A complete guide to

Trust Accounts

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Hello and thanks for reading!

After talking with thousands of lawyers and bar executives across the country, we noticed a common theme—confusion and anxiety around trust accounting compliance. TrustBooks and LawPay share a common vision—to develop technologies that help alleviate this stress for lawyers.

At both TrustBooks and LawPay, we have two guiding principles for our products:

1. It must always maintain compliance with state bars and ABA guidelines
2. Everything must be incredibly simple

We've done everything we can to develop our products in a way that makes accepting payments and trust accounting easy and intuitive.

This guide was written for the non-accountant as a quick-start manual to trust accounts. Don't worry—reading it won't turn you into an accountant, but it will make you comfortable with the high-level details of managing your trust account.

Thanks again for reading. We hope it's useful and we welcome your feedback or questions.

To your success,

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Trust accounting overview

You finished law school and passed the bar. As a practicing attorney, you thought you'd never have to think about accounting. Unfortunately, that's not the case. If you're accepting advance payment for your fees or receiving money on behalf of a client, you'll need to maintain a trust account. Trust accounts can be tricky to master but this guide will help.

It will walk you through the ins and outs of trust accounting. It will cover everything you need to know from how to open a trust bank account to how to reconcile it. Although not state-specific, this guide will provide information commonly required by many state bars.

What is a trust account?

A trust account is a special bank account that holds money on behalf of your clients or third parties. This account is separate from your law firm's operating bank account.

Why is a trust account needed?

As a lawyer, you assume the role of a fiduciary when representing a client. As a fiduciary, you have a high level of responsibility to the person you represent. In this role, you may receive funds that belong to a client or someone else.

To reduce the risk of using that money incorrectly, you must place it into a trust account. You don't put this type of money in your personal bank account or the firm's operating account.

In your role as a fiduciary, you can never comingle or mix any personal funds with funds received on behalf of a client or third party. The trust account helps prevent comingling of different types of funds.

State bars provide comprehensive rules and regulations to guide lawyers and ensure that proper trust account records are kept. State bars enforce these rules and regulations and a violation could result in disciplinary action, even disbarment.

How to set up and maintain a trust account

We'll talk about each of these in more detail, but here are the key steps in setting up and maintaining your trust account:

1. Select a bank
2. Design procedures and processes
3. Maintain records
4. Keep client ledgers
5. Complete 3-way reconciliations
6. Generate month-end reports
7. Choose a trust accounting system

Setting up your trust account

You'll need to choose a bank and open a trust account before you accept any funds on your clients' behalf. Additionally, you'll need to develop trust management procedures.

Choosing a bank

Each state's bar determines which banks you can use for your trust account. Some common requirements are:

- ☑ The bank must have physical locations within your state.
- ☑ The bank must automatically report any overdrafts to the state bar.
- ☑ The bank must send any interest earned on trust accounts directly to the state bar.
- ☑ The bank must provide copies of cancelled checks, either physically or digitally.
- ☑ If only digital check copies are provided, they must be maintained for a certain period of time (up to six years is a common timeframe for most state bars).

Check with your state's bar for specifics on bank requirements where you practice.

Opening a trust account

After you've chosen a bank, open a trust account. (Most state bars require that the bank account be titled "Trust Account" to distinguish it from other accounts.)

Order blank checks that are business-sized, as opposed to the smaller personal checks. Make sure the checks have "Trust Account" printed on them.

Although you shouldn't commingle personal funds with your client trust funds, you can use your personal funds to initially fund a trust account, if necessary. You shouldn't use client funds to pay for trust account expenses (i.e., purchasing blank checks or paying monthly account service fees), so you are allowed to keep a small amount of personal funds in your trust account to cover non-client payments.

Choosing a payment partner

Once you've opened your trust account, you'll need to find a partner to use for accepting credit card and eCheck payments. To make sure you stay compliant, look for a partner developed specifically for lawyers and who understands the rules lawyers are required to follow when accepting client payments.

Unlike generic processors who don't understand the business of law, look for a payment partner that correctly separates earned and unearned fees and protects your trust account against any third-party debiting. This includes debiting processing fees from your trust account.

Developing trust management procedures

Now that your trust account is set up, create procedures to safeguard and properly manage it. Consider the following items:

Safeguarding funds: Ensure you develop internal processes for safeguarding trust funds when received. Consider who will be handling the trust funds, where the trust funds will be stored before they are deposited, and who will have oversight over the trust funds.

Depositing funds: All trust funds need to be promptly deposited into your trust account. Develop a process where funds are deposited into your trust account as quickly as possible (our recommendation is one business day from receipt).

Recording transactions: Develop a process for recording trust account transactions in a complete and timely manner to maintain accurate records (our recommendation is to record transactions when they happen).

Signing authority: Determine who will have check-signing authority (our recommendation is to keep this responsibility at the attorney level and not delegate it to non-attorney staff).

Understanding the flow of a trust account: Review your state bar's rules for what funds should and should not be deposited into your trust account. Generally, every receipt of money from a client or for a client should be placed in the trust account.

Creating a retention policy: Develop a system where all required documents are identified and securely kept. This could be for up to ten years, depending on your state bar's rules.

Recordkeeping

To properly maintain your trust account, you must maintain a record of all receipt and payment of funds for each client. Things like bank statements, bank documents, instructions or authorizations from a client, and records relating to the quarterly and monthly reconciliations help keep you in compliance.

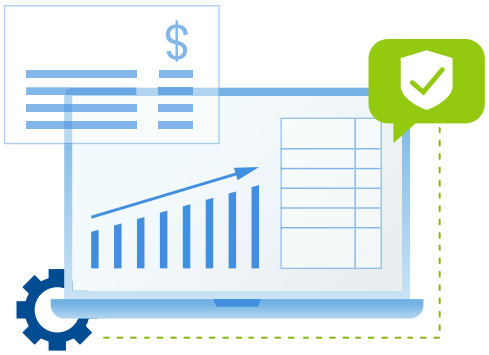
The mere act of opening a trust account at your bank isn't the only thing you need to do. You'll need to keep track of the money each client has in your trust account. This segregation of funds is crucial for two reasons:

1. As a fiduciary, you must adequately safeguard your client's money. Whether it's because your client asks or the state bar asks, you need to be able to accurately and quickly report transactions for each client.
2. You must ensure that your client's money isn't being used incorrectly. Properly segregating your client's money ensures you don't use Client A's money to pay Client B's obligations.

How do you segregate client funds when all your clients' money is in one bank account?
You can keep a paper log for each client and manually list out every client, add all money that comes in and out, and track available funds. This can be tedious if you have more than a few clients. Plus, you must store the papers in a safe or secure place and hope that your office doesn't catch on fire, or you don't spill coffee on that paper.

An electronic spreadsheet can function as a more modern version of the paper log. You will still need to add and subtract and calculate the available balance, but you eliminate the risk of ruining it by spilling coffee.

Or, you can use a software program designed for trust accounting. Trust accounting software makes segregating client money easy. After you set up each client's ledger, you can enter all additions and subtractions and generate a report with one click of a button. You can quickly see the balance for each client keeping you in compliance with your state bar.



To properly maintain your trust account, you must keep a record of all receipt and payment of funds for each client.

Client ledgers

As a central part of your recordkeeping, you need to generate two reports: a trust ledger and client ledgers. Think of these this way—the trust ledger is the big picture view of your trust account and the client ledgers are the granular view.

Big picture view

The trust ledger tracks all the transactions flowing in and out of your trust account. Transactions are not segregated by client on this report.

Granular view

All the transactions on your trust ledger are assigned to a specific client. Those transactions make up the individual client ledgers.

These individual client reports show all funds received, payments disbursed, and remaining balance. A client ledger should always start with a deposit because the balance in a client ledger should never be negative. The sum of all your client ledger balances should always match your trust ledger balance at any point in time. One way to confirm this is to complete a three-way trust reconciliation that reconciles:

1. Your trust bank statement,
2. Your trust ledger, and
3. Your client ledgers

> *The sum of all your client ledger balances should always match your trust ledger balance at any point in time.*

Depending on your state, you may need to do this monthly or quarterly. This process helps ensure that your internal recordkeeping procedures are complete and accurate.

We'll discuss reconciliations in more detail in the *Reconciliations section*.

Deposits and payments

Receipts and disbursements of money on behalf of a client all flow through your trust account. Keep the following items in mind when making deposits or payments from your trust account.

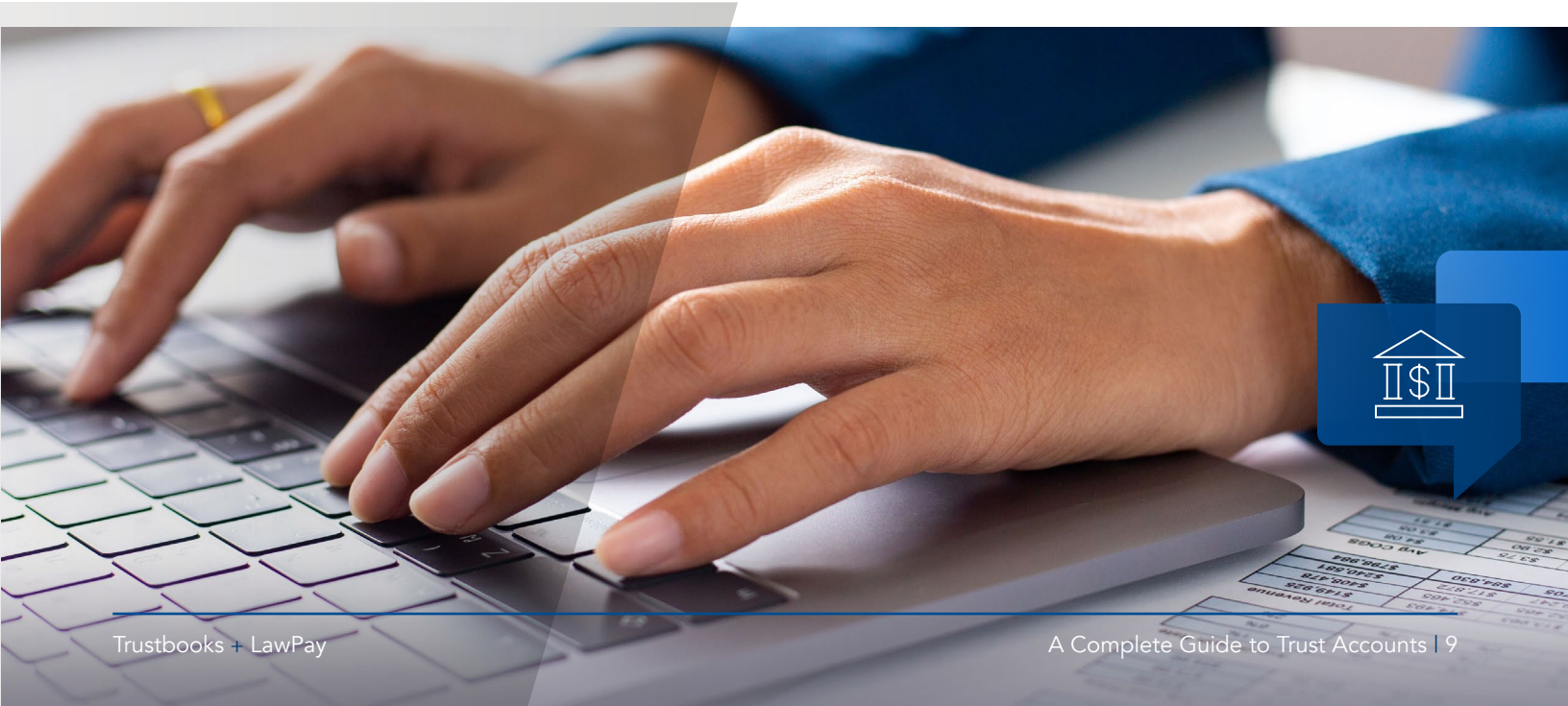
Deposits

Don't deposit any of your own money into the trust account except when necessary to open the account or maintain the account (i.e., to cover monthly service fees).

Deposit slips should include the name of the lawyer or law firm, trust account designation, account number, and routing number. When filling out a deposit slip, include client name, check numbers, and amount. When recording deposits to a client ledger, include check number, date of deposit, description, and amount.

Payments

1. Payments can be made for things such as client costs and expenses, settlement proceeds, and paying your earned and undisputed fees.
2. Payments may not be made against a client's deposited funds before the deposited funds have cleared and become available according to the bank. This prevents returns for insufficient funds.
3. If your bank charges services fees to your trust account, you can deposit personal funds to cover these costs.
4. A trust account check needs to include the trust account designation by clearly stating "Trust Account" on the face of the check. Also, the client's name and purpose of the payment should appear on the memo line.



Reconciliations

In the simplest definition, a trust reconciliation compares your internal trust accounting to the activity in your bank account. Your bank provides an independent, third party accounting of the activity that flows in and out of your bank account.

You reconcile your internal records to the bank statement because your bank statement gives you the most reliable evidence to track your trust activity.

But wait! You already know how to do this because this is no different than how you would reconcile your own personal bank accounts.

The goal of the reconciliation process is to match the transactions in your trust accounting records to the transactions on your bank statement.

There might be some things that you have on your records but aren't on the bank statement. That's OK. These are usually items that are in transit, meaning the bank hasn't seen them yet. It could be a check that you wrote two days ago that hasn't been cashed. These items usually will appear on next month's bank statement.

Starting the reconciliation

You'll first want to start with the deposits from your bank statement and compare them to the deposits in your trust accounting records. For each deposit on your bank statement, one of two things can happen:

1. The deposit on the bank statement matches the deposit in your trust accounting records (ideal).

2. The deposit on the bank statement does not match any deposit in your accounting records.

In the first scenario, you can mark the transaction as cleared since it appears in both places. In the second scenario, your trust accounting records are incomplete, and you need to add this entry to your accounting records. Remember the goal—you need every transaction that flows through the bank account to be captured in your trust accounting records.

You reconcile your internal records to the bank statement because your bank statement gives you the most reliable evidence to track your trust activity.

Perform the same matching process for disbursements. Compare the checks or withdrawals from the bank statement to the disbursements recorded in your trust accounting records. Again, you have two options:

1. The withdrawal on the bank statement matches the withdrawal recorded in your trust accounting records (ideal).

2. The withdrawal on the bank statement does not match any withdrawal recorded in your trust accounting records.

Tip: Remember the goal—you need every transaction that flows through the bank account to be captured in your trust accounting records.

As with deposits, in the first scenario, the transactions reconcile, and no further action is necessary. These transactions are considered cleared. In the second scenario, your trust accounting records must show the transaction from the bank statement. You'll need to record the disbursement in your trust accounting records.

Congratulations on getting this far!

You have matched the deposits and withdrawals from the bank statement to the trust accounting records, and you have your list of uncleared transactions (those in-transit items that the bank hasn't seen yet). The next step is to take the ending balance from the bank statement, plus any uncleared deposits, minus any uncleared disbursements, to calculate your adjusted ending balance.

This adjusted ending balance must match the ending balance from your trust accounting records. If the two balances do not match, then a mistake happened and you need to redo each step in the reconciliation process.

To make this a bit clearer, let's look at a quick example:

Assume that a lawyer has three clients with balances in a trust account as of June 30. The lawyer should have three separate client ledgers tracking the cash inflow and outflow for these three clients.

At month-end, the lawyer will add up the three client ledger balances and reconcile these balances to the bank statement for the trust account.

Starting with the bank statement, add and subtract any in-transit items to the ending balance shown on the bank statement to arrive at the adjusted bank balance.

Monthly trust reconciliation example

BANK ACTIVITY	
Bank Balance at 6/30/19	$1,460.00
Reconciling Items	
Plus: Deposits in Transit	$0.00
Minus: Outstanding Checks	($200.00)
Adjusted Bank Balance at 6/30/19	**$1,260.00**

CLIENT LEDGER ACTIVITY	
Client XX Balance at 6/30/19:	$750.00
Client YY Balance at 6/30/19:	$110.00
Client ZZ Balance at 6/30/19:	$400.00
Total Client Balances at 6/30/19	**$1,260.00**

**Note: In this example, the Trust Ledger Balance at 6/30/19 is not shown. The assumption is that the Client Ledger Balances at 6/30/19 and the Trust Ledger Balance at 6/30/19 match.*

A few keys to successfully performing trust reconciliations

Maintain timely records. If you keep up-to-date records, your ability to track and monitor the transactions in both your trust bank account and your trust accounting records improves significantly.

Utilize software. Software exists to make your life easier, more efficient, and reduce the risk of human error. Be sure to use software built for trust account compliance, like TrustBooks and LawPay. These software solutions, developed specifically for law firms, were made with trust compliance in mind and can dramatically simplify trust accounting in your practice.

Document, document, document. Go overboard with your documentation for your trust account. Your state bar will appreciate this, and you will have a much easier time if you ever need to trace your steps and fix anything.

Develop processes. Spend some time up front developing and documenting your processes for managing your trust account. Once you do this, be consistent with executing the processes.

Reporting

Insight and transparency into your trust account are a must for every attorney, but it can be challenging to know exactly which report(s) will give you the most thorough overview of your account.

With an endless number of reports at hand, attorneys can be overwhelmed with choices causing decision paralysis and an ineffective review of your trust account.

But how do you know which reports will strike that balance between efficiency and insight and give you the peace of mind that your review is complete? These six reports should be consistently included in the review of your trust account.

1. Three-way reconciliation report

What is this report? The three-way reconciliation report compares your bank balance, your trust ledger balance, and the sum of your client balances.

Why is it important? For any trust account, this is the ultimate reconciliation report. State bars require this report to be completed on a periodic basis—either monthly or quarterly.

Since you are required to track each transaction to a client, the three-way reconciliation ensures this is being completed and highlights any clients whose accounts have gone into the negative.

Tip: Don't be fooled into thinking that your general accounting software will automatically generate this report. General accounting programs (think QuickBooks) only perform a two-way reconciliation that compares your bank balance to your trust ledger; they do not incorporate your client ledgers.

This can cause a lot of panic and anxiety for attorneys who only think they are properly meeting this requirement by doing a reconciliation in their software.

2. Detailed reconciliation report

What is this report? This report provides the supporting detail of the reconciliation between your bank account and your trust ledger. It shows all the cleared items from your trust ledger, as well as the uncleared or in-transit items from your trust ledger.

Why is it important? This report is the foundation of any good accounting process. When maintaining your trust ledger, you need to periodically compare it to your bank statement. This gives you the confidence that your internal accounting records are complete and accurate.

Tip: Get into the habit of doing your detailed trust reconciliation in a timely manner. We suggest doing this within the first ten days following month-end. This will help you catch and resolve any errors quickly.

3. Client activity report

What is this report? This is a single report that lists each client, shows their balance at the beginning of the month, lists their activity, and calculates their balance at month-end.

Why is it important? This single report is a great tool to review all your clients and their activity for the month. You get a quick and easily-consumable snapshot that gives insight into account activity on a client-by-client basis.

Tip: Spend five to ten minutes reviewing this report each month to quickly identify high-level issues. The report may not be able to help you resolve the issues, but it's a great first step in identifying potential problems.

4. Trust ledger report

What is this report? This report can also be called a check register, general ledger, or statement of costs and receipts. It tracks all the transactions into and out of your trust account. It's a high-level report that does not separate out each transaction by client (although good trust accounting software will include the client information for each transaction).

Why is it important? This is your fundamental accounting report that tracks all activity into and out of your trust account—you need this to compare and reconcile to your bank statement.

Tip: Make sure that each transaction on your trust ledger gives you the information you need to do any follow-up research. Things like date, client name, description, and amount should be recorded. If you ever need to resolve an issue in your trust accounting, this report will help. Ensuring you've captured all the right data for each transaction means you can make changes quickly and efficiently. In the real world, mistakes will be made, so it's best to have a clear and easy way to correct them.

5. Payments report

What is this report? This report tracks all the payments from your trust account.

Why is it important? This report is a great tool to check for fraud by scanning all payments and comparing them to your bank statement. In addition, you can also use this report to check your accounting processes. If you start to see a lot of voided checks or other irregularities in check information, this report will highlight those areas that will need follow up procedures.

Tip: When checking for fraud, take a sample of checks or credit card payments that have cleared your bank.

Compare the information on your bank statement to your payments report. Look for discrepancies or irregularities in the following fields: payee, payment amount, signature line, as well as check number and endorsement if you're accepting a paper check. If you find any anomalies, you'll need to investigate. This can be a quick exercise and it will add a level of internal control to your review.

6. Deposits report

What is this report? This report provides a breakdown of each deposit.

Why is it important? Typically, when you look at the deposits on your bank statement, they show up as one lump sum—there's no breakdown of the actual checks or credit card transactions. With this report, you'll have that breakdown, and reviewing it will give you greater insight into the makeup of each deposit.

Tip: When you do your reconciliation, use this report as a shortcut to confirm the deposits on the bank statement match your trust account records.

Choosing technology

Choosing the correct trust accounting technology will make recording and reconciling your trust account painless.

Whether you're looking to replace your current system or you're just starting your firm, review your current process for recording your trust activity. Look for areas of efficiencies and areas where you need stronger internal controls. Here are some questions to consider:

- ☑ Can I automate this process?
- ☑ Do I have the right personnel completing each task?
- ☑ Do I have proper oversight to reduce my risk of fraud or embezzlement?

Once you've taken an inventory of where your trust account management stands, consider whether your current software meets your needs. Some questions to ask yourself are:

- ☑ Can I run a client ledger to send to clients?
- ☑ Can I run reports by the responsible attorney?
- ☑ Is my accounting software designed to perform monthly reconciliations?
- ☑ Does the software generate three-way reconciliation?
- ☑ Does my software prevent me from bringing a client's balance into the negative?
- ☑ Does the software have embedded features to help stay in compliance with state bar rules? For example, can I digitally sign and date reconciliation directly in the software?
- ☑ Am I spending the least amount of time managing my trust account because I have the right technology in place?

Conclusion

With these actionable steps, you'll be well on your way to remaining compliant with your state bar. Since each state bar has its own rules and laws for administering trust accounts, be sure to check with your state for any specific requirements.

We hope you feel more comfortable with what it takes to manage your trust accounts. Getting it set up properly at the beginning will give you peace of mind and reduce the amount of time you spend on reviewing it.

If you have any questions about trust accounts, please reach out to us. We love talking about trust accounting! Send us an email at info@trustbooks.com or experts@lawpay.com.

TrustBooks

About TrustBooks

TrustBooks is cloud-based software designed to help law firms easily manage their trust account while staying compliant with their state bar. TrustBooks provides a simple and intuitive trust accounting solution for attorneys with no accounting background. With built-in features, like always maintaining client ledgers and automatically generating Three-Way Reconciliations, attorneys have confidence that their trust account meets state bar requirements. TrustBooks partners with LawPay to provide an efficient and seamless trust accounting process.

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LawPay

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About LawPay

LawPay was developed specifically to provide a sophisticated payment solution for legal professionals. The LawPay platform contractually protects client funds by correctly separating earned and unearned fees and by restricting the ability of any third-party from debiting monies from a trust or IOLTA account. LawPay is available through 110+ state, local, and specialty bars, the ABA, and the ALA as a vetted and approved payment solution for the legal industry.

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