

SECTION I

Law Firm Management, Compliance & Fiduciary Controls

This manual provides a structured compliance and management framework for law firms navigating the fiduciary, operational, and professional responsibility dimensions of legal practice. It is designed for law firm principals, office administrators, and compliance personnel responsible for trust accounting, client fund management, and internal operational controls.

Law firms operate in a fiduciary environment where small administrative errors can become major professional responsibility issues. Client funds, settlement proceeds, retainers, advanced costs, disputed funds, and third-party property must be handled through disciplined systems that preserve client trust and protect the lawyer's license.

This framework is built around practical risk controls: trust accounting, monthly reconciliation, staff supervision, documentation, software workflows, and written oversight procedures.

- Solo practitioners and small to mid-size law firms
- All practice areas handling client funds, retainers, or third-party property
- Firms subject to state bar trust account rules (IOLTA or equivalent)
- Firms undergoing or preparing for state bar audit or peer review
- Law firm administrators and nonlawyer staff with trust account responsibilities

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SECTION II

IOLTA & Client Trust Accounting

What Is IOLTA?

Interest on Lawyers' Trust Accounts (IOLTA) is a program under which lawyers hold client funds in pooled interest-bearing accounts. The interest generated is remitted to state-designated foundations supporting legal aid initiatives. IOLTA accounts are mandatory in most U.S. jurisdictions for nominal or short-term client funds.

Core Trust Accounting Rules

Rule	Description
No Commingling	Client funds must never be mixed with firm operating funds.
No Conversion	Client funds may not be used for any purpose other than the client's benefit.
Prompt Deposit	Client funds must be deposited promptly upon receipt.
Earned-Fee Transfers	Fees are earned only upon completion of the agreed service. Unearned retainers stay in trust.
Client Notification	Clients must be notified of receipt and disbursement of their funds.
Separate Ledgers	A separate client ledger must be maintained for each matter.
Accurate Records	All trust account transactions must be recorded accurately and completely.

Retainer Types & Trust Treatment

Retainer Type	Trust Account Treatment
Classic (True) Retainer	Earned upon receipt — may be deposited to operating account
Advance Fee Retainer	Unearned — must be held in trust until fees are earned
Security Retainer	Client's property — held in trust throughout representation
Fixed-Fee Retainer	Jurisdiction-specific — verify local rules before deposit

SECTION III

Three-Way Reconciliation

What Is Three-Way Reconciliation?

Three-way reconciliation is the monthly process of confirming that three independent records are in complete agreement: (1) the adjusted bank statement balance, (2) the total of all individual client ledger balances, and (3) the firm's trust account register. Any discrepancy must be investigated and resolved immediately.

Component	What It Is	Common Issues
1. Adjusted Bank Balance	Bank statement adjusted for outstanding checks and deposits in transit	Missing deposits, unrecorded checks, bank errors
2. Client Ledger Total	Sum of all individual client matter balances	Missing ledgers, posting errors, negative balances
3. Trust Register	Running total in the firm's own trust checkbook or software	Unrecorded transactions, data entry errors

Monthly Reconciliation Checklist

- Obtain the end-of-month bank statement for the trust account
- List all outstanding checks (issued but not yet cleared)
- List all deposits in transit (deposited but not yet on statement)
- Compute: Adjusted Bank Balance = Statement Balance + Deposits in Transit - Outstanding Checks
- Total all individual client ledger balances as of month-end
- Confirm trust register running total as of month-end
- All three figures must match — investigate any discrepancy immediately
- Document the reconciliation with supporting schedules
- Responsible attorney must review and sign the reconciliation
- Retain records for the period required by jurisdiction

SECTION IV

Fiduciary Risk Management

Core Fiduciary Obligations

- Duty of Loyalty — client interests come before the firm's in any trust account decision
- Duty of Care — trust funds must be handled with the skill and diligence of a competent lawyer
- Duty of Accounting — complete, accurate records of all client fund transactions must be kept
- Duty of Safekeeping — client property must be kept safe and identifiable at all times
- Duty of Prompt Delivery — client funds must be delivered promptly upon entitlement

High-Risk Situations

Risk Area	Description	Control Measure
Disputed Funds	Funds in dispute between client and firm or between parties	Hold in trust pending resolution — never disburse unilaterally
Unclaimed Funds	Client funds that cannot be returned due to lost contact	Follow jurisdiction escheat / unclaimed property procedures
Settlement Funds	Received on behalf of clients in litigation matters	Hold in trust; disburse only after client approval and lien clearance
Third-Party Liens	Medical providers, government agencies with claims on proceeds	Do not disburse until all valid liens are resolved
Negative Ledger Bal.	A client ledger showing less than zero — always negative	Investigate immediately; indicates commingling or conversion

SECTION V

Internal Controls

Segregation of Duties

No single person should have end-to-end control over trust account transactions. The person who authorizes disbursements should not be the same person who records them.

Function	Recommended Assignment
Trust account deposits	Paralegal or administrator
Disbursement authorization	Responsible attorney only
Client ledger posting	Bookkeeper or administrator
Monthly reconciliation	Office manager or outside accountant
Reconciliation review & sign-off	Responsible attorney
Bank statement review	Responsible attorney (not preparer)

Wire Controls & Approval Authority

- All disbursements require written or documented attorney authorization
- Wire transfers require dual authorization where staffing permits
- No disbursement should be processed on verbal instruction alone
- Wire instructions received by email must be verified by callback to a known number
- Maintain a disbursement log: date, payee, amount, matter, authorizing attorney

Audit Trail Requirements

- All transactions must be recorded at the time they occur — not reconstructed later
- Every entry must identify: date, amount, payor/payee, matter number, nature of transaction
- Bank statements, deposit slips, cancelled checks, wire confirmations must be retained
- Retention period: follow jurisdiction-specific rules — typically 5–7 years minimum

SECTION VI

State Bar Audit Readiness

Audit Readiness Checklist

- Written trust account policy — adopted, dated, and signed by responsible attorney
- Complete client ledger for every matter with trust account activity
- Monthly three-way reconciliations for the full audit period — signed and dated
- Bank statements, cancelled checks, deposit slips — organized by month
- Wire transfer records — confirmations, authorizations, callbacks documented
- Disbursement authorization log — all disbursements with attorney sign-off
- Settlement fund records — receipts, lien resolutions, client approvals, disbursements
- Staff training records — who was trained, when, on what
- Documentation of any irregularities and how they were resolved

Common Trust Accounting Deficiencies

Deficiency	Root Cause	Corrective Measure
Commingling	Firm funds in trust or client funds in operating	Stricter trust account separation; immediate investigation of any cross-over
No monthly reconciliation	Not performed or not documented	Mandatory monthly reconciliation with attorney sign-off
Missing client ledgers	No matter-level ledger maintained	Software setup requiring ledger creation for each trust matter
Premature fee withdrawal	Fees withdrawn before earned	Written earned-fee policy; attorney authorization required
Negative client balances	Disbursements exceeding individual client balance	Software controls blocking negative-balance disbursements
No written policy	Procedures exist in practice but not in writing	Adopt a written trust account policy manual

SECTION VII

Recommended Compliance Framework

01	Adopt Written Trust-Account Policies <p>Every firm handling client funds must have a written trust account policy covering: account setup, deposit procedures, disbursement authorization, reconciliation schedule, ledger requirements, staff responsibilities, and record retention. The responsible attorney must sign and date the policy and review it annually.</p>
02	Maintain Matter-Level Client Ledgers <p>A separate ledger must exist for every client matter in which trust funds are held. It must record every deposit and disbursement, the running balance, the date, and the nature of each transaction. No disbursement should proceed without confirming sufficient balance.</p>
03	Complete Monthly Three-Way Reconciliations <p>Reconciliation must be performed within 30 days of month-end, comparing the adjusted bank statement balance, total client ledger balances, and the trust register. Any discrepancy must be resolved before the reconciliation is signed off.</p>
04	Require Responsible Attorney Review and Sign-Off <p>Every monthly reconciliation must be reviewed and signed by the responsible attorney. This review confirms that all trust account activity is properly accounted for and cannot be delegated to nonlawyer staff.</p>
05	Use Legal-Specific Accounting Software Where Possible <p>Legal accounting software (Clio, MyCase, PCLaw, Tabs3) includes client ledger management, three-way reconciliation tools, and controls that prevent negative ledger balances — safeguards that general accounting software typically lacks.</p>
06	Retain Records for the Required Period <p>Trust account records must be retained for the minimum period required by the governing jurisdiction — typically five to seven years. Records include bank statements, cancelled checks, client ledgers, reconciliations, and disbursement authorizations.</p>
07	Cross-Reference Local Professional Responsibility Rules <p>This manual provides a general framework. Every firm must verify that its procedures comply with the specific rules of each jurisdiction in which it practices. State bar trust account rules vary significantly — particularly on earned retainers and reporting requirements.</p>

SECTION VIII

Disclaimer & Closing

Legal Disclaimer

This manual is an educational and operational resource prepared by ARH Consults LLC. It does not constitute legal advice and is not a substitute for consultation with qualified legal, ethics, or professional responsibility counsel. This manual must be customized to the law firm's specific jurisdiction, practice area, governing rules, and professional responsibility obligations.

- This manual does not constitute legal advice and does not create an attorney-client relationship
- Compliance with this manual does not guarantee compliance with applicable state bar rules
- Firms must verify all procedures against current local professional responsibility rules
- This manual should be reviewed by qualified legal ethics counsel before implementation

About ARH Consults LLC

ARH Consults LLC provides advisory and consulting services to law firms, professional practices, and businesses across Manhattan, Beverly Hills, Austin, and internationally. Our law firm management practice covers operational compliance, IOLTA and trust accounting protocols, AI governance, and professional practice development.

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