



# How Should Law Firms Manage Client Retainers

White Paper by CosmoLex Cloud, LLC

When it comes to legal accounting it is important to understand that not all funds are the same. Attorneys deal with two major types of bank accounts: operating accounts and trust accounts.

In most situations operating accounts contain funds that belong to the firm. This means all of the funds in this operating account have been earned by the firm in some fashion, and recognized as income after all other liabilities have been paid and accounted for.

In most situations law firms or attorneys use trust accounts to hold funds or monies that do not belong to them. These are usually funds that are being held for clients. It could be for fee or costs retainers associated with legal matters, or it could be funds that are to be paid out to various parties related to a settlement.

This is only what happens in most situations though. The truth is depending on your jurisdiction and what the firm is comfortable with - client retainers are not always exclusively held in trust accounts. For example, in New Jersey & New York, lawyers are generally permitted to keep client retainers in operating accounts (unless, for example, there is an agreement with the client that the retainer will be held in trust).

At this point you may be asking yourself, “What is the best way to handle client retainers? Should my firm be putting client retainers in an operating account or a trust account?” Unfortunately, or fortunately, depending on how you look at it, there is no right or wrong answer.

While law firms may be permitted to keep client retainers in the firm’s operating or trust accounts (depending on your jurisdiction), it is important that these funds are properly accounted for and accurately applied to the client’s matter it is associated with.

### How Will The Handling Of Client Retainers Impact Your Firm

Now that we have established that in some jurisdictions law firms have a choice in how they handle client retainers, it is important to understand what impact those choices will have on a firm. Here are three different situations.

1. The Law Firm Only Uses Trust Accounts For Client Retainers
2. The Law Firm Uses A Combination of Trust & Operating Accounts For Client Retainers
3. The Law Firm Only Uses Operating Accounts For Client Retainers

### The Law Firm Only Uses Trust Accounts For Client Retainers

The following situation will illustrate how multiple clients’ retainers live inside the same trust account but remain separate to avoid any ethics violations.

**Step-1: Client A provided \$1K retainer and Client B provided \$2K retainer.**

**Client Balances:**

	Client Retainers	Account Receivables
Client A	\$1000	\$0
Client B	\$2000	\$0

**Bank Balances:**

Business Account	Trust Account
\$0	\$3000

**Step-2: Firm issues \$800 invoice to Client A and \$2500 invoice to Client B.**

**Client Balances:**

	Client Retainers	Account Receivables
Client A	\$1000	\$800
Client B	\$2000	\$2500

**Bank Balances:**

Business Account	Trust Account
\$0	\$3000

**Step-3: Firm draws existing retainers to pay issued invoices.**

**Client Balances:**

	Client Retainers	Account Receivables
Client A	\$200	\$0
Client B	\$0	\$500

**Bank Balances:**

Business Account	Trust Account
\$2800	\$200

**The Law Firm Uses A Combination of Trust & Operating Accounts For Client Retainers**

In some situations, and if permitted by the jurisdiction, a law firm may utilize both its operating account and trust account to handle retainers, on a matter-by-matter basis (for example, based on how the firm and client agree the retainer should be handled). Just as is the case in our first situation, firms who use both trust and operating accounts to handle client retainers need to ensure every penny is accounted for and accurately applied to the client’s matter it is associated with.

**Step-1: Client A provided \$1K retainer (deposited in operating) and Client B provided \$2K retainer (deposited in trust)**

**Client Balances:**

	Client Retainers	Account Receivables
Client A	\$1000	\$0
Client B	\$2000	\$0

**Bank Balances:**

Business Account	Trust Account
\$1000	\$2000

**Step-2: Firm issues \$800 invoice to Client A and \$2500 invoice to Client B.**

**Client Balances:**

	Client Retainers	Account Receivables
Client A	\$1000	\$800
Client B	\$2000	\$2500

**Bank Balances:**

Business Account	Trust Account
\$1000	\$2000

**Step-3: Firm draws existing retainers to pay issued invoices.**

**Client Balances:**

	Client Retainers	Account Receivables
Client A	\$200	\$0
Client B	\$0	\$500

**Bank Balances:**

Business Account	Trust Account
\$3000	\$0

## The Law Firm Only Uses Operating Accounts For Client Retainers

Finally, as noted above, attorneys in some jurisdictions may deposit retainers into their operating accounts (unless there is an agreement with the client to hold such funds in trust). Thus, in what is very similar to our first situation, this example illustrates what it would look like if a firm were to generally keep all client retainers in an operating account. While this example does not use trusts accounts, it is nevertheless important to ensure one client's retainer is properly accounted for.

### Step-1: Client A provided \$1K retainer and Client B provided \$2K retainer

#### Client Balances:

	Client Retainers	Account Receivables
Client A	\$1000	\$0
Client B	\$2000	\$0

#### Bank Balances:

Business Account	Trust Account
\$3000	\$0

### Step-2: Firm issues \$800 invoice to Client A and \$2500 invoice to Client B.

#### Client Balances:

	Client Retainers	Account Receivables
Client A	\$1000	\$800
Client B	\$2000	\$2500

#### Bank Balances:

Business Account	Trust Account
\$3000	\$0

**Step-3: Firm draws existing retainers to pay issued invoices.**

**Client Balances:**

	Client Retainers	Account Receivables
Client A	\$200	\$0
Client B	\$0	\$500

**Bank Balances:**

Business Account	Trust Account
\$3000	\$0

Depending on your jurisdiction, any one of these three examples would be considered an acceptable way to handle client retainers inside of trust accounts, operating accounts, or even across both trust and operating accounts.

The one common factor across all three situations, is that in every example- every single penny needs to be accounted for and attached to the appropriate client and matter it is associated with. Regardless of the type of account a firm uses to manage client retainers, failing to properly account for retainer deposits can result in bookkeeping nightmares and ethics violations.

This type of accounting scrutiny is specific to the legal industry. For that reason, it is extremely important that law firms and attorneys utilize billing & accounting software that is specific to legal accounting. General business accounting software simply will not do the trick.

Most legal billing systems do not include accounting functionality and cannot adequately differentiate between trust and operating accounts, particularly in the context of retainer deposits. Only unique solutions like CosmoLex bring both legal billing and accounting together in one system as well as ensure that a firm's handling of client retainers, however they choose to do it, remains clean and compliant with the regulations put forth in the state they practice law.

**About CosmoLex**

CosmoLex ([www.cosmolex.com](http://www.cosmolex.com)) is a Cloud-based law practice total solution, specifically designed for small law firms and solo attorneys. CosmoLex combines practice management and accounting functions, allowing lawyers to focus on the practice of law. CosmoLex's CEO, Dr. Rick Kabra, has over 10 years of experience in the legal software industry, meeting to the specialized technology needs of small to mid-sized law firms.