

ALTA Best Practice #2: Follow the Money

Ever since Mark Felt, Watergate scandal informant, met Woodward and Bernstein in a dark parking garage and uttered the phrase, "Follow the Money," these three words have defined how to investigate any and all suspicious activity. However, this iconic message has roots that are much older than the Watergate scandal. After all, it took an IRS audit to catch Al Capone. Whether capturing a notorious gangster or merely balancing a personal checking account, following the money can reveal both an indiscretion and a legitimate mistake. This is the guiding principle behind ALTA Best Practice #2. Following the money will help you to safeguard your clients' funds.

ALTA Best Practice #2

ALTA Best Practice #2 states: *Adopt and maintain appropriate written procedures and controls for Escrow Trust Accounts allowing for electronic verification of reconciliation.*

The stated purpose of this procedure is to safeguard client funds to help ensure accuracy and minimize exposure to loss. In short, "follow the money."

There are three steps required to comply with ALTA Best Practice #2:

- 1) Have a written policy and procedure for trust account controls;
- 2) Include in your written policy and procedure the necessary elements; and
- 3) Adhere to your policy and procedure.

The Written Policy

You already have a written policy that governs how you administer your trust account. The NC State Bar has promulgated rules that require you to follow the money. Now, as a result of the CFPB's recent actions, the ALTA best practices seek to bring consistency to the national settlement landscape.

In writing a policy and procedure on trust accounts, you must consider traditional and non-traditional threats to the trust account. Most of the current controls on trust account management are controls that think and act locally. They are concerned with your employees and what access they have to entrusted funds. You cannot abandon these proven controls. Today, however, we have to examine threats that do not enter our office through the door, but rather through our computer network. We have to think in a 2013 mentality and not a 1983 mentality. We have to think globally.

What Should Be Included in the Trust Account Controls Policy?

- a. **Federally Insured Bank.** All of the entrusted funds should be kept in a federally insured bank unless you have written instructions from the owner of the funds to the contrary. Wherever possible, you want to make sure that there is insurance to protect your clients' funds.
- b. **Separation of Funds.** All entrusted funds should be kept in a bank account that is separate from all other funds. Do not ever commingle your money with your clients' money. To that end, all supporting information for the trust account should be marked "escrow" account or "trust" account. This includes all of the checks, deposit tickets, bank statements, bank agreements, and all other account related supporting documentation.
- c. **Authorized Personnel Only.** Transactions regarding entrusted funds should only be performed by authorized employees. Some employees do not have the requisite training to be allowed access to the trust account. Others have no need to access the trust account to perform their daily functions.

You should perform adequate employee training to make sure that mistakes are kept to a minimum. Additionally, before you allow any employee access to your office and potentially the trust account, you should perform a criminal background check. Subsequent background checks every three years (going back 5 years) should also be part of this process.

When an employee leaves your firm (or disappears with no explanation), their access to the office, the trust account, and the computer should be terminated immediately. In the old days, we would simply ask for the key to be returned. Today, we need to get that key, but also terminate passwords, change signature cards (if applicable), and change the alarm code.

- d. **Reconcile Trust accounts.** You balance your personal checking account every month. Your clients' funds in the trust account require at least that same level of care. This simply means that the account is prepared with trial balances, which match the checkbook and the bank statement. In the event that there are open file balances, they must be documented and tracked to resolution. Additionally, there should never be any negative file balances. When all of this is complete, the monthly three-way reconciliation should be reviewed by management.

The reconciliation is the old school way to follow the money, but still vital to the protection of the trust account. The new school way includes a timeliness that increases the security and detection. ALTA Best Practice #2 calls for the daily reconciliation of receipts and disbursements and three-way reconciliation within ten (10) days of the closing date of the bank statement. Once it is performed, the three-way monthly reconciliation must also be electronically available for verification.

- e. **Separation of Duties.** Traditionally, when we think of separation of duties, we think about separating check writing from check signing authority or separating wire preparation from wire approval authority. Both of these are solid practices and recommended for prudent and practical trust controls. For compliance with ALTA Best Practice #2, the reconciliation of the trust account should be performed by someone without disbursement authority over the account. This simple precaution adds a math checker, for a simple mistake, and a watchful eye, for a greater indiscretion. Whether there is a simple error in math, a wayward employee or a cyber-attack, the one following the money should not have access to the money.

- f. **Block International Access.** As you are forced to think globally, you have to concern yourself with new threats that do not walk in your door. If you have ever paid by check on the phone, you have experienced the convenience of Automated Clearing House ("ACH") transactions. All that you need is a routing number, a checking account number, and a phone. Convenient and easy. Just think how convenient and easy that would be for a criminal. There is no place for an ACH transaction on the trust account. They can easily be blocked by merely requesting it from the bank.

Another easy protection that is there for the asking is an International Wire Block. How often is it necessary for you to wire funds overseas – outside the jurisdiction of our law enforcement? The answer is almost never. Certainly, requiring additional confirmation before allowing the bank to wire funds to a foreign country is not an unreasonable hindrance to the daily operation of your business. To implement these two controls, all you have to do is ask your bank.

- g. **Positive Pay.** Positive Pay is also available at most banks. This control requires a little more effort than merely requesting it, but it is worth the effort. Would it not be great if the bank would check with you before clearing any trust account checks? Positive Pay provides you the opportunity to communicate electronically with your bank to pre-approve any check that will be presented for payment.

As you write a check on your trust account in your settlement production software, it creates a file that includes every check that you have written and uploads it electronically to your bank. The bank then compares every check that comes in the door against the pre-approved list. If

the check is not on the list, they contact you for approval. No check gets paid unless they have your approval. In the old days, it would require a phone call on every check. With the technology available today you can make this communication by pressing a few buttons. Additionally, most Positive Pay connections to the bank are outside of their other online banking functions. Criminals hate Positive Pay.

Follow the Policy Locally for Global Deterrence

When Mark Felt uttered "Follow the Money," no one could possibly have anticipated the global threats currently facing your trust account. Computers occupied entire buildings, not the palm of your hand. Today, one cannot fully anticipate the global threats that are going to exist ten years from now. The old threats still exist, and you must continue to be diligent in choosing and training employees. However, new threats emerge every day, as any criminal in a foreign land armed with an internet connection can ruin your business. You must continue to be diligent on all fronts to protect your clients' money. Whether guarding against wrongdoing or a simple mistake, the policies and procedures required for compliance with ALTA Best Practice #2 are not only designed to protect your clients' money, they are designed to protect you.

There have been assertions that some of these policies will alter the manner in which you do business, may make your daily routine more inconvenient or may increase the time you spend on the trust account. All of these are likely true. Some may think that all that you are accomplishing is being compliant with ALTA Best Practice #2 when you follow a written policy that includes the above requirements. In fact, by following these policies, you are protecting your clients' entrusted funds from disappearing and yourself from a financial disaster. Remember that when the money is in the trust account it is our clients' money, but if and when it goes missing it **WAS** our money and we have to put it back.