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## What Is Trust Accounting? Rules, Types, and How-To

Katie Langer · Wednesday, April 9th, 2025

For legal professionals, understanding trust accounting is important to build client trust. This area of [law firm accounting](#) is a fundamental component of the legal industry because it involves the management of client funds that a law firm holds in trust for its clients and requires strict adherence to ethical and legal obligations.

Trust accounting is not just a procedural necessity; it helps maintain the integrity of the attorney-client relationship. This article discusses the fundamentals of trust accounting, including its purpose, set-up process, types of trust accounts, and the rules for maintaining compliance.

### Main Takeaways From This Article:

- Trust accounting is essential for managing client funds ethically and legally to avoid regulatory penalties and reputational damage.
- There are different types of client trust accounts, such as IOLTA, individual client-based, and retainer-based, each serving unique purposes.
- Compliance with trust accounting rules, such as using dedicated accounts for holding client monies and conducting three-way reconciliations, is critical to managing assets in trust accounts and steering clear of legal trouble.
- Implementing specialized trust accounting software like Centerbase can enhance accounting efficiency and ensure accurate fund management.

## What Is Trust Accounting?



Trust accounting refers to the management of funds held by a law firm on behalf of its clients. Lawyers receive funds from clients for various purposes, such as retaining legal services, covering court costs, or settling claims. These funds are kept separate from the firm's operating funds and are only disbursed for their intended purpose. The primary objective of trust accounting is to ensure that client funds are securely held, properly managed with a high degree of transparency, and used only as authorized.

## Types of Client Trust Accounts



Firms use different types of client trust accounts, each serving a distinct purpose. Here are the three commonly used trust accounts:

### **IOLTA (Interest on Lawyers' Trust Accounts)**

IOLTA accounts are designed to hold client funds that are nominal in amount or expected to be held for a short period. These accounts aggregate funds from multiple clients, and any interest earned on these accounts is directed to local bar foundations or similar organizations that use the funds for legal aid and other public interest initiatives. Attorneys must adhere to specific IOLTA regulations, including reporting requirements.

### **Individual Client Trust Accounts**

These accounts are used to store funds for specific clients when the amounts held are substantial or expected to be held for a longer duration. Individual client trust accounts ensure that interest earned benefits the clients for whom they exist. This type of account provides a clear and direct audit trail for each client's funds.

### **Retainer-Based Trust Accounts**

Retainer-based trust accounts are established when a client pre-pays for legal services. These accounts are used to hold fees collected in advance for services that will be rendered over time. Funds are gradually drawn from this account as legal services are provided, ensuring clients' funds are not used until the services are executed.

## **The Trust Accounting Process: Key Steps for Law Firms to Stay Compliant**

To manage client funds effectively and in line with legal requirements, firms must follow a structured trust accounting process. Here are the key steps that every law firm should take to ensure compliance and proper management of trust accounts:

### **1. Open a Client Trust Account**

The first step in the trust accounting process is to open a dedicated client trust account at a financial institution. This account must be separate from the firm's operating accounts to clearly delineate funds.

To comply with the regulatory requirements of the local bar association, firms should ensure that the account adheres to the guidelines set forth.

### **2. Deposit Client Funds**

Once the trust account is established, attorneys deposit the money they receive from their clients. This can be in a pooled account or a dedicated client account. The decision will depend on the amount, the duration it needs to be held for, and client preferences.

Keeping detailed records of each deposit and the purpose of each deposit is crucial to upholding accountability and transparency at all times. Traditionally, attorneys used ledger cards to track client trust funds, but today it's recommended to keep track of trust assets with specialized legal accounting software, as that can help minimize human errors.

### **3. Manage Trust Account Transactions**

Managing transactions within the trust account involves tracking disbursements to and from the account. Attorneys must ensure that only authorized transactions occur and that client funds are not used for firm expenses. Accumulating detailed records of all transactions helps maintain compliance.

#### 4. Conduct Trust Account Reporting and Audits

To comply with regulations and ensure financial oversight, firms should routinely audit their trust accounts and [prepare thorough reports](#). Checking the accounts requires three-way reconciliation, which includes comparing client ledger, firm records, and bank balances.

Law firms should identify any discrepancies promptly. Frequent audits not only ensure compliance but also build client trust.

### Trust Accounting Rules



Every firm dealing with trust accounts is required to follow certain guidelines set by the American Bar Association. These guidelines are the requisite dos and don'ts that can help your efforts to build trust with your customers.



## 1. Client Funds Must Be Kept in a Separate Account

Trust accounts should not be combined with personal or professional funds. This means you cannot supplement a shortfall in your firm's operating accounts by transferring money from a trust account to help pay employees or the business's overhead. This is because you are obligated to uphold the fiduciary responsibility that you, as an attorney, have to your clients.

By keeping client funds in a designated trust account, you avoid the risk of unintentionally using these funds for personal or business expenses. This practice ensures that the funds remain readily identifiable and accessible for their intended purpose.

## 2. No Use of Client Funds for Firm Expenses

Client funds held in trust are strictly for the client's benefit and must not be used for any firm expenses. Using client funds to cover operational costs, even temporarily, constitutes a serious breach of fiduciary duty and can result in severe disciplinary action.

Using client funds strictly to pay for the expenses of the cases they're involved with ensures that the funds are kept in reserve for the purposes they were meant for, such as costs of litigation, [distribution of settlements](#), or other costs related to the client.

## 3. Maintain Accurate and Detailed Records

Law firms must meticulously document all transactions involving client funds, including deposits, withdrawals, disbursements, and service fees. These records serve several crucial purposes, such as:

- Providing a transparent account of all financial activities related to client trust accounts
- [Upholding compliance](#) with legal and regulatory requirements
- Substantiating the firm's adherence to ethical standards

Thorough documentation becomes invaluable during monthly, quarterly, or [yearly audits](#) and assessments, as it reflects the firm's integrity and commitment to responsible fiduciary practices. Law firms should invest in effective accounting tools that can streamline record-keeping and help them keep all entries accurate and up-to-date.

#### **4. Conduct Regular Three-Way Reconciliations**

Three-way reconciliation is a critical practice in effective trust account management. By comparing the law firm's internal accounting records, the client ledger, and the bank statements for the trust account, attorneys can identify and rectify discrepancies promptly and ensure that all client funds are accurately accounted for.

Regular reconciliations serve as a strong preventive measure against potential fraud or mismanagement and are vital for cultivating a culture of accountability in the firm, which reinforces the importance of ethical handling of client funds.

#### **5. Earned Fees Must Be Transferred Promptly**

Law firms should have clear and accessible policies for prompt processing and transfer of earned legal fees from trust accounts to operating accounts. This is imperative for maintaining the integrity of the attorney-client relationship and ensuring compliance with ethical standards.

Delays in transferring earned fees can create confusion regarding the status of client funds and may even suggest impropriety in the management of those funds.

#### **6. No Overdrawing of Client Trust Accounts**

Overdrawing a client's trust account is a serious violation of trust accounting rules. It demonstrates a lack of diligence to maintain accurate records and can result in disciplinary action.

To prevent this, firms must diligently monitor account balances and keep detailed records. Regular reconciliations of account records and the careful management of funds are keys to ensuring you do not overdraw client trust accounts and that client funds are available when needed.

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## **7. Obtain Proper Client Authorization for Disbursements**

All disbursements from the trust account must be authorized by the client. Obtaining written authorization before making any disbursement is crucial for compliance. This documentation serves as evidence of the client's consent and protects the firm from potential disputes.

Proper authorization ensures that client funds are disbursed only for their intended purpose and following the client's wishes.

## **8. Trust Account Interest Rules Must Be Followed**

Law firms that manage client funds through an IOLTA must understand the trust account interest rules. These rules dictate how interest earned on client funds should be managed and distributed to organizations that run legal aid programs and other public interest initiatives.

Attorneys must be knowledgeable about their state's specific regulations regarding interest accrual on trust accounts, as well as how to report and remit any earned interest appropriately. Not understanding how to handle interest can lead to penalties and may damage client trust and the firm's reputation.

## **9. Follow State Bar or Regulatory Authority Guidelines**

Law firms must adhere to the guidelines established by their state bar associations or regulatory authorities concerning trust accounting. These guidelines provide detailed instructions on trust account creation, management, record-keeping, and reporting requirements.

Each state may have unique requirements that attorneys should be aware of and follow meticulously. By familiarizing themselves with these requirements, firms can ensure they remain compliant and avoid potential sanctions, including fines or disciplinary action. Law firms must stay informed of any changes to these regulations to ensure their trust accounting practices are always compliant.

## **Boost Firm Efficiency With Trust Accounting Software**



Maintaining meticulous trust accounting records and upholding regulatory standards is a complex process. However, leveraging specialized trust accounting software can greatly streamline these tasks, reduce errors, and enhance the overall efficiency of this key legal function.

Centerbase's [accounting and online banking tools](#) provide a comprehensive solution to simplify trust account management. These tools offer automated reconciliation, which eliminates the manual work involved in comparing bank statements, client ledgers, and trust account balances.

The comprehensive suite of reporting tools enables law firms to quickly generate detailed reports, simplifying audits and demonstrating compliance with regulatory requirements. The secure data management features protect sensitive client financial information, reassuring clients that the firm meets data privacy regulations. Using [Centerbase](#) means law firms can dedicate more time and effort to providing legal services than to administrative chores. Ready to see the software in action? **[Get a free demo](#)** today!

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