business expense.

Example no 2

Estate agents are also required to deposit client monies into a trust bank account and may only claim their commission on the final completion of the transaction.

The usual practice is for the seller to pay the commission selling agent and the purchaser to pay the deeds transfer costs to the transfer conveyancer.

Estate agent Floyd conducts his business as a sole trader and employs two sales staff on a commission basis. Record the transactions below via journal entries, in addition the entries in each individual client trust account: -

- 1 Mr James accepts a sale contract to sell his house for a gross sales price of \$ 800 000 and he agrees to a commission rate of one and a half percent on the gross selling price.
- 2 Since it is his intention to downsize Mr James makes an offer on a smaller property in amount \$ 400 000 which is duly accepted. The seller is Mr Right, and he agrees to a commission rate of one and a half percent. Both purchaser and seller agree to Mr Floyd handling the transaction. The second transaction is conditional on the sale of Mr James larger house and no deposit is payable, but the full purchase price is payable on transfer of the property.
- 3 The purchaser of Mr James house pays a deposit of \$ 160 000 which is deposited into the trust account. Mr Floyd instructs the conveyancer to prepare the transfer documents to enable a simultaneous transfer of the two properties. Prospective purchaser being Mrs Gat

- 4 On the transfer date the mortgage provider pays the balance of the purchase price to Mr Floyd in amount \$ 640 000 which is credited to the trust client account of Mr James via the trust bank account.
- 5 Mr Floyd raises invoice no 630 in amount \$ 12 000 in respect of the property sold by Mr James.
- 6 Mr Floyd transfers \$ 12 000 from the client trust account to the business account to cover the amount due in respect of invoice no 630.
- 7 Mr Floyd also makes an eft payment to the conveyancer of \$ 6 000 being the balance due by Mr James in respect of the transfer fees in respect of his new property
- 8 Mr Floyd passes a journal entry transferring \$ 400 000 dollars from the trust account Mr James to the trust account Mr Right being the full purchase price on the property bought by Mr James.
- 9 Mr Floyd raises invoice no 631 in amount \$ 6 000 being his commission due by Mr Right on the sale of his house. This is debited to Mr Right's account in the business account
- 10 Mr Floyd transferred \$ 6 000 from the trust bank account to the business account in payment of invoice no 631 and this was debited to Mr Right's client account.
- 11 Mr Floyd paid the balance due to Mr Right by eft in amount \$ 394 000.
- 12 Mr Floyd paid the balance due to Mr James by eft in amount \$ 382 000.

Mr Floyd
Journals

	Dr	Cr
	\$	\$
Trust bank account	160000	
To Trust client account Mr James		-160000
Being deposit on Mr James house paid by Mrs Gat		
.....		
Trust bank account	640000	
To Trust client account Mr James		-640000
Being balance of purchase price received from mortgage provider Mexton Bank		
.....		
Debtor-Mr James	12000	
To Commission receivable		-12000
Being commission due from Mr James on sale of his property as per invoice no 630		
.....		
Trust client account - Mr James	12000	
To Trust bank account		-12000
Being commission due as per invoice no 630 paid from trust account to business account and client account Mr James debited		
.....		
Business bank account	12000	
To Debtor - Mr James		-12000

Being payment from trust account to business account in respect of invoice no 630

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Trust client account - Mr James	6000
To Trust bank account	-6000

Being conveyancing fees due by Mr James in respect of his new property debited to his trust as per his instructions.

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Trust client account - Mr James	400000
To Trust client account - Mr Right	-400000

Being transfer of purchase price from Mr James to Mr Right as per written instructions

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Debtor- Mr Right	6000
To Commission receivable	-6000

Being commission due from Mr Right on sale of his property as per invoice no 631

.....

Trust client account - Mr Right	6000
To Trust bank account	-6000

Being payment of invoice no 631 debited to Mr Right's trust account.

.....

Business bank account	6000
To Debtor - Mr Right	-6000

Being receipt from trust account of payment for invoice no 631.

.....

Trust client account - Mr Right	394000
To Trust bank account	-394000
Being balance due to Mr Right paid by eft transfer to close account.	

.....

Trust client account - Mr James	382000
To Trust bank account	-382000
Being balance due to Mr James by eft to close account.	

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Mr Floyd
Trust Client ledger accounts only

	<u>Dr</u>	<u>Cr</u>	<u>Balance</u>
	\$	\$	
<u>Mr James - trust client account</u>			
Deposit received from Mrs Gat		-160000	-160000
Melton Bank - mortgage loan advance to Mrs Gat		-640000	-800000
Transfer to Mr Right - new house sold by Mr Right	400000		-400000
Commission on sale of old house paid on transfer	12000		-388000
Conveyancing fees on new house	6000		-382000
Payment to Mr James - final balance owing	382000		0
	800000	-800000	

	<u>Dr</u>	<u>Cr</u>	<u>Balance</u>
	\$	\$	
<u>Mr Right - trust client account</u>			
Transfer of purchase price of house from Mr James		-400000	-400000
Sales commission paid into business account	6000		-394000
Payment to Mr Right - final balance owing	394000		0
	400000	-400000	

	<u>Dr</u>	<u>Cr</u>	<u>Balance</u>
	\$	\$	
<u>Trust bank account</u>			
Deposit from Mrs Gat - Mr James property	160000		160000
Melton Bank - mortgage advance to Mrs Gat on Mr James house	640000		800000
Commission paid on transfer of Mr James old house		-12000	-788000
Conveyancing fees paid on Mr James new house		-6000	-782000
Commission paid on transfer of Mr Rights new house		-6000	-776000
Mr Right - balance owing on sale of his property		-394000	-382000
Mr James - balance owing after sale old house and purchase new house		-382000	0
	800000	-800000	

There were not many transactions but to record them accurately requires attention to detail. A quick glance at the question and one would think this is a very simple question but the transfers between the bank accounts requires one to account for the entries on the bank statements.

The fact that the client trust accounts are reduced to nil plus the trust bank account balance gives one confidence that all entries have been brought to account.

In examination conditions one would probably not use credit signs on the credit entries and balance column could be ignored.

Pension funds

The whole pension fund is a trust entity governed by statutes. The rules are drawn up to control the administration of the specific pension fund. The statutes usually require that a certain percentage of the pension funds be invested in secure government investments.

Pension funds governed by quoted companies have been raided by certain quoted companies over the years. The rules sometimes provide for the companies to make up any shortfall in the fund. When there are surpluses certain quoted companies have helped themselves to the surplus. In certain instances, they have acquired other quoted entities with the sole purpose of accessing the pension fund surpluses.

Inflation has caused certain pension funds to become vulnerable. It may happen that the pension funds controlled by the management of the employee company in uncertain times fail to pay the contributions to the pension funds.

Another unfortunate outcome is that government and SOE controlled entities are badly managed. Reasons include political parties appointing unfit managers, and officials who are employed at excessive salaries and are thus entitled to very high pension settlements.

Pension funds are usually subject to audit but in some instances by the time the audit is completed the damage has been done. Also, it is very difficult to try and recover excessive payments to political appointed officials as the political party usually controls the judicial system.