Managing a firm’s trust accounts can be one of the most important administrative tasks facing attorneys according to Cindy Emmerson of the Affinity Consulting Group. Whether you are a solo practitioner or a partner in a large firm, your responsibilities remain the same. Even if you employ bookkeepers or accountants to handle your financial matters, the ultimate responsibility still rests with the firm’s owners or partners. And everyone benefits from avoiding any unnecessary audits or investigations.

What is a Trust Account?
A trust account is used exclusively to hold funds for clients. A separate operating account must be used for the firm’s day-to-day business operations. It is imperative to ensure that there is no commingling of funds. Commingling of funds is a serious violation of state and ABA regulations in all states, as well as a potential accounting nightmare for the firm. You may be allowed to deposit a minimum amount to open the account or handle any service charges, but you should check your state’s rules to confirm that this is permitted.

Trust Accounting Rules Vary State to State
There are no simple, all-encompassing rules for handling trust accounts. Each state bar has its own regulations, and there are many variations on the basic fiduciary themes. There is, however, one constant: Ignorance of the law is no excuse. Bar associations will not accept pleas of ignorance from practitioners when it comes to trust accounts. You must familiarize yourself with your state’s rules and regulations and make sure that your firm is in compliance with them. Most states require firms to submit a Trust Accounting Certificate each year certifying that they are in compliance. This should not be treated as a mere formality. You must be confident that your firm is in compliance with your state’s regulations, no matter how burdensome or counter intuitive they may seem.

Good trust accounting practices and a formal accounting program can help you reduce liability and avoid time-consuming trust audits.
IOLTA Accounts
Most trust accounts are Interest on Lawyers Trust Accounts (IOLTA). This means that interest is earned on the trust account. However, the interest earned does not belong to the client or the firm. It is remitted monthly by the bank to the American Bar Foundation, a nonprofit organization that focuses on helping represent the indigent or those who cannot afford representation.

Deposits
What kinds of funds can be properly deposited into trust accounts? As stated above, trust accounts are meant to contain funds held on behalf of your clients, e.g., closing funds, mortgage proceeds, settlement funds, etc. Advance fee payments that are billed against each month and which are refundable if not earned can also be put into trust accounts. However, a note of caution must be sounded here. Some bar associations distinguish carefully between retainer funds and advance fee payments. True general retainers should not be placed in trust accounts, but instead in operating accounts. True general retainers are deemed earned when paid and are non-refundable. Thus, they cannot be placed into trust accounts. What if a client sends one check that covers both an invoice and some escrow funds? You are permitted to deposit the check into the trust account. However, as soon as the check clears, that portion of the funds remitted for the invoice must be transferred to the operating account.

Disbursements
Knowing when funds can be safely disbursed is another key piece of information in managing a trust account. Just because a bank makes funds available does not mean that a deposited item has actually cleared. And if you do disburse from your trust account without first affirming the deposit is cleared and funds are available, you may be issuing checks that in fact “overdraw” a particular client’s funds while the overall account balance remains positive. As discussed below, having the right legal-specific accounting software to earmark funds clearly and to assign realistic clearing times can make this issue moot.

Of course, some matter such as real estate closings, require immediate disbursements. Your state bar rules will usually provide for this situation. Florida, for example, permits lawyers to disburse immediately upon receipt of certain instruments that are considered low risk. Included in this category would be cashier’s checks, certified checks, government checks and checks drawn on attorney trust accounts.

Internal Controls
Not only are tight internal controls a good business practice, but they also prevent fraud. According to Ms. Emmerson, there are no options in this regard. In today’s troubled economy, law firms are just as vulnerable to embezzlement or other financial crimes as other businesses. Good controls will also reduce malpractice liability exposure and make time-consuming trust audits less likely. Internal controls help to clearly define job responsibilities and lines of authority, and overall help to keep everyone honest. Partners and owners must participate in these controls. No one should ever be “too busy” to review and monitor the trust account. As well as being legal practitioners, a firm’s partners are also business owners and must diligently retain control of the business end of their responsibilities.

Policies and Procedures
Most of the recommended internal control policies follow common sense. Bank statements should be delivered to a home address or directly—and unopened—to the lawyer charged with reviewing bank statements.
Only lawyers should have signing authority for trust accounts and people without signing authority should reconcile the bank statements. Bank reconciliation reports should be reviewed and approved by someone directly tasked with this responsibility. Stale-dated checks outstanding for over 120 days should be voided and reissued. Be on the lookout for uncleared deposits on the bank reconciliation report. The check stock for the trust account should be controlled and verified regularly. If there are funds sitting in the account for a long time, determine what their status is. There is no problem with having funds for pending matters remain in the account for a long time, but the pending status should be confirmed for long-term deposits. Make sure that all deposited items have cleared and that no funds have been disbursed against “available” funds that have not truly cleared. In addition to the paper disbursements, electronic transfers and deposits should be examined for correctness.

A great tool for handling all of this is a monthly, three-way reconciliation. The bank statement balance should be reconciled to your checkbook ledger balance (allowing for outstanding issued checks and deposits that have not cleared). The checkbook ledger balance should then be checked against a listing of every client/matter balance.

Monthly Trust Binder

An easy way to organize all your bank records and electronic bank reconciliation reports from your legal accounting system is a three-ring tabbed binder. Your reports should be organized by month and clearly reflect the trust activity and balances per client for that month. By filing key documents and reports this way, you can make records readily specific to an individual client’s trust report available in case of an audit. It will also make your recordkeeping simpler and comprehensive. Each binder should represent one trust account with tabs for each month that include the original bank statement, the bank reconciliation report signed by the reviewing attorney, any bank notices, a trust receipts journal with copies of all deposit slips, the trust checks journal, and a client balances report matching the reconciled bank statement.

Overdrafts

Despite all your best efforts at monitoring and control, an overdraft may occur. Since banks are required to report overdrafts to your state bar association, this is a serious matter. You should contact the bank immediately to correct the deficiency. Keep full documentation of all the steps you take to identify and correct the problem. If the overdraft triggers an audit, you want to be able to provide a full record of events. If the overdraft is the result of a bank error, be sure to get a written explanation of the overdraft from the bank.

Technology to the Rescue

The most important tool a firm can have in dealing with the financial complexities facing today’s practitioners is a formal accounting software program that is geared specifically to the needs of a law practice and that is designed to handle trust accounting regulations. For Cindy Emmerson, that program is LexisNexis® PCLaw®. Because PCLaw® software is an end-to-end integrated system, significant efficiencies can be realized. Banking functions, general ledger entries, billing, reconciliation, case and matter management and reporting can all be handled by the same system. PCLaw security settings ensure compliance in client/matter reporting. Detailed client/matter reports show matter-to-matter transfers and the total of every matter trust balance by bank account. Complete audit trails show who entered, changed or deleted entries. The balance protection feature prevents the issuance of checks that will overdraw the account. Deposits can be marked as unavailable for whatever
length of time is needed for the item to truly clear. The bank reconciliation feature verifies balances and makes it easier to identify discrepancies. Automatic transfers of invoiced amounts from trust accounts to operating accounts can be programmed and current trust account balances can be included on invoices.

With all of these features, it is no wonder that Cindy Emmerson recommends PCLaw for all firm trust accounting compliance needs!

**Know Who You Can Trust**

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This practice management article is based on the original *Best Practices: Managing Trust Accounting for Compliance* Webinar presented by Cindy Emmerson, founder and president of Legal-Tech Solutions, Inc. Ms. Emmerson is a member of the Affinity Consulting Group, a LexisNexis Premier CIC, providing law office technology and practice consulting services for small-to-mid-sized law firms.

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