



Practice 360°

# Perils and Pitfalls of Legal Accounting

Presented By: Rick Kabra, Ph.D.  
CEO, CosmoLex

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## Agenda

- What is Legal Account?
- Classical Billing & Accounting Gap
- 7 Law Firm Accounting Pitfalls
- How Can We Bridge the Gap?
- Conclusion
- Q/A

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## Danger: Deep Waters



- We will be taking a deep dive into Law Firm Accounting
- We anticipate many questions; they will be answered at the end of the presentation.

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## What is Legal Accounting

- Business Accounting
- Matter Cost / Income Accounting
- Fee Advances/Retainers/Client Funds Accounting

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## Law Firm Chart of Accounts

Bank | Chart of Accounts | Journal Entries

Add | Edit | Delete

Show: Active | Search where: | Search | Clear

Number	Account	Type	Balance
1610	Accumulated Depreciation	Fixed Asset	0.00
1620	Furniture and Equipment	Fixed Asset	2,000.00
1700	Advanced Client Costs	Other Current Asset	0.00
1725	Allowance for Bad Debt	Other Current Asset	0.00
1900	Security Deposits Asset	Other Asset	0.00
2200	Sales Tax	Other Current Liability	1,232.41
2300	Client Trust Funds	Current Liability	180,330.43
2310	Client General Retainer (Trust)	Current Liability	0.00
2320	Client General Retainer (Operating)	Current Liability	38,054.32
2400	Payroll Liabilities	Current Liability	0.00
2550	Internal Bank Transfer	Current Liability	0.00
2600	Notes Payable	Long Term Liability	0.00
3100	Opening Bal Equity	Equity	0.00

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## P&L Items

- Active use of Income and Expense Accounts
  - Generate revenue by providing service to clients
  - Disburse payment associated with matters
  - Collect compensation for "overhead" or "in house" expenses
  - Pay expenses for firm's activities

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## Balance Sheet Items

- Active use of Balance Sheet Accounts
  - Bank and Credit Card Accounts
  - Trust Activities \*
  - Advanced Client Costs \*
  - Partner Draws and Equity

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## General Ledger

**Justice Law Firm, LLC**

**General Ledger**

01/01/2015 - 12/31/2015

DATE	TYPE	REF #	PAYEE	ACCOUNT	AMOUNT
<b>6625:Rent (Expense)</b>					
01/31/2015	Debit		landlord	1001:Capital One Financial-Capital One Oper	2,000.00
06/23/2015	Debit		landlord	1001:Capital One Financial-Capital One Oper	1,000.00
07/10/2015	Debit		landlord	1001:Capital One Financial-Capital One Oper	100.00
<b>Total :</b>					<b>3,100.00</b>

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## Management Reports - Balance Sheet

Justice Law Firm, LLC  
**Balance Sheet**  
 3/3/2016

<b>ASSETS</b>	<u>2016</u>	<u>2015</u>	<u>Difference</u>	<u>Percent</u>
<b>Current Assets</b>				
Bank Accounts				
1003:Wells Fargo-Wells Fargo Operating .....	\$80.00	\$80.00	\$0.00	0.00
1002:U.S. Bancorp-U.S. Bancorp Operating .....	\$6,880.00	\$6,880.00	\$0.00	0.00
1084:Trust1-Trust1 .....	(\$1.00)	\$0.00	(\$1.00)	0.00
1053:Trust Bank-Trust Acct .....	\$2,200.00	\$0.00	\$2,200.00	0.00
<b>Total Bank Accounts</b>	<u>\$9,159.00</u>	<u>\$6,960.00</u>	<u>\$2,199.00</u>	<u>27.28</u>
Other Current Assets				
1700:Advanced Client Costs .....	\$400.00	\$0.00	\$400.00	0.00

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## Management Reports - Profit & Loss

	<u>2015</u>	<u>2014</u>	<u>Difference</u>	<u>Percent</u>
<b>Income</b>				
4100:Fee Income .....	\$85,573	\$38,747.64	\$46,825.48	120.85
4101:Fee Income-Family Law Income .....	\$1,345	\$0.00	\$1,345.00	0.00
4103:Fee Income-Criminal Law .....	\$1	\$0.00	\$1.00	0.00
4104:Fee Income-Estate Planning .....	\$390	\$0.00	\$390.00	0.00
4125:Discounts .....	(\$298)	(\$106.25)	(\$191.75)	180.47
4150:Other Business Income .....	\$6,727	\$4,485.00	\$2,241.80	49.98
4200:Reimbursed Client Costs (Direct) .....	\$744	\$0.00	\$744.09	0.00
4250:Inhouse Reimbursed Costs (Indirect) .....	\$12,093	\$8,311.16	\$3,781.46	45.50
<b>Total Income</b>	<u>\$106,574.63</u>	<u>\$51,437.55</u>	<u>\$55,137.08</u>	<u>107.19</u>
<b>Cost of Goods Sold</b>				
5000:Cost of Goods Sold .....	\$100.00	\$0.00	\$100.00	0.00
<b>Total Cost of Goods Sold</b>	<u>\$100.00</u>	<u>\$0.00</u>	<u>\$100.00</u>	<u>0.00</u>
<b>Gross Profit</b>	<u>\$106,474.63</u>	<u>\$51,437.55</u>	<u>\$55,237.08</u>	<u>396.80</u>

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## Other Management Reports

- Trial Balance Reports
- Statement of Cash Flows
- Collection Reports
- Revenue by Timekeeper Report

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## Classical Billing & Accounting Gap



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## Law Firm Accounting Pitfalls

### #1 - Customization for Legal Accounting

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## Legal Specific General Ledger Accounts

- Client Trust Funds (Liability)
- Client General Retainer - Trust (Liability)
- Client General Retainer - Operating (Liability)
- Advanced Client Costs (Asset)
- Reimbursed Client Expenses (Direct) (Income)
- Inhouse Reimbursed Expenses (Indirect) (Income)
- Fee Income (Income)
- Discount (Income)
- Reimbursable Client Costs (Expense)
- Non-Reimbursable Client Costs (Expense)
- Unrecovered Client Expenses (Expense)

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## Law Firm Accounting Pitfalls

#2 - Double Data Entry

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## Law Firm Accounting Pitfalls

#3 - Handling Client Funds

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## Handling Client Funds

- Operating Retainers
  - Balance sheet account -- liability of the firm
  - Revenue not yet earned



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## Handling Client Funds

- Trust Accounts
  - Balance sheet account -- liability of the firm
  - Monies held on behalf of clients
  - Revenue not yet earned
  - Funds for the benefit of clients, e.g. real estate escrow, estate probate funds

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## Types of Trust Funds

- Settlement funds (Personal Injury, Real Estate Settlements..)
- Unearned Income (*aka* "Fee & Cost Advances" or "Retainers")
- Advances for Cost
- Judgment Funds
- Third-Party funds

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## Types of Funds Not In Trust

- Personal Funds
- Earned Income
- Payroll
- Where you are not Fiduciary Trustee

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## Trust Accounting Is Easy

- No Profit or Loss
- No Depreciation or Amortization
- No Interest Accumulation
- No Tax Accounting
- No Account Management Fees/Bank Fees

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## Trust Accounting Is Hard

- You MUST track funds for each matter.
- You MUST reconcile books monthly.
- Must provide three-way reconciliation – liability account, bank account, client ledger
- You MUST maintain audit trail

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## So What Goes Wrong?

1. Lack of trust-specific knowledge & rules
2. Small Law Firm Challenges
3. Manual Systems
4. Trust Funds Gets Co-Mingled
5. Trust Ledger Overdrafts
6. Absence of Safeguards to Prevent Common Trust Mistakes
7. Un-cleared Funds Not Addressed
8. Bank Reconciliation is Sloppy
9. Separate Billing & Trust is kept separate
10. Lack of Controls & Data Protection

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## Trust Accounting Records

- Bank Ledger
- Receipts Journal
- Disbursements Book
- Client Ledger Balances
- Individual Client Trust Ledger
- Bank Reconciliations
- 3-Way Reconciliation



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## Keep Client Funds Separate

### Sample Law Firm LEDGER CARD BALANCE REPORT

Balances as of 06/20/2014

Keep track of client funds & status

BANK: TD Bank  
ACCOUNT: Attorney Trust Acct  
ACCOUNT #: 123456

CLIENT ID  
MATTER #  
SUB-A/C #

CLIENT  
MATTER OWNER  
Richmond, Tom  
Matrimonial  
Erica Birstler  
Smith, Joan  
Divorce  
Erica Birstler  
Suave, Rico  
Consultation-RS  
Erica Birstler

CLEARED BALANCE	UNCLEARED BALANCE	BALANCE	CURRENT STATUS
0.00	340.00	340.00	Open
0.00	99,450.00	99,450.00	Open
0.00	5,950.00	5,950.00	Open

**SUMMARY:**  
LEDGER CARD BALANCES TOTAL: 105,740.00

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## Individual Client Ledger Cards

### Sample Law Firm LEDGER CARD DETAIL

For All dates:

Running Balances for EACH ledger card is critical.

DATE	TRANS TYPE REF #	PAYOR/PAYEE Memo	INCREASE (DECREASE)	BALANCE	STATUS
12/11/2013	Deposit	Smith, Joe	2,000.00	2,000.00	Reconciled
12/13/2013	Check 1	Law Offices of Erica Birstler	(250.00)	1,750.00	Reconciled
12/17/2013	Check 2	ABC Company	(150.00)	1,600.00	Reconciled
12/18/2013	Check 3	Law Offices of Erica Birstler	(500.00)	1,100.00	Reconciled
12/19/2013	Deposit	Smith, Joe	2,000.00	3,100.00	Reconciled
01/13/2014	Wire Out	Law Office	(500.00)	2,600.00	Reconciled
01/14/2014	Deposit	Smith, Joe	800.00	3,400.00	Reconciled
01/14/2014	Check 4	Law Offices of Erica Birstler	(500.00)	2,900.00	Reconciled
01/14/2014	Check 5	Law Offices of Erica Birstler	(250.00)	2,650.00	Reconciled
01/14/2014	Check 6	AbC Company	(100.00)	2,550.00	Reconciled
<b>SUMMARY:</b>					
TOTAL CREDITS (INCREASES):			4,800.00		
TOTAL DEBITS (DECREASES):			(2,250.00)		
ENDING BALANCE:			2,550.00		

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## Reconciliation Report

### Sample Law Firm BANK RECONCILIATION

01/01/2014 - 01/31/2014  
\*\* COMPLETE \*\*

Bank Name: TD Bank  
Bank Account Name: Attorney Trust Acct  
Bank Account #:

Beginning Statement Balance: 01/01/2014 3,100.00  
Plus Cleared Deposits 800.00  
Less Cleared Payments (Decreases): (850.00)  
Difference: 0.00  
Ending Statement Balance: 01/31/2014 3,050.00  
Plus Uncleared Deposits (Increases): 2,010.00  
Less Uncleared Payments (Decreases): (300.00)  
Difference: 2,750.00  
Ending Checkbook Balance: 01/31/2014 4,560.00

DATE	TRANS TYPE	REF #	PAYOR/PAYEE	Amount
<b>Cleared Deposits (Increases):</b>				
01/14/2014	Deposit		Smith, Joe	800.00
<b>Total Cleared Deposits (Increases):</b>				<b>800.00</b>
<b>Cleared Payments (Decreases):</b>				
01/14/2014	Check	3	Law Offices of Erica Birstler	(250.00)
01/14/2014	Check	4	Law Offices of Erica Birstler	(100.00)
01/14/2014	Check	6	ABC Company	(100.00)
<b>Total Cleared Payments (Decreases):</b>				<b>(850.00)</b>
<b>Uncleared Deposits (Increases):</b>				
01/27/2014	Deposit		Law Offices	2,010.00
<b>Total Uncleared Deposits (Increases):</b>				<b>2,010.00</b>
<b>Uncleared Payments (Decreases):</b>				
01/13/2014	Wire Out		Law Office	(300.00)
<b>Total Uncleared Payments (Decreases):</b>				<b>(300.00)</b>

Bank ending balance

Book ending balance

Cleared Transactions

Uncleared Transactions

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## Three-Way Reconciliation

### Sample Law Firm THREE-WAY RECONCILIATION

01/01/2014 - 01/31/2014  
\*\* COMPLETE \*\*

Bank Name: TD Bank  
Bank Account Name: Attorney Trust Acct  
Bank Account #:

#### I. Book Balance

Beginning Balance: 01/01/2014 3,100.00  
Plus Cleared Deposits (Increases): 800.00  
Less Cleared Payments (Decreases): (850.00)  
Balance at End of Month: 01/31/2014 4,560.00

#### II. Bank Balance

Ending Statement Balance: 01/31/2014 3,050.00  
Plus Deposits in Transit (Increases): 2,010.00  
Less Outstanding Payments (Decreases): (300.00)  
Reconciled Bank Balance: 4,560.00

#### III. Client Ledger Balance

See attached report

SUB-A/C #	ATTORNEY	BALANCE	BALANCE	BALANCE	OPEN STATE
	Dunn, James	0.00	2,010.00	2,010.00	Open
	Estes				
	Attorney X				
	Smith, Joe				
	Contract				
	Attorney X	3,050.00	(600.00)	2,550.00	Open
<b>SUMMARY:</b>					
<b>LEDGER CARD BALANCES TOTAL:</b>				<b>4,560.00</b>	

3 Difference Balance Sources being Tied

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## Law Firm Accounting Pitfalls

### #4 - Client Costs Recovery

Leakage

Accounting Issues

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## Matter Costs Accounting Issues

- Types of Matter Costs
  - Hard Costs (Direct)
  - Soft Costs (Indirect)

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## Matter Cost Accounting

### Hourly Matter

Matter Costs	Cost Posted to Expense
Filing Fees: \$57	Reimbursable Client Costs
Transcription Fees: \$1,125	Reimbursable Client Costs
Photocopying: \$23	Indirect Reimbursable Client Cost
Auto Mileage: \$65	Non-Reimbursable Client Cost

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## Law Firm Accounting Pitfalls

#5 - Allocate Revenue Receipts

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## Allocation of Revenues

- Allocation of Payments from Clients
  - Sales Tax payables
  - ACC
  - RCC – hard costs
  - RCC – soft costs
  - Finance charges and late fees
  - Fee Income

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## Matter Cost Accounting

### Hourly Matter

Matter Costs	Posted to Expense	Payment Allocation to Income Account
Filing Fees: \$57	Reimbursable Client Costs	Reimbursed Client Cost
Transcription Fees: \$1,125	Reimbursable Client Costs	Reimbursed Client Cost
Photocopying: \$23	Indirect Reimbursable Client Cost	Reimbursed Client Cost (Indirect)
Auto Mileage: \$65	Non- Reimbursable Client Cost	NONE

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## Law Firm Accounting Pitfalls

#6 - Track Income By Practice Area

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## Law Firm Accounting Pitfalls

#7 - Challenges of Credit Card Processing

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## Challenges of Credit Card Processing

1. How will your accounting system know whose invoice is paid?
2. How will you manage credit card "batching"?
3. How will you handle voids/chargebacks?

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## How Can We Bridge The Gap?

Practice Management  
+  
Law Firm Accounting



COMPLETE LAW FIRM MANAGEMENT

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## Integrated Practice Management, Billing AND Accounting System

- All transactions have impact on financial position of firm
  - Legal obligations are met within one General Ledger system
  - “Unique” nature of law firm activities are recognized and managed
  - Mitigate issues relevant to firm’s bottom line

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## How Can It Work?

System Driven Solution

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?

YOUR OPINION MATTERS!

Please take a moment now to evaluate this session.

Thank You!

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