Cubs Consulting Inc.

ENHANCED TRUST ACCOUNTING

White Paper

The purpose of Enhanced Trust Accounting (ETA) is to provide a methodology and programs that enable an agency to balance, on a daily basis, their payables, receivables, cash, MTD fees, and trust account(s) in their general ledger with the results of trust activity in The Collector System (TCS).

Like it or not, TCS "Trust Accounting" is an accounting system, albeit a partial one. TCS Trust Accounting creates and maintains transaction logs (a.k.a. audit trail), issues checks to clients and bills clients for sums due. Receivable aging is provided as well. Additionally, the transaction file is used as the basis for commission reports for sales staff and collectors. In every sense these are accounting functions. What TCS doesn't do is provide the necessary entries that allow an accountant to know at the end of a day how changes in TCS affected the corresponding GL accounts in the accounting system.

Buried in the files of TCS Trust Accounting is the ability to create client sub-ledgers and accrual entries for outside accounting systems such as Quick Books, Peachtree, and Great Plains. However, current TCS reports do not fully report how transactions should be posted to your external accounting package in a manual or automated way.

Therefore, two key questions emerge:

- What entries do we make into our main accounting system to mirror the entries in TCS, which is providing a transaction log(s) for audit and research purposes?
- "How do I reconcile the general ledger balances in my accounting systems with the sub ledger balances in TCS?

The answer lies in the series of reports and procedures laid out in this paper. These reports are a combination of familiar reports (Daily Trans, Sales Tax, and NSF) enhanced to comply with the Remit Code Matrix and new reports (Net Offset, AR/AP Report and Reversal/Repost).

Fundamentals of Trust Accounting

There is broad functionality and flexibility in the TCS Trust Accounting and statement processing. A basic understanding of this functionality in combination with basic accounting principles is presented in this section.

1. Invoice vs. Statement. TCS can produce a statement or invoice (through "open item invoicing"). Statements produce a rolling account balance, reconciled on each statement run with a balance forward, if applicable, on each statement. Invoices are unique billing documents for the time period of the statement. Payments received can be posted against specific invoices.

2. Gross vs. Net. Through the "Remit Code Matrix," TCS can produce statements in several formats. A Gross statement/invoice, in its simplest form, treats the commission as a receivable and the payment as a

payable. A Net statement/invoice treats the payment less the commission as a payable. This flexibility is controlled in the Client Screen at label "REMIT CODE".

3. Hold Days and HOLDOVER. TCS allows transactions to have a "hold" on them for a specific time period (in days). When statements are run, transactions with a holdover date greater than the statement date will not be processed. Transactions that have not appeared on a statement at month-end close-out will be rolled into the HOLDOVER file and will be processed on the next eligible statement in the next month.

4. Reversals vs. NSFs vs. "Cancel Input Error". TCS allows deletion of transactions with the "Cancel Input Error" menu item. One of the fundamental principles of accounting is that once a transaction is posted it should never be deleted. Rather, the transaction should be "reversed and reposted." The reasoning is simple; it gives a transaction history of or path to what occurred. If there is ever a question concerning the transaction, the documentation is there in the TCS logs. Reversals behave in a manner similar to NSFs except they are non-cash transactions.

5. Unique Invoice/Statement Numbers. Like any good invoicing system, Invoices and Statements should contain a unique and traceable number.

6. Remit Code 6. REMIT CODE 6 has historically been used as one of the main remit codes. It is the alternative most suited to a collection agency. It is the remit code that causes the lowest outflow of funds. However, it does not conform to accounting principles in that monies due the agency are treated as contra-payables, resulting in an understatement of the Trust Balance amount. A quick review of the Remit Code Matrix confirms why this occurs. All transactions related to a Remit Code 6 affect only the Due You (Payables) account. All amounts due or owing are applied to this account. Therefore, a client payment on a balance owed will increase this amount. The commission on a direct pay will reduce this amount. A Due Us (Receivable) will never be recorded with this remit code.

7. Net Offset. An accounting term which allows an entity with both a receivable from a client and a payable to the client to "offset" or cancel the lower amount against the higher amount.

ETA Procedures and Reports for Handling of Trust Accounting

Purpose: to retain the benefit of a Remit Code 6 while adhering to accounting principles and Trust Balance guidelines (imposed by most state agencies or association membership). We have created a new remit code - 11. Remit Code 11 treats sums due an agency as a receivable but offsets the DUE US and DUE YOU amounts to produce a net remittance.

ETA provides an incremental invoice numbering system to ensure the uniqueness of each invoice/statement. Like a database, each accounting item should be unique.

ETA does not allow cancellation of a shared payment using "Input Error" or "Other" once the day's batch is closed and balanced. The reason is simple. Financial transactions, like database transactions work on a commitment basis. Once committed, a transaction cannot be rolled back. It should be reversed or adjusted, then reposted correctly. Choosing either one of these options deletes the transaction from the Trans file, eliminating the audit trail and leaving a hole for potential fraud. If TCS cannot see it, it cannot report on it. Also, Enhanced Trust Accounting adds special functions to the Trust Posting "cancellation" option that prevents cancelled and reversed transactions from appearing on statements.

Additionally, ETA properly tracks the configuration of each client and reports accordingly. Therefore, it is irrelevant to ETA whether the client is gross or net, invoice- or statement-based, or uses holdover days or not. ETA allows for all of these situations.

Application

Daily posting is accomplished in the normal manner. However, NSFs, reversals and cancelled transactions are entered using an enhanced version of the "cancellation" function in Posting. This enhancement allows the clerk to view all payment transactions for the account and select which payment to NSF or reverse. If the original payment has not appeared on a statement, both the original and the NSF or reversal will automatically be flagged to not appear on future statements.

At the end of each day up to four reports could be generated: Account Activity, NSF, Reversal/Repost and the AR/AP report

The Account Activity report is very similar to the Daily Trans report except for the following:

- It does not report reversals, only payments and adjustments.
- Separate accounting for forward fees, as a contra revenue account, has been added.
- The Due Client column properly reflects the remit code matrix.
- The report footer includes your accrual entries for the day.

The accrual entries delineate the debits and credits as well as the amount of cash which should be deposited in the Trust Account versus the Operating Account.

Currently, the Account Activity report requires the user to input the opposing entry for an adjustment to the Due Us balance. From an accounting standpoint, TCS knows that you have either debited or credited receivables (Due Us). However, it cannot assume the other half of the entry. A shared adjusting trans code can be for a multitude of functions, including write-off to bad debt, billing for legal costs, and billing for a letter series, just to name a few. Therefore, currently it is the responsibility of the agency to add the entry for the adjustment showing on the Payments and Adjustments Report.

The Daily NSF report is the flip side of the Account Activity Report. It reports the NSFs for the day and gives you your journal entry for the day in the report footer. This report should reconcile with the day's NSF advice from your bank.

The Reversal/Repost is similar to the NSF report. However, it consists of only the non-cash reversals and reposts, i.e., the correcting entries of previous entries. It too produces the journal entry for the day.

Up to three accounting events occur when statements are run. First, statements accrue the sales tax and add the accrued amount to each statement. The sales tax report run with the statement again gives you your accounting entry for this transaction. Except for remit code 6, the entry will always be a debit to accounts receivable and a credit to accrued sales tax payable.

The second accounting event after printing statements is printing checks. This reduces the balance of the Due You account maintained by TCS. These checks must be entered into your cash disbursements journal. ETA can provide an export of these disbursements to import into your accounting system, saving time and preventing errors that can come with manual entry of these amounts.

Finally, the net offset report will detail the amount of your payable being applied to your receivable or vice-versa. The entry will almost always be a debit to payables and a credit to receivables. This is a simple netting of the Due Us and Due You columns when statements are run. Also be aware, that a negative offset can occur, such as an overpayment by a client. The net offset report properly handles this situation.

To summarize, the following entries should be made to your accounting system.

- Daily Payments entry off the Account Activity Report
- Daily Reversals off the Daily NSF
- Daily Adjustments off the Reversal Report
- When Statements are Run
    - Sales Tax Accrual (if applicable)
    - Post Checks (if applicable)
    - Net Offset Entry (if applicable)

When the entries above have been completed, you can run the AR/AP Report against your general ledger to verify that your accounting system and CUBS are in balance. The AR/AP Report is a real-time sub ledger and TCS general ledger of your client account receivables and payables. The grand total should reconcile to your general ledger balance.

The AR/AP Report was designed to run on individual clients or on all clients. You will need to run the report on individual clients when you change their remit code, i.e., from net to gross and vice versa. Changing the remit code changes how CUBS accounts for the transactions for that client. By running a before and after snapshot with the AR/AP Report, you can calculate the change and make the corresponding change to your accounting system.

What happens if I'm out of balance?

You're out of balance because you made an entry in one system but not the other. For instance, if you're out of balance the same amount in both accounts, then you probably changed a remit code or didn't enter a net offset entry.

If you're out in one account and not the other, then you probably have an out of phase transaction, for example:

- A check may not have been voided.
- Statement flags may have been cleared when they shouldn't have been.
- An entry may have been made to TCS after the AR/AP report was run.

This brings us to the second to last point. Always compare apples to apples. Complete your postings to TCS, make your entries to your accounting system, then run the AR/AP Report to verify balancing. The AR/AP report can be run at anytime and gives you a real time picture of your receivables and payables position. It is recommended that balancing be done daily. This reduces the number of transactions to review in the event of errors. It also means that the transactions are fresh in the minds of your posters.

The last point is that the AR/AP report tells you exactly what your Trust Balance should be. The Due You column is the Trust Balance.