What are Trust Accounts?

Lawyers regularly receive funds from clients to be held in trust or for future use. These funds are referred to as trust money and must be stored in specific interest-bearing accounts, commonly referred to as trust accounts, that are separate from the firm's own money. The most common sources of these funds include:

- Client Retainers
- Proceeds from a Settlement
- Real Estate Closing Deposits
- Proceeds from an Estate
- Disputed Funds
- Cost Advances

If the amount of funds from a single client is large or a client's funds are going to be held for a long period of time, an attorney can open an interest-bearing trust account specifically for that client. The interest on an account that holds funds from a single client, is earned by that client.

However, attorneys often receive funds that are either too small or are being held for too short a time that it is impractical to open a separate account for each client. If they did, the cost of establishing and managing each trust account would be greater than any interest generated, therefore resulting in a net loss for the client. Instead, attorneys can open Interest on Lawyer Trust Accounts (IOLTA), which hold funds from many clients in one account. The interest earned on these accounts is gathered by the bank, sent to the State Bar, and pooled to provide civil and legal aid to those in need and support improvements to the justice system.

Every state, along with the District of Columbia and the US Virgin Islands, operates an IOLTA program, and each respective State Bar has specific rules that regulate the opening, managing, and accounting for these special accounts.

Opening Trust Accounts

After receiving funds, attorneys are responsible for notifying clients whether their funds are being held in a single interest-bearing trust account or an IOLTA. A firm may open as many IOLTAs as they deem necessary, and most firms are required to open an account in each state where their lawyers are practicing.

Each State Bar Association has a list of financial institutions that are approved to hold IOLTAs. When opening an IOLTA, the rate of interest on the account may not be lower than the highest interest rate or dividend available for non-IOLTA accounts at that institution.

Maintaining and Accounting for Trust Accounts

The American Bar Association, and each State Bar Association, specifies the record keeping requirements for trust accounts and IOLTAs. ABA Rule 1.15 Safekeeping Property, specifies that accounting records must be maintained for seven years and that specific information is required for each transaction in the account. All deposit records must include: the source of the funds, which client matter the funds are being held for, the date, and a description. All withdrawal records must include: the client matter, a description of the purpose of the transaction, the check number or form of payment, and the date. Finally, all transactions made on behalf of the client must include detailed records of all deposits and withdrawals. Any documents used in the movement of the funds should be provided to the client along with the statement of funds.

Funds that are held as retainer and compensation must be accompanied by their respective agreements. If such funds are applied as compensation for a lawyer's services, an invoice and an accounting of funds must be presented to the client. Any other payments made from a client's trust fund must be described and supported with documentation. Finally, records for outside legal and related services, copies of all related agreements, and closing statements must be maintained and saved along with the trust records. All of the above documentation may be stored on paper or digitally, as long as it is secure.

With so much information to keep track of, many attorneys use trust accounting systems that help record transactions, store detailed information, and provide detailed reports of trust account balances. For trust accounts that hold funds from a single client, a firm's accounting system must maintain a chronological double-entry journal that lists all transactions (i.e., deposits and withdrawals) associated with that account. This journal, like all accounting records, must be reconciled on regular basis, usually monthly. In this case, since the account only holds funds from one client, the client balance in the accounting system (after reconciliation) should equal the bank's balance of the trust account.

Trust accounting systems use the same basic process to track and maintain IOLTA transactions and balances, but since these accounts hold funds from many clients, the system must classify each transaction by its respective client matter information. In other words, the system still maintains a chronological double-entry journal that lists all IOLTA transactions and should be reconciled monthly. However, each transaction is labeled with specific client matter information that gives attorneys the ability to sort transactions by client and determine individual client balances. In this case, the sum of all client balances, in a single IOLTA, provided by the accounting system (after reconciliation) should equal the bank's IOLTA balance.

Auditing Trust Accounts

Every state will perform random audits of attorney's trust accounts. The audit process verifies that the lawyer can present a reconciliation of the trust funds, referred to as a three-way reconciliation. The audit team will review the reports by account and client, prepared by the attorney, as well as the account reconciliation, provided by the bank, to confirm that all funds are accounted for and are in balance.

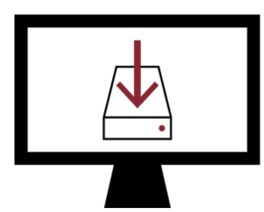
Why Proper Recordkeeping is Important

Improper record maintenance is the most common error made by attorneys, in regard to trust accounting. Often, an error is identified when a check, from a single-client trust account or IOLTA, is requested for payment and there are insufficient funds remaining in the account to process the payment. The bank holding the trust account or IOLTA, is required to notify the State Bar whenever an account has insufficient funds, and it is the attorney's responsibility to identify why the account did not have enough funds and then correct for any errors, usually by depositing their own funds into the account to make up the difference

In most cases, this is the result of sloppy, untimely, or improper recordkeeping of trust accounts. Law firms are responsible for having processes, known as internal controls, that maintain the integrity of accounting information and prevent the firm from spending money on behalf of a client that does not have sufficient funds in their account. The most common internal control for businesses worldwide is the separation of duties for those who have banking and/or accounting responsibilities. For example, its ideal to have one person at a firm responsible for depositing funds and/or writing checks and a second person responsible for reconciling accounts. With this set up in place, a system of checks and balances is created to ensure the integrity of each step in the accounting process and safeguards against fraud or embezzlement because no single person is responsible for all accounting duties.

Legal Office Software

Legal office software should have tools and functions built-in that automatically record and reconcile trust account information. Generalized accounting packages, on the other hand, are designed to be used by any business in any industry, and therefore do not have trust accounting features. Many legal accounting software packages are designed to help firms properly handle trust accounting information.



It is not optional for attorneys to comply with the rules of safekeeping and accounting for trust money. However, many law firms struggle to do so because they do not have the proper accounting systems in place to keep track of transactions as well as information and implement proper internal controls that keep mistakes from happening. The easiest way to be a well-managed firm and avoid the common errors associated with trust accounting, is to utilize the best technological solutions available and perform internal audits that certify accounts are balanced and software is running as it should.