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Frequently Asked Question on the accounting treatment of an attorney's trust account in terms of International Financial Reporting Standards (IFRS)

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Question

How should an attorney's trust account be accounted for in the attorney's financial statements?

Answer

Attorneys Act No.53 of 1979

An attorney's trust account is defined in the Attorneys Act No.53 of 1979 (Act) in relation to a practising practitioner (also referred to as attorney), as an account comprising that practitioner's trust banking account referred to in section 78 (1) of the Act; and any trust savings or other interest-bearing account referred to in section 78 (2) or (2A) of the Act opened by that practitioner.

In accordance with section 78 of the Act:

"(1) Any practising practitioner shall open and keep a separate trust banking account at a banking institution in the Republic and shall deposit therein the money held or received by him on account of any person.

(2) (a) Any practitioner may invest in a separate trust savings or other interest-bearing account opened by him with any banking institution or building society any money deposited in his trust banking account which is not immediately required for any particular purpose.

(b) Any trust savings or other interest-bearing account referred to in paragraph (a) shall contain a reference to this subsection.

(2A) Any separate trust savings or other interest-bearing account—

(a) which is opened by a practitioner for the purpose of investing therein, on the instructions of any person, any money deposited in his trust banking account; and

   (b) over which the practitioner exercises exclusive control as trustee, agent or stakeholder or in any other fiduciary capacity, shall contain a reference to this subsection.

(3) The interest, if any, on money deposited in terms of subsection (1) and the interest on money invested in terms of subsection (2) shall be paid over to the fund by the practitioner concerned at the prescribed time and in the manner prescribed.

(4) Any practising practitioner shall keep proper accounting records containing particulars and information of any money received, held or paid by him for or on account of any person, of any money invested by him in a trust savings or other interest-bearing account referred to in subsection (2) or (2A) and of any interest on money so invested which is paid over or credited to him.

(7) No amount standing to the credit of any practitioner's trust account shall be regarded as forming part of the assets of the practitioner, or may be attached on behalf of any creditor of such practitioner: Provided that any excess remaining after payment of all claims of persons whose money has, or should have, been deposited or invested in such trust account, and all claims in respect of interest on money so invested, shall be deemed to form part of the assets of such practitioner."

Relevant financial reporting requirements
The following references to IFRS should be noted in this regard:

- Paragraph 4.4(a) of the *Conceptual Framework for Financial Reporting (Conceptual Framework)* states that *"An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity"*.

- Paragraph 4.4(b) of the *Conceptual Framework* states that *"A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits"*.

- Implementation Guidance to IAS 39 – *Financial Instruments: Recognition and Measurement* and IFRS 9 – *Financial Instruments* D1.1 states the following:
  Question: *"Entity B transfers cash to Entity A as collateral for another transaction with Entity A (for example, a securities borrowing transaction). The cash is not legally segregated from Entity A's assets. Should Entity A recognise the cash collateral it has received as an asset?"*
  Response: *"Yes. The ultimate realisation of a financial asset is its conversion into cash and, therefore, no further transformation is required before the economic benefits of the cash transferred by Entity B can be realised by Entity A. Therefore, Entity A recognises the cash as an asset and a payable to Entity B while Entity B derecognises the cash and recognises a receivable from Entity A"*.

- The following references in IFRS 10 – *Consolidated Financial Statements* are also of relevance:

  - Paragraph B77: *"An investor shall treat a portion of an investee as a deemed separate entity if and only if the following condition is satisfied: Specified assets of the investee (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the investee. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. In substance, none of the returns from the specified assets can be used by the remaining investee and none of the liabilities of the deemed separate entity are payable from the assets of the remaining investee. Thus, in substance, all the assets, liabilities and equity of that deemed separate entity are ring-fenced from the overall investee. Such a deemed separate entity is often called a 'silo'."*

Also, please refer to paragraph 19 of the *Guide for Registered Auditors: Engagements on Attorneys Trust Accounts* published by the Independent Regulatory Board for Auditors in 2011.

Other financial reporting considerations
With reference to the Act, practitioners are required to maintain a separate trust account to be utilised for holding clients' funds. The relevant legal, regulatory and contractual requirements, including the terms and conditions of the agreement between the practitioners and their clients, should therefore be carefully reviewed and judgement applied to determine whether the 'control' and 'benefits' tests in the *Conceptual Framework* have been met. Judgement should be applied in assessing the particular facts and circumstances with respect to the account in determining whether the funds in the account are legally segregated from the rest of the attorney's assets. Whilst the following list is not exhaustive, the indicators below would suggest that the **funds are legally segregated from the practitioner's assets and in such instances separate recognition of the account's assets and liabilities would not be required:**

- The separate account is established, approved and regulated under special rules in terms of law.
- In the event of wind up of the practitioner, the assets in the account are ring-fenced and only available to reimburse the practitioner's clients.
- The clients are not subject to the practitioner's default risk as a result of the funds being held in a separate account.
- The account's assets may not be comingled with that of the practitioner's, i.e. the assets in the account cannot be used to settle another client's account or to include the practitioner's own cash in the same bank account as the client money or to use the funds for its own purposes and replace them when settlement is due to its clients.
- No creditor, other than the clients for whom such money is held, has any legal title to those assets.

- The practitioner bears no credit risk on the account's assets, i.e. the practitioner is not contractually obliged to compensate clients if the deposit-holding bank fails (nor is there a constructive obligation to reimburse any losses).
- The account's assets are administered separately from the practitioner's assets.
- With the exception of a fee that the practitioner may earn as a result of administering such assets on behalf of its clients, the practitioner has no ability to direct the use of the account's assets to derive a return from such assets other than to enhance the return (within the account's mandate) that is due to its clients.
- The practitioner receives no benefit from the funds in terms of interest income.

Conclusion

Practitioners should consider the above-mentioned indicators and, based on the weighting of the outcome of each indicator, conclude whether:

- the assets **are legally segregated** from the practitioner's other assets, in which case the funds should not be recognised by the practitioner as an asset. Similarly, no corresponding liability to the practitioner's clients will be required to be recognised. In such instances disclosure of the income, expense, gains or losses relating to such fiduciary activities should be provided in either the notes to the financial statements or in the statement of comprehensive income in terms of IFRS 7 – *Financial Instruments: Disclosures* paragraph 20c(ii).

- the assets **are not legally segregated**, in which case such funds should be recognised by the practitioner as an asset with a corresponding liability to the attorney's clients. In such instances, IFRS 7's disclosures with respect to the asset and liability and associated income, expenses, gains and losses should be provided.

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