LAW(B) 105 - Legal-Specific Accounting

Comprehensive Outline

Module 1 - What Makes Legal Accounting "Legal-Specific"

Core idea: ownership of funds

- **Operating funds** belong to the law firm.
- **Client (trust) funds** belong to the client/third party and must be:
  - segregated from operating funds,
  - tracked by matter/client,
  - supported by detailed records,
  - reconciled regularly.

The 2-ledger world (Operating vs Trust)

Table Illustration: "Two Buckets"

Topic	LAW FIRM MONEY (Operating Account)	CLIENT MONEY (Trust/IOLTA Account)
Ownership	Firm-owned funds	Client/3rd-party-owned funds
Typical inflows	Earned fees deposited; reimbursements (if treated as revenue)	Retainers; settlement proceeds; cost advances; escrow-type holds
Typical outflows	Payroll, rent, subscriptions, taxes, office expenses	Client costs, lien payments, client disbursements, earned fee transfers
Tracking requirement	Normal business accounting	Must track by client/matter
Key compliance risk	Misstated income/expense	Commingling, misappropriation, negative client balances
Required routine	Bank reconciliation	Three-way reconciliation + client ledger support

1.0 Module Overview

Goal: Explain why accounting in a law office is different from "regular" small business accounting, and identify the core rules that drive legal-specific workflows (especially trust/IOLTA handling).

What students should know by the end of Module 1:

- The difference between **firm-owned money** and **client/third-party money**
- Why legal accounting uses a **two-ledger world** (operating vs trust)
- The meaning of **segregation, matter-level tracking, documentation, and reconciliation**
- Common early mistakes (commingling, mislabeling deposits, sloppy memos)

1.1 Core Idea: Ownership of Funds (The Rule That Changes Everything)

1.1.1 Definition: "Ownership" drives classification

Legal accounting starts with one question:

"Who owns the money right now?"

Table: Ownership Decision Rule

If the money is owned by…	It belongs in…	Why
The law firm (earned fees, firm revenue)	**Operating**	Firm can spend it on business expenses
A client or third party (unearned retainers, settlements, liens)	**Trust/IOLTA**	Firm is holding it as a fiduciary

1.1.2 Practical examples of ownership

Table: Typical Transactions by Ownership

Situation	Owner of funds at receipt	Account used	Notes
Client pays an **advance fee retainer**	Client (until earned)	Trust/IOLTA	Moves to operating only after earned + billed + documented
Client pays a **past-due invoice**	Firm (already earned)	Operating	Not trust money
Settlement check received	Client + 3rd parties + firm fee portion	Trust/IOLTA	Must allocate and disburse correctly
Client reimburses a cost already paid by firm	Usually firm	Operating	Treatment depends on firm policy (expense reduction vs income)

1.1.3 Key compliance duties (what "legal-specific" requires)

Client/trust funds must be:

- **Segregated** (kept separate from operating funds)
- **Tracked by matter/client** (individual ownership records)
- **Documented** (proof for every deposit/withdrawal/transfer)
- **Reconciled regularly** (to catch errors and prevent misuse)

Table: Duties and What They Look Like in Practice

Duty	What it means	Example
Segregation	No mixing trust + operating money	Retainer goes to trust, not operating
Matter-level tracking	Each client/matter has its own ledger	"Client A ledger balance = $3,400"
Documentation	Clear audit trail for each transaction	Invoice # on fee transfer; receipt on cost payment
Reconciliation	Regular balancing of records	Monthly three-way trust reconciliation

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1.2 The Two-Ledger World (Operating Books vs Trust Books)

1.2.1 Why two ledgers exist

A law firm is managing:

1. A normal business (operating), and
2. A fiduciary holding account (trust)

These are fundamentally different responsibilities, so they must be accounted for separately.

1.2.2 "Two Buckets" Illustration (table)

Table: Operating vs Trust

Topic	LAW FIRM MONEY (Operating)	CLIENT MONEY (Trust/IOLTA)
Primary purpose	Run the firm	Safeguard client/3rd-party funds
Ownership	Firm	Client/third party
Examples of deposits	Earned fees, interest (operating), reimbursements (policy)	Unearned retainers, settlements, cost advances
Examples of payments	Payroll, rent, subscriptions, taxes	Client costs, lien payments, client disbursements, earned-fee transfers
Required tracking level	Business-level categories	**Client/matter-level ownership**
Primary compliance risk	Tax/reporting errors	Commingling, misuse, negative client balances

1.2.3 How money moves between the two

Most legal-specific errors happen during **movement** from trust → operating.

Table: Allowed Movement Between Accounts

Movement	When allowed	Required support
Trust → Operating (earned fees)	After fees are earned and billed	Invoice reference + authorization language
Trust → Vendor/Third party	When paying legitimate client costs or liens	Receipt/vendor bill + matter reference
Trust → Client	Refunds or net proceeds	Written approval (when applicable) + distribution details
Operating → Trust (rare)	Only in limited situations per rules/policy	Documented reason; cannot “prop up” client shortages

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1.3 What Makes Legal Accounting "Stricter" Than Normal Accounting

1.3.1 The fiduciary standard (plain English)

When a firm holds client money, the firm is a **custodian**—not the owner. That means:

- You must be able to prove what you did with every dollar.
- Records must show **who the dollar belonged to** and **why it moved**.

1.3.2 Audit trail expectations

Table: Audit Trail Requirements

Trust Event	Minimum record needed	Common missing item
Deposit to trust	Deposit detail by client/matter	Allocation list (who got credit)
Trust disbursement	Payee + purpose + ref #	Receipt/vendor invoice
Fee transfer	Invoice # + amount earned	Missing invoice reference
Settlement distribution	Signed settlement statement	Lien documentation

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1.4 Early Failure Points (Where New Bookkeepers Get Burned)

1.4.1 Commingling

Definition: Mixing firm money and client money improperly.

Table: Commingling Examples

Mistake	What happened	Why it's a problem
Retainer deposited into operating	Client money treated like firm money	Misuse risk + ethics violation
Firm adds money to trust "temporarily"	Firm money parked in trust	Distorts ownership records
Paying firm expenses from trust	Trust used as operating	Direct misuse

1.4.2 Negative client balances (the “borrowing” problem)

Table: Negative Balance Example

Client	Trust balance	Cost to pay	Result
Client A	$200	$300	✕ Not allowed (would go negative)

Why it matters: A negative client ledger often means the firm is using **someone else’s funds** to cover a shortage.

1.4.3 Weak memos and missing references

Table: Documentation Pitfalls

Weak entry	Why it fails	Better entry
“Transfer”	No purpose, no authority	“Earned fees Inv#2201 per engagement §4”
“Expense”	Doesn’t identify client	“Filing fee — Client A — Case #— Receipt attached”
“Deposit”	No allocation	“Retainer deposit — Client B — Allocation sheet attached”

1.5 Mini Practice Scenarios (Module 1 Exercises)

Exercise 1: Classify the money (Operating or Trust?)

Table: Student Classification Drill

Transaction	Operating or Trust?	Why (ownership)
Client pays $2,500 advance retainer		
Client pays invoice for last month's work		
Settlement check arrives for $40,000		
Client reimburses a filing fee the firm already paid		

Exercise 2: "Two Buckets" workflow mapping

Students describe:

- What ledger records the event first
- What documentation is needed
- Whether reconciliation is impacted

Table: Workflow Mapping

Event	Goes to which account first?	Documentation	Reconciliation impacted?
Retainer deposit			
Fee transfer to operating			
Cost paid to vendor from trust			

1.6 Module 1 Key Takeaways (Student Summary)

Table: One-Screen Summary

Concept	Remember This
Ownership	Ask: "Who owns the money right now?"
Two ledgers	Operating = firm money; Trust = client/3rd-party money
Trust duties	Segregate, track by matter, document, reconcile
Biggest risks	Commingling, negative client balances, weak audit trail
Best habit	Every trust transaction must show: client/matter + purpose + support

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Module 2 - Trust Accounting Fundamentals (IOLTA / Client Trust)

2.0 Module Overview

Purpose: Learn the foundational rules, records, and daily workflows for handling **client/third-party funds** held in a trust/IOLTA account.

Learning outcomes (you can do this by the end):

- Explain **why** trust accounting exists and what risks it prevents
- Identify what **belongs** in trust vs what must stay in operating
- Maintain the core trust records: **trust register + client ledgers + bank statement**
- Understand **deposits, disbursements, transfers**, and the "never negative" rule
- Prepare for the next module: **three-way reconciliation** and audit trail expectations

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2.1 Why Trust Accounting Exists

2.1.1 Fiduciary duty (plain English)

A law firm holding trust funds is acting as a **fiduciary/custodian**:

- The firm is **not the owner**
- The firm must safeguard funds and use them only for authorized purposes
- The firm must keep detailed proof of all activity

Table: What Trust Accounting Prevents

Risk	What It Looks Like	Why It Matters
Commingling	Mixing client funds with operating funds	Violates ethical rules; can lead to discipline
Misuse/misappropriation	Using one client's funds to pay another's bills	Serious compliance risk and potential fraud claims
Poor audit trail	"Transfer" entries with no invoice/backup	Cannot prove funds were handled properly
Hidden errors	Missing deposits/checks or wrong client coding	Leads to shortages and negative ledgers

2.1.2 The compliance logic

Trust accounting creates:

- **Transparency** (clear records)
- **Accountability** (who approved what)
- **Proof** (document trail for every movement)

2.2 The Trust/IOLTA Account: What It Is (and What It Isn't)

2.2.1 Trust account definition

A **trust/IOLTA** account is a bank account used to hold:

- client funds,
- settlement funds,
- third-party funds (liens/providers),
- cost advances,

until properly distributed.

2.2.2 Trust account is NOT:

- A second operating account
- A place to "park" firm money temporarily
- A place to hold earned fees indefinitely
- A tool to cover cash flow shortages

Table: Trust vs Not-Trust

Allowed Trust Purpose	Not Allowed / Not Recommended
Hold client/third-party funds temporarily	Hold firm reserves or payroll funds
Pay client costs/settlement distributions	Pay rent, payroll, subscriptions
Transfer earned fees after invoicing	"Borrow" between clients or cover shortages

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2.3 What Can Be in Trust (Allowed Funds)

2.3.1 Common trust deposits

Table: Funds Commonly Held in Trust

Category	Examples	"Release Trigger" (When It Can Leave Trust)
Advance fee retainers	Retainer for future work	Earned + billed + authorized transfer
Cost advances	Filing fees, service, experts, records	Pay vendor OR apply per invoice/policy
Settlement proceeds	Client net, liens, fees, costs	Signed settlement statement + cleared funds
Third-party holds	Escrow-like holds	Condition satisfied + documented disbursement

2.3.2 Key rule: clarity at intake

At the moment funds arrive, you must determine:

- **Who owns the money now**
- **What the money is for**
- **Which matter gets credit**

2.4 What Should NOT Be in Trust (Pitfalls)

2.4.1 Earned fees must not "live" in trust

Once fees are:

- earned, and
- billed (or otherwise properly documented),
  they should be transferred to operating promptly (per firm policy and rules).

2.4.2 Client-to-client borrowing is prohibited

You cannot use one client's money to cover another client's payment.

2.4.3 Parking firm funds in trust is a red flag

Even "temporary" deposits create confusion about ownership and reconciliation.

Table: Pitfalls & Correct Handling

Pitfall	Why It's Wrong	Correct Handling
Leaving earned fees in trust	Blurs ownership; increases audit risk	Transfer with invoice reference
Paying firm bills from trust	Misuse of client funds	Pay from operating only
Covering Client A shortage with Client B	Misappropriation	Collect funds first or delay payment
Parking firm money	Distorts trust totals and records	Keep firm funds in operating

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2.5 Core Trust Records (Daily Required Books)

2.5.1 The three core records

Trust accounting revolves around:

1. **Trust bank statement** (bank record)
2. **Trust register / trust journal** (master trust activity)
3. **Client/matter ledgers** (ownership by matter)

Table: The “Big Three” Trust Records

Record	What It Tracks	Why It’s Essential
Bank statement	What the bank shows	External verification
Trust register	Total trust activity and running balance	Controls overall trust funds
Client ledgers	Each matter’s running balance	Proves who owns the funds

2.5.2 The “audit triangle”

You should be able to tie every transaction across:

- bank evidence,
- register entry,
- client ledger entry,
- documentation (invoice/receipt/settlement statement).

2.6 Deposits: How to Record Trust Money Correctly

2.6.1 Deposit workflow

Table: Trust Deposit Workflow

Step	Action	Documentation
1	Identify payor and purpose	Check copy/wire detail
2	Assign to client/matter	Matter ID
3	Record in trust register	Deposit line with memo
4	Record in client ledger	Same deposit credited
5	Keep deposit detail	Allocation sheet if multiple matters

2.6.2 Deposit allocation (one check, multiple matters)

If one deposit must be split:

- create an **allocation list** showing each matter and amount,
- post to each client ledger accordingly,
- ensure the trust register totals equal the deposit.

Table: Allocation Example

Deposit Ref	Total Deposit	Matter A	Matter B	Matter C
DEP-010	$6,000	$2,000	$3,000	$1,000

2.7 Disbursements: Paying Vendors, Liens, and Clients

2.7.1 Disbursement rules

Disbursements must:

- be tied to an authorized purpose,
- be supported by documents,
- be posted to both trust register and client ledger,
- never create a negative client balance.

2.7.2 Disbursement types

Table: Common Trust Disbursements

Disbursement Type	Payee	Example	Required Backup
Client cost payment	Court/vendor	Filing fee	Receipt/vendor bill
Lien payment	Provider/lienholder	Medical lien	Lien letter + settlement stmt
Client payment	Client	Net proceeds/refund	Settlement stmt or refund approval
Earned fee transfer	Firm operating	Fees per invoice	Invoice # + authorization

2.7.3 Memo quality matters

Table: Weak vs Strong Memos

Weak Memo	Why It's a Problem	Strong Memo
"Payment"	No purpose	"Filing fee—Client A—Receipt attached"
"Transfer"	No invoice/authority	"Earned fees Inv#2201 per engagement §4"

2.8 Transfers to Operating (Earned Fees)

2.8.1 When transfers are allowed

A trust → operating transfer for fees is typically allowed when:

- work is completed (earned),
- invoice is generated (or other documented earning basis),
- engagement agreement supports withdrawal,
- the client ledger has enough funds.

2.8.2 Transfer workflow

Table: Earned Fee Transfer Workflow

Step	Action	Evidence
1	Confirm funds in client ledger	Client ledger balance
2	Generate invoice	Invoice #
3	Record transfer in trust register	Transfer line with memo
4	Reduce client ledger balance	Same amount out
5	Record deposit in operating	Bank/entry matching transfer

2.9 The "Never Negative" Rule (Client Ledger Integrity)

2.9.1 Rule statement

No client/matter ledger should ever be negative.

2.9.2 Why it's non-negotiable

A negative ledger usually means:

- paying costs without sufficient client funds, or
- using other clients' funds in the pooled trust account.

Table: Never Negative Example

Client	Balance	Proposed Payment	Allowed?	Fix
Client A	$200	$300	✕ No	Collect more funds or delay payment
Client B	$2,000	$350	☑ Yes	Proceed with documentation

2.10 Minimum Trust Control Practices (Foundation Controls)

2.10.1 Basic controls every firm should use

Table: Trust Controls

Control	What It Prevents	Frequency
Limited access to edit entries	Hidden changes/fraud	Ongoing
Approval for trust disbursements	Unauthorized payments	Every transaction
Standard memo + matter ID rules	Poor audit trail	Every transaction
Monthly reconciliation package	Hidden shortages/errors	Monthly

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2.11 Student Practice (Fundamentals Drills)

Drill A: "Trust or Operating?"

Table: Classification Drill

Transaction	Trust or Operating?	Reason (ownership)
Client pays $2,500 advance retainer		
Client pays a past-due invoice		
Settlement check arrives		
Filing fee to court from client cost advance		

Drill B: Build a mini client ledger

Students post:

- retainer deposit,
- filing fee payment,
- earned fee transfer,
  and show the running balance.

Table: Blank Ledger for Students

Date	Ref	Description	In	Out	Balance

2.12 Module Wrap-Up: Key Takeaways

Table: “If You Remember Nothing Else”

Core Rule	What It Means
Ownership first	Determine who owns funds immediately
Trust is fiduciary money	Not firm cash flow
Big Three records	Bank + trust register + client ledgers
Document everything	Invoice/receipt/settlement support
Never negative	No client ledger below $0

Module 3 — Accounting Records You Must Maintain (Trust + Operating)

3.0 Module Overview

Purpose: Students will learn the required accounting records that support (1) normal law firm bookkeeping and (2) trust/IOLTA compliance—plus how those records work together to create a complete audit trail.

Learning outcomes (you can do this by the end):

- Identify the required records for **trust** and for **operating**
- Explain the "Big Three" trust records and what each proves
- Build an **audit trail** from bank activity → books → client/matter support
- Perform (or prepare) a **three-way reconciliation** package (overview level here; deeper in reconciliation module)
- Recognize common recordkeeping failures and how to fix them

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Part A — Trust Records (Compliance-Critical)

3.1 The "Big Three" Trust Records (Non-Negotiable)

3.1.1 Trust Bank Statement (Bank Evidence)

What it is: The official bank record showing deposits, cleared checks, ACH activity, fees (if any), and ending balance.
What it proves: What actually happened at the bank.

Table: Trust Bank Statement — What to Verify

Checkpoint	What to Look For	Why It Matters
Deposits	Each deposit appears and matches deposit detail	Prevents missing/unknown funds
Disbursements	Cleared checks/ACH match register entries	Confirms legitimacy
Timing items	Deposits in transit, outstanding checks	Needed for reconciliation
Unusual activity	Reversals, returned items, fees	Red flags and corrections

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3.1.2 Trust Register / Trust Journal (Book Evidence)

What it is: A checkbook-style running ledger of **all trust transactions**, with a running balance.
What it proves: The firm's internal record of trust activity and the expected trust balance.

Table: Trust Register — Required Fields

Field	Requirement	Example
Date	Always included	02/01
Reference	Check/ACH/Deposit ID	CK102, ACH55, DEP12
Type	DEP/CHK/ACH/XFER	XFER
Payor/Payee	Full name	County Clerk
Purpose/Memo	Clear description	"Filing fee—Client A"
Client/Matter	Must be identified	A-2026-001
Amount in/out	Deposit or payment	Out $400
Running balance	Updated each line	$4,600

Instructor note: A trust register line should *never* be missing the **client/matter** field.

3.1.3 Individual Client/Matter Ledgers (Ownership Evidence)

What it is: A subledger showing the running balance for each client/matter.
What it proves: Exactly **who owns what** inside the pooled trust total.

Table: Client Ledger — What It Must Show

Must Show	Details
Deposits	Source, date, amount
Disbursements	Payee, purpose, reference
Fee transfers	Invoice reference + authorization basis
Running balance	Never negative
Notes/support	Receipts, invoice #, settlement statement

3.2 The Three-Way Reconciliation Package (Trust "Proof File")

3.2.1 What gets reconciled (three numbers that must match)

Table: Three-Way Reconciliation Components

Component	Source	Meaning
Bank balance	Bank statement (adjusted)	What the bank shows after timing adjustments
Book balance	Trust register	What your books say total trust should be
Client total	Sum of client ledgers	Total client-owned funds in trust

Rule: Adjusted Bank = Trust Register = Client Ledger Total

3.2.2 Outstanding items lists (required support)

Table: Outstanding Items

Item Type	Why It Exists	Where It Appears
Outstanding checks	Issued but not cleared	In register, not yet cleared at bank
Deposits in transit	Recorded but not yet posted by bank	In register, not yet on statement

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3.2.3 Example of a reconciliation summary (table)

Table: Reconciliation Example

Item	Amount
Bank ending balance	$12,000
Less: outstanding checks	(2,000)
Add: deposits in transit	+500
Adjusted bank balance	**$10,500**
Trust register balance	$10,500
Client ledger totals	$10,500 ☑

3.3 Trust Supporting Documents (Backup Files That Complete the Audit Trail)

3.3.1 Deposit support (deposit detail / allocation sheet)

Table: Deposit Backup Requirements

Deposit Type	Required Backup	Common Failure
Single-matter deposit	Copy of check/wire + memo	Missing purpose
Multi-matter deposit	Allocation sheet by matter	One line entry with no split
Settlement deposit	Settlement check copy + case ID	Not tied to settlement file

3.3.2 Disbursement support (receipts, invoices, approvals)

Table: Disbursement Backup Requirements

Disbursement	Required Backup	Memo Best Practice
Filing/service/expert cost	Vendor invoice/receipt	"Service fee—Client B—Receipt attached"
Fee transfer	Invoice # + engagement authority	"Earned fees Inv#2201 per engagement §4"
Settlement distribution	Signed settlement statement	"Client net proceeds—per signed stmt"
Lien payment	Lien letter + signed stmt	"Lien payment—Provider X—per stmt"

Part B — Operating Records (Business Bookkeeping)

3.4 Operating Bank Account Records

3.4.1 Operating bank statement and register

Focus: normal small-business banking controls:

- monthly bank reconciliation,
- consistent categorization,
- support for major expenses.

Table: Operating Records — Must Maintain

Record	What It Does	Why It Matters
Operating bank statement	External bank record	Confirms cash activity
Operating register	Tracks deposits/payments	Ensures clean bookkeeping
Credit card statements	Expense capture	Prevents missing liabilities
Receipt/invoice files	Support expenses	Audit + tax proof

3.5 Chart of Accounts (COA) — The Operating “Map”

3.5.1 Why COA matters

A clean COA ensures consistent reporting and easier review.

Table: Sample Operating COA (Condensed)

Category	Typical Accounts
Revenue	Legal fees, contingency fees, cost recovery (optional)
Expenses	Payroll, rent, insurance, software, marketing, CLE
Liabilities	Payroll taxes payable, credit cards payable
Equity	Owner draws, capital, retained earnings

3.6 Billing and A/R Records (If the Firm Bills Clients)

3.6.1 Billing records

- invoices,
- payment application history,
- A/R aging,
- retainer application records (when trust transfers are used).

Table: Billing Records & Trust Connection

Billing Record	Operating Impact	Trust Impact
Invoice	Creates A/R (if accrual)	Supports fee transfer
Payment in operating	Reduces A/R, increases cash	None
Trust transfer applied	Increases operating cash/revenue	Decreases client trust balance
Write-down/write-off	Lowers revenue/A/R	None

Part C — How Records Work Together (Audit Trail + Control)

3.7 The "Traceability" Standard (Follow One Dollar)

Students must be able to trace a dollar from:

- source → deposit → ledger → disbursement → support document → reconciliation.

Table: Audit Trail Example (One Transaction)

Step	Record	What You See
1	Bank statement	Deposit posted
2	Trust register	DEP entry + matter ID
3	Client ledger	Client credited
4	Supporting doc	Copy of check + allocation sheet
5	Reconciliation	Included in totals and matched

3.8 Common Recordkeeping Failures (and Fixes)

Table: Failures & Fixes

Failure	Why It's a Problem	Fix
Missing matter ID on trust entries	No ownership proof	Require matter field on every line
No invoice reference for fee transfers	Unauthorized withdrawal risk	Add invoice # + engagement support
Client ledger not updated	Can hide negative balances	Update client ledgers with every entry
No allocation sheet for split deposits	Cannot prove credits	Create deposit allocation form
Skipping monthly reconciliation package	Errors go undetected	Monthly close checklist + proof file

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3.9 Module 3 Key Takeaways (Student Summary)

Table: "What You Must Maintain"

Area	Required Records
Trust/IOLTA	Bank statement, trust register, client ledgers, backup docs, monthly reconciliation package
Operating	Bank + credit card statements, registers, COA, receipts/invoices, payroll records, billing/A/R records (if applicable)
Control concept	Every trust dollar must be traceable end-to-end

Module 4 — Matter-Level Accounting: Client Ledger Mechanics

4.0 Module Overview

Purpose: Learn how to maintain **client/matter-level ledgers** (the ownership record inside a pooled trust account) and how matter-level posting prevents negative balances, commingling, and audit failures.

Learning outcomes (you can do this by the end):

- Explain what a **client/matter ledger** is and why it is required
- Post trust **deposits, disbursements, and fee transfers** correctly to a matter
- Maintain a **running balance** and enforce the **never negative** rule
- Identify and correct common posting errors (wrong matter, missing memo, duplicate entry)
- Tie a matter ledger to the **trust register** and reconciliation package

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Part A — What a Client/Matter Ledger Is (and Why It Matters)

4.1 Definition: The Client Ledger as "Sub-Accounting" (Ownership Record)

A client/matter ledger is a **subledger** that shows:

- all trust activity for one matter,
- the matter's running balance,
- exactly how much the firm is holding for that client/matter at any time.

4.1.1 Why client ledgers are mandatory

Because a pooled trust account contains funds for multiple matters, the firm must prove:

- **who owns what** portion of the pooled total, and
- that no matter is funded by another matter.

Table: What the Client Ledger Proves

Question	Answered by the Client Ledger
How much trust money belongs to Client A right now?	Running balance by matter
What was that money used for?	Disbursement lines with payee/purpose
Were fees withdrawn properly?	Transfers tied to invoices
Did any matter go negative?	Balance history shows compliance

4.2 Relationship Between Trust Register and Client Ledgers (They Must Agree)

4.2.1 Two levels of trust books

- **Trust register** = total trust account activity and total balance
- **Client/matter ledgers** = breakdown of ownership by matter

Table: Trust Register vs Client Ledgers

Record	Scope	Must Match
Trust register	Entire trust account	Must match adjusted bank balance (monthly)
Client ledgers total	Sum of all matters	Must equal trust register balance (monthly)

4.2.2 The "one transaction, two postings" rule

Every trust transaction must be posted to:

1. the **trust register**, and
2. the **correct matter ledger**.

Table: Dual Posting Rule

Transaction Type	Post to Trust Register?	Post to Matter Ledger?
Trust deposit	☑ Yes	☑ Yes
Vendor cost payment	☑ Yes	☑ Yes
Fee transfer to operating	☑ Yes	☑ Yes
Client refund	☑ Yes	☑ Yes
Settlement distribution	☑ Yes	☑ Yes (and often multiple sub-lines/notes)

Part B — Required Fields and Quality Standards

4.3 Required Ledger Fields (Minimum Data for Compliance)

Each matter ledger line should include:

- date,
- reference number (check/ACH/deposit/transfer),
- description/purpose,
- in/out amount,
- running balance,
- support reference (invoice/receipt/settlement statement).

Table: Matter Ledger Field Standards

Field	Standard	Example
Date	Actual transaction date	02/10/2026
Ref #	Unique identifier	CK-104 / ACH-22 / DEP-009 / XFER-03
Type	DEP / CHK / ACH / XFER	XFER
Description	Specific purpose	"Earned fees Inv#2201"
In/Out	One side per line	Out $1,200
Running balance	Update every line	$3,400
Support	Link to backup	"Receipt attached" / "Inv#2201"

4.4 Documentation Rules at the Matter Level

4.4.1 Fee transfers must cite invoices

A fee transfer line should include:

- invoice number,
- fee description (earned fees),
- engagement authority reference (optional but strong).

4.4.2 Cost payments must cite receipts/vendor bills

Cost disbursement lines should include:

- vendor name,
- purpose (filing fee/service/expert),
- receipt or bill reference.

Table: Strong vs Weak Ledger Lines

Weak Entry	What's Missing	Strong Entry
"Transfer"	No invoice/purpose	"Earned fees Inv#2201 per engagement §4"
"Payment"	No vendor/purpose	"Filing fee—County Clerk—Receipt attached"
"Deposit"	No source/purpose	"Retainer deposit—check #5521"

Part C — Posting Workflows (Deposits, Disbursements, Transfers)

4.5 Posting Deposits to the Matter Ledger

4.5.1 Deposit workflow

Table: Deposit Posting Steps (Matter Level)

Step	Action	Result
1	Identify the correct client/matter	Correct ownership
2	Post deposit to trust register	Total trust increases
3	Post deposit to matter ledger	Matter balance increases
4	Attach deposit detail	Audit trail complete

4.5.2 Deposit allocation across matters

If one deposit is split, each matter ledger must show its portion.

Table: Split Deposit Example

Deposit Ref	Total Deposit	Client A	Client B
DEP-010	$6,000	$2,000	$4,000

4.6 Posting Disbursements (Costs, Liens, Client Payments)

4.6.1 Disbursement workflow

Table: Disbursement Posting Steps

Step	Action	Rule
1	Confirm matter has sufficient funds	Never negative
2	Issue check/ACH with clear payee/purpose	Strong memo
3	Post to trust register	Total trust decreases
4	Post to matter ledger	Matter balance decreases
5	Store supporting documents	Receipt/lien/approval

4.6.2 Disbursement types by matter

Table: Common Matter-Level Disbursements

Type	Payee	Example	Support
Cost payment	Court/vendor	Filing fee	Receipt/vendor bill
Lien payment	Provider/lienholder	Medical lien	Lien letter + settlement statement
Client payment	Client	Refund/net proceeds	Approval/settlement statement

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4.7 Posting Fee Transfers (Trust → Operating)

4.7.1 Preconditions

Before transferring earned fees:

- work is earned,
- invoice exists (or documented earning basis),
- client ledger has sufficient balance.

Table: Fee Transfer Preconditions

Check	Why
Invoice # exists	Proves amount and purpose
Engagement authorizes withdrawal	Proves authority
Matter balance is sufficient	Prevents negative ledger

4.7.2 Fee transfer workflow

Table: Fee Transfer Steps

Step	Action	Posting
1	Generate invoice	Invoice file
2	Transfer from trust to operating	Bank transfer/check
3	Post transfer in trust register	Outflow
4	Post transfer in matter ledger	Outflow tied to invoice
5	Confirm operating deposit	Matches transfer

Part D — The "Never Negative" Rule (Core Compliance Test)

4.8 Rule Statement and Meaning

Rule: No matter ledger may drop below **$0.00** at any time.

Table: Never Negative Decision

Matter Balance	Proposed Payment	Allowed?	Next Step
$200	$300	✗ No	Collect funds or delay payment
$2,000	$350	☑ Yes	Pay with documentation

4.8.1 Why it matters

A negative balance typically indicates:

- disbursing before funds are available, or
- using another client's funds (borrowing).

Part E — Common Posting Errors and Corrections

4.9 Common Errors

Table: Errors & Fixes

Error	What It Causes	Fix
Wrong matter selected	Misstates ownership	Correct the matter posting + document change
Missing invoice # on fee transfer	Audit failure	Update memo/support fields
Duplicate posting	Inflated activity	Void/adjust with traceable entry
Late posting	Reconciliation mismatch	Post timely; run weekly checks
Weak memos (“payment/transfer”)	No audit trail	Require standardized descriptions

Part F — Student Practice & Outputs

4.10 Practice Exercise A: Build a Matter Ledger (3 transactions)

Students record:

1. retainer deposit,
2. filing fee payment,
3. earned fee transfer,
   and compute balances.

Table: Blank Matter Ledger

Date	Ref	Description	In (+)	Out (-)	Balance

4.11 Practice Exercise B: Spot the Error

Give a ledger with:

- a negative balance,
- a fee transfer with no invoice #,
- a payment with no receipt reference,
  and have students correct entries.

4.12 Module 4 Key Takeaways (Student Summary)

Table: One-Screen Summary

Concept	Remember This
Matter ledger purpose	Proves ownership inside pooled trust
Dual posting	Every trust transaction posts to register + matter ledger
Required fields	Date, ref, purpose, in/out, running balance, support
Never negative	Any negative matter balance = compliance problem
Best habit	Strong memos + invoice/receipt references every time

Module 5 — Chart of Accounts for Law Firms (Operating Books)

5.0 Module Overview

Purpose: Learn how to design and use a **law-firm operating Chart of Accounts (COA)** so transactions are categorized consistently, financial reports are meaningful, and trust activity stays properly separated.

Learning outcomes (you can do this by the end):

- Explain what a **Chart of Accounts** is and why it matters in a law firm
- Identify the core account types: **assets, liabilities, equity, income, expenses**
- Build a practical law-firm operating COA (starter template)
- Classify common law-firm transactions into the correct accounts
- Avoid common COA mistakes that distort reporting (especially cost recovery and owner draws)

Part A — COA Fundamentals (What It Is and Why It Matters)

5.1 Definition and Role of a Chart of Accounts

A **Chart of Accounts** is the firm's accounting "map"—a list of accounts used to record every operating transaction in a consistent way.

5.1.1 Why COA matters in law firms

- Produces clean **Profit & Loss** and **Balance Sheet**
- Supports budgeting and profitability review
- Separates key categories unique to law firms:
  - fee revenue (hourly/flat/contingency),
  - client cost treatment (advanced costs vs overhead),
  - owner draws vs expenses,
  - trust-to-operating transfers (earned fees).

Table: COA Benefits

COA Benefit	What Improves	Example
Consistency	Same items coded the same way	All software subscriptions to “Technology—Software”
Report accuracy	True profitability picture	Marketing vs payroll not mixed
Control	Easier review and audit	Unusual expenses stand out
Decision-making	Better pricing/staffing choices	Profitability by practice segment

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5.2 Account Types (Operating Books)

Operating COA uses five main categories:

Table: Core Account Types

Type	What It Represents	Examples
Assets	What the firm owns/controls	Cash, A/R, equipment
Liabilities	What the firm owes	Credit cards, payroll taxes payable
Equity	Owner’s interest	Capital, draws, retained earnings
Income	Earned revenue	Legal fees, contingency fees
Expenses	Costs to run the firm	Payroll, rent, insurance

Part B — Operating Accounts a Law Firm Typically Needs

5.3 Assets (Operating)

5.3.1 Cash and banking

- Operating checking
- Savings (if used)
- Merchant/Undeposited funds (if used)

Table: Operating Asset Accounts

Account	Use	Example Transactions
Operating Checking	Main cash account	Deposits, rent, payroll
Undeposited Funds	Holds payments before deposit	Client card payments batched daily
Accounts Receivable (A/R)	Client invoices not yet paid (if accrual)	Monthly billed work outstanding
Advanced Client Costs (Asset)*	If firm pays costs in operating to be reimbursed	Filing fees paid by firm pending reimbursement
Fixed Assets	Equipment/furniture	Computers, furniture
Prepaid Expenses	Items paid ahead	Annual malpractice premium

*Some firms track advanced costs as an expense instead; policy must be consistent.

5.4 Liabilities (Operating)

5.4.1 Common payables

- Credit card payable
- Payroll taxes payable
- Sales tax payable (rare for legal fees; depends on jurisdiction and services)
- Loans payable

Table: Operating Liability Accounts

Account	Use	Example
Credit Card Payable	Tracks card balance	Monthly card statement
Payroll Taxes Payable	Withheld + employer taxes owed	941 liabilities
Client Cost Advances Payable*	If treating cost advances as liability	Client funds owed back
Loans Payable	Borrowed funds	Bank loan payments
Accrued Expenses	Incurred, not yet paid	Year-end accruals

5.5 Equity (Operating)

Equity accounts track owner investment and withdrawals.

Table: Equity Accounts

Account	Meaning	Example
Owner Capital	Owner contributions	Deposit from owner
Owner Draws/Distributions	Owner withdrawals (not expenses)	Owner takes $5,000
Retained Earnings	Cumulative net income	Prior years' profit

Key teaching point: Owner draws are not business expenses.

5.6 Income (Operating)

5.6.1 Core revenue categories

Table: Common Income Accounts for Law Firms

Income Account	Use	Example
Legal Fees — Hourly	Hourly billed work	$350/hr invoice
Legal Fees — Flat Fee	Fixed-fee matters	Uncontested divorce flat fee
Contingency Fee Revenue	Earned on settlement	Fee from PI settlement
Cost Recovery / Reimbursed Costs	Reimbursement of advanced costs	Client reimburses filing fee
Other Income	Interest, referral fees (if allowed)	Bank interest

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Part C — Expense Accounts (Law Firm-Friendly Structure)

5.7 Expense Categories (Operating)

A clean COA groups expenses into logical buckets.

Table: Suggested Expense Structure

Bucket	Typical Accounts
Payroll & Benefits	Salaries, payroll tax expense, benefits
Occupancy	Rent, utilities, maintenance
Insurance	Malpractice, general liability, health insurance (if firm-paid)
Technology	Software subscriptions, IT support, hardware under threshold
Professional	Bar dues, CLE, professional memberships
Marketing	Advertising, website, lead services
Office	Supplies, postage, printing
Banking & Merchant Fees	Card processing fees, bank charges
Travel & Meals	Travel, lodging, meals (policy-driven)
Contract Labor	Freelance paralegal, investigators
Depreciation	Depreciation expense (if applicable)

Part D — Law-Firm Specific COA Decisions (Where Firms Differ)

5.8 Handling Client Costs (the Big COA Decision)

Law firms typically choose one of two approaches:

Table: Two Common Methods for Advanced Client Costs

Method	How Costs Are Recorded When Paid	When Client Reimburses
Asset Method	Debit “Advanced Client Costs (Asset)”	Credit the asset (reduces it)
Expense + Recovery Method	Debit expense account (e.g., Filing Fees Expense)	Credit “Cost Recovery/Reimbursed Costs” income

Instructor tip: Pick one method and apply consistently.

5.9 Trust-to-Operating Transfers (How They Show in Operating Books)

When earned fees are transferred from trust:

- the operating deposit should be coded to the correct income account (e.g., Hourly Fees).
- the firm should retain the invoice reference for support.

Table: Trust Transfer Posting (Operating Side)

Event	Operating Record	Coding
Deposit from trust hits operating	Bank deposit entry	Legal fee income (by type)
If using clearing account	“Funds in transit from trust” cleared	Avoid duplicates

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Part E — COA Setup Template (Starter COA)

5.10 Starter COA (Operating) — Sample List

Table: Starter COA

Account Type	Account Name
Asset	Operating Checking
Asset	Undeposited Funds
Asset	Accounts Receivable
Asset	Advanced Client Costs (Asset)
Asset	Office Equipment
Liability	Credit Card Payable
Liability	Payroll Taxes Payable
Liability	Loans Payable
Equity	Owner Capital
Equity	Owner Draws
Income	Legal Fees — Hourly
Income	Legal Fees — Flat Fee
Income	Contingency Fee Revenue
Income	Cost Recovery / Reimbursed Costs
Expense	Payroll
Expense	Rent

Account Type	Account Name
Expense	Utilities
Expense	Insurance — Malpractice
Expense	Technology — Software
Expense	Marketing
Expense	Office Supplies
Expense	Postage
Expense	Bank & Merchant Fees
Expense	CLE & Dues

Part F — Classification Practice (Student Exercises)

5.11 Practice Exercise A: Code the Transaction

Table: Coding Drill (Blank)

Transaction	Correct Account
Client pays hourly invoice into operating	
Monthly office rent paid	
Credit card payment	
Malpractice insurance premium	
Filing fee paid by firm (to be reimbursed)	
Owner withdraws $3,000	

5.12 Practice Exercise B: Spot the COA Mistake

Students identify misclassifications:

- Owner draws recorded as “Wages”
- Cost recovery recorded as “Legal Fees”
- Filing fees for client case recorded as “Office Supplies”

5.13 Common COA Mistakes (Teach Explicitly)

Table: Mistakes & Fixes

Mistake	Why It's Wrong	Fix
Mixing trust accounts into operating COA	Blurs fiduciary funds	Keep trust books separate
Owner draws booked as expenses	Distorts profit	Use equity draw account
No separate legal fee categories	Reporting is unclear	Split hourly/flat/contingency
Random expense categories	Hard to review	Standardize expense buckets
Inconsistent client cost treatment	Misstates profit	Choose asset vs expense method

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5.14 Module 5 Key Takeaways (Student Summary)

Table: One-Screen Summary

Concept	Remember This
COA purpose	It's the map for consistent bookkeeping
Must-have accounts	Cash, A/R, credit cards, payroll taxes, owner equity
Law-firm income	Separate hourly/flat/contingency + cost recovery
Client costs	Pick a method and apply consistently
Biggest mistake	Recording draws as expenses and mixing trust with operating

Module 6 — Billing + Accounting Integration

6.0 Module Overview

Purpose: Show how **timekeeping, billing, payments, trust transfers, and accounting** connect—so the firm's books accurately reflect revenue, client balances, and compliance requirements.

Learning outcomes (you can do this by the end):

- Explain how billing "feeds" accounting (and how bad billing creates bad books)
- Distinguish **earned fees vs unearned funds** and how that affects trust/operating
- Map common workflows: invoice → payment → application → deposits → reconciliation
- Handle trust-to-operating transfers correctly (invoice-linked)
- Understand key reports: **A/R aging, unbilled time, WIP, trust balances**
- Spot common integration errors (duplicate revenue, missing deposits, misapplied payments)

Part A — Why Integration Matters (Billing Drives the Books)

6.1 Billing is an Accounting Input

Time entries and invoices are not just "client paperwork"—they are:

- the basis for revenue recognition,
- support for trust withdrawals,
- the audit trail for payments and balances.

Table: Billing Data → Accounting Consequences

Billing Weakness	Accounting Problem Created	Result
Missing/late time entries	Underbilling or wrong invoice totals	Lost revenue, disputes
Wrong matter coding	Payment applied to wrong client	Trust errors, bad ledgers
Vague descriptions	No audit trail for trust transfers	Compliance risk
No invoice numbers on transfers	Unsupported fee withdrawal	Audit failure

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Part B — Core Concepts: Earned vs Unearned + Where Money Sits

6.2 Earned Fees vs Unearned Funds

- **Earned fees**: firm's money (operating) once earned and billed/documented.
- **Unearned funds** (advance retainers): client's money (trust) until earned.

Table: Earned vs Unearned

Item	Owned By	Where Held	When It Changes
Advance retainer (unearned)	Client	Trust/IOLTA	Moves when earned + billed + authorized transfer
Earned fees	Firm	Operating	Recognized after billing/payment method
Settlement proceeds	Mixed (client/third party/firm fee)	Trust/IOLTA	Disbursed per settlement statement
Client cost advance	Client	Trust/IOLTA	Used for costs or applied per billing policy

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Part C — Billing-to-Cash Workflows (Operating Payments)

6.3 Standard Invoice → Payment → Deposit Workflow (Operating)

6.3.1 Typical steps

1. Create invoice
2. Receive payment (check/card/ACH)
3. Apply payment to invoice
4. Deposit to operating bank
5. Reconcile bank deposit to accounting

Table: Operating Payment Workflow

Step	Action	Accounting Record
1	Invoice issued	A/R increases (if accrual)
2	Payment received	Payment recorded (reduces A/R)
3	Deposit made	Bank deposit entry
4	Reconcile	Match bank to books

6.3.2 Key control point: payment application

Misapplied payments create:

- wrong A/R balances,
- wrong client statements,
- wrong trust activity if mixed.

6.4 Payment Methods and Posting Considerations

Table: Payment Method → What to Watch

Payment Method	Common Issue	Best Practice
Check	Deposit timing mismatch	Use Undeposited Funds until deposited
Credit card	Merchant fees & net deposits	Record gross receipt + fee expense
ACH/Wire	Duplicate posting risk	Post once; match bank line
Third-party payor	Allocation clarity	Note payor and matter

Part D — Trust Integration: Paying Invoices from Trust (Critical)

6.5 Using Trust Funds to Pay Earned Fees (Trust → Operating Transfer)

6.5.1 Conditions before transferring fees

- Fees are **earned**
- Invoice exists (or documented earning basis)
- Engagement terms authorize withdrawal
- Client ledger has enough funds (never negative)

Table: Preconditions for Trust Fee Transfer

Precondition	Why It Matters
Invoice # exists	Proves amount and purpose
Authorization exists	Proves right to withdraw
Sufficient trust balance	Prevents negative ledger/borrowing
Proper posting	Keeps books and trust aligned

6.5.2 Trust transfer workflow (integrated)

Table: Trust-to-Operating Billing Integration

Step	Billing System	Trust Books	Operating Books
1	Create invoice	—	A/R or sales entry
2	Apply trust to invoice	Reduce client trust ledger	Record deposit/fee income
3	Transfer funds	Trust register shows out	Operating bank shows in
4	Reconcile	—	Match transfer to bank deposit

6.5.3 Avoid double-counting revenue

A common integration error is recording:

- revenue at invoicing **and**
- revenue again when trust deposit hits operating.

Table: Double-Count Risk & Fix

Risk Scenario	What Happens	Fix
Revenue recorded twice	Income overstated	Use consistent method (accrual/cash) + clearing accounts if needed
Trust transfer posted as “new sale”	Duplicate revenue	Link transfer to invoice payment

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Part E — Refunds, Write-Offs, and Adjustments

6.6 Refunds of Unused Retainers (Trust → Client)

6.6.1 When refunds occur

- Matter closes and retainer remains unearned/unused.

Table: Retainer Refund Workflow

Step	Trust Books	Operating Books
Confirm remaining trust balance	Client ledger shows remainder	—
Issue refund	Trust register outflow	No revenue impact
Document	Refund approval/memo	—

6.7 Write-Downs and Write-Offs (Billing Adjustments)

6.7.1 Definitions

- **Write-down:** reducing invoice before finalizing/sending (often discretionary)
- **Write-off:** reducing outstanding A/R after invoicing (uncollectible or adjustment)

Table: Adjustments Impact

Adjustment	Billing Effect	Accounting Effect
Write-down	Smaller invoice	Lower revenue/A/R
Write-off	Reduce balance owed	Reduce A/R and possibly revenue (policy)

Part F — Key Reports that Tie Billing to Accounting

6.8 Reports for Managing the Integration

Table: Core Reports & What They Tell You

Report	Shows	Why It Matters
A/R Aging	Unpaid invoices by age	Collection priorities
Unbilled Time	Time recorded not invoiced	Revenue pipeline
WIP (Work in Process)	Work performed not billed/recognized	Forecasting
Trust Balances by Matter	Client funds held	Compliance + planning
Realization Report	Billed vs collected vs worked	Pricing and profitability

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Part G — Common Integration Failures (and How to Prevent Them)

6.9 Top Errors

Table: Integration Errors & Fixes

Error	What It Causes	Prevention
Misapplied payments	Wrong balances and statements	Require matter/invoice matching
Deposits posted twice	Cash and revenue overstated	Use Undeposited Funds workflow
Trust transfer without invoice reference	Compliance risk	Mandatory invoice # on transfers
Earned fees left in trust	Ownership confusion	Prompt invoice + transfer process
Client ledger not updated	Negative balances hidden	Post to matter ledger same day
Merchant fees ignored	Bank rec mismatch	Record fees as expense

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6.10 Student Practice (Hands-On Exercises)

Exercise A: Map the workflow

Students map:

- invoice → payment → deposit → reconciliation.

Table: Workflow Map (Blank)

Event	Billing Action	Trust Impact	Operating Impact
Invoice created			
Payment received			
Deposit posted			
Reconciliation			

Exercise B: Trust pays invoice

Scenario:

- Client has $3,000 in trust
- Invoice is $1,200
  Students:
- apply trust to invoice
- record trust transfer
- update ledger balance to $1,800

6.11 Module 6 Key Takeaways (Student Summary)

Table: One-Screen Summary

Concept	Remember This
Billing feeds accounting	Bad billing data = bad books
Earned vs unearned	Determines trust vs operating
Trust fee transfers	Must tie to invoices + authorization
Reconciliation	Bank must match books and deposits
Avoid errors	Prevent duplicates, misapplied payments, weak documentation