



Basic Legal Accounting Information You Need to Know

Legal accounting is a little different than standard business accounting, as there are unique financial issues within a law firm environment, including trust accounting and client costs advanced. Retainers and trust funds are particularly important to understand, as attorneys have an obligation to adhere to the Rules of Professional Conduct and ethics opinions that govern them. These materials will discuss the fundamental concepts of a legal accounting system, including various rules that directly affect the management of client funds.

Components of a Law Firm's Financial System

There are four or five main components to every law firm's financial system, and it is important for you to understand how everything ties together.

Time & Billing

Every business has a product or service they are selling, and this is the heart of their income. In a law firm, that commodity is your time. You may also have costs that you bill your clients for, but ultimately the bulk of your income comes from time spent servicing client's legal needs. Accordingly, the time & billing portion of your financial system is what tracks your time, including flat fee and contingency work, and keeps a running tally of what is owed by each of your clients. Unbilled time and costs (also known as Work in Progress or "WIP" for short) are kept track of until they are billed, at which point they move from WIP to Accounts Receivable (aka "A/R"). Payments are posted against the Accounts Receivable, thus reducing the balance owed. These payments may be in the form of trust monies or regular payments.

Trust

Law firms are required to keep client funds separate from their firm operating bank account until such time as it is earned. Accordingly, these monies are typically kept in a separate trust bank account. This is also referred to as an IOLTA account.

We will discuss trust regulations in greater detail later in these materials. For the purpose of explaining how it affects your legal accounting system, you need to understand that client funds

will be deposited to a trust account that will be kept separate from the operating account, and that as the firm earns their fees, you will need to transfer money from the trust account to the firm in payment for those fees (and potentially costs as well). Those payments will reduce the accounts receivable balance in your time and billing system and the income will post to your general ledger.

Accounts Payable

The concept of Accounts Payable is fairly simple. It equates to the money owed by your firm to various vendors or payees. It may be easiest to think of this as your check register or checkbook of outbound monies; when you pay an invoice, the expense posts to your general ledger. When you pay an invoice for a client cost, it also posts to your time & billing as a billable cost.

General Ledger

The general ledger is what brings all of these other components together and gives you the financial statements for the firm. For instance, when a payment is posted to the Time & Billing system against accounts receivable, it flows through to the general ledger as income. When you pay a bill in Accounts Payable, it posts as an expense to the general ledger. When all is said and done, the various transactions that post to the general ledger allow you to see the overall financial health of the firm on the Balance Sheet and Income Statement.

Payroll

Payroll is the last component to most financial systems. If you have an external payroll service, then you may just post journal entries on your general ledger to account for the payroll transactions. If you do the payroll in-house, then the likelihood is that you have software setup to automatically calculate the taxes, etc. This software should post the journal entries for you back to your general ledger for you.