



BOOKKEEPING BASICS FOR THE SOLO OR SMALL FIRM

You can set up a simple bookkeeping system for the solo practice or small firm using only a checking account (which we'll call your operating account), a notebook with ledger sheets you make yourself (see below), and a receipt book with numbered receipts.

This system won't serve you very long if you develop a busy practice, but it will be satisfactory as you get started and help you to understand what type of financial information you will need to capture in an automated system as your practice grows, so that you can keep on top of your own financial position while keeping up with your clients' affairs.

Because your practice may grow more quickly than you expect, I recommend that you combine this written system with Quicken® checking account software. Quicken will help you search for a particular transaction and prepare simple reports easily, and will do the math for you, and the written system will serve as a check against changing transactions within Quicken "after the fact" and will also serve as a backup.

The ledger sheets and receipt book will be used for documenting your fees and other payments you receive, and paying your office expenses and yourself. You should only pay offices expenses and write yourself draws from this account. Never pay personal expenses from it, as doing so will make it much more difficult to assemble your deductible business expenses at the end of the year when it's time to prepare your tax return. Instead, deposit your draw check into another checking account used for paying personal expenses, just as you would deposit a pay check if you were employed by a large firm.

You will need a separate receipt book, set of ledger sheets and checking account (IOLTA trust account) for funds received from clients/third parties as deposits for fees and costs or in settlement of client matters, but setting up and maintaining your trust account is discussed in *Trust Accounting for Alabama Lawyers*.

It's important for you to have a way to keep track of funds received. In accounting terminology, this is done through the use of a cash receipts journal.

The cash receipts journal is exactly what its name implies. It is a record used to show the details of a receipt by cash or check. Every receipt will be entered into two columns

of the journal; one for the total cash amount received, the other designating the source of the cash received. (*Accounting & Finance for Lawyers*, p. 7)

The easiest thing to use for your cash receipts journal in the small practice is a cash receipt book, such as the kind you can purchase from an office supply store. The book should have duplicate sets, so that whenever you write a receipt you can give the top copy to the client who brings you cash or wants a receipt for his or her payment by check. Receipt books with NCR paper are easier to use and less messy than those with carbon paper (if anybody still makes those).

The receipt book serves the function of a cash receipts journal very well, because each individual receipt has a place to record all the information you need to capture. There is a place for the date you received the payment, how much you received, who you got it from, and what case it was paid in connection with. Again, let me stress that this applies only to fees you have earned. Deposits for as yet unearned attorney fees and deposits for filing fees or other costs (sometimes referred to as "retainers") must be placed in your trust account. [See *Trust Accounting for Alabama Lawyers* for more information on how to determine whether a payment should be deposited to your trust account or operating account and how to handle trust receipts.]

Whenever you receive a payment that does not need to go into your trust account, you should write a receipt for it from the operating account receipt book. If the client doesn't want the top copy then shred it, but always enter every payment into the book, whether you receive it in cash or by check or money order. This way, you can search the bottom copy for payments by date, and you can add up all the receipts for a given month at the end of the month to see what your gross income was.

After you've written receipts for all the payments you've received, you're ready to make your deposit. After filling out your deposit slip, listing each check by payor/client/matter on the back of the deposit slip (order business style deposit slips even if you use a personal style book of checks), enter your deposit on the ledger. Rather than writing down the names of all the parties whose funds made up that deposit in the ledger, you can just enter the beginning and ending receipt numbers covered by the deposit and refer back to the receipt book if you need more information.

One function of your accounting system is to keep up with how much money you receive and how much you spend, so that you'll always know how much you have and your operating account won't be overdrawn. The other function of your system is to help you classify your receipts and your disbursements, so that you'll know where your money came from, and what you spent it on. This is where Quicken® will really help save you time, but you can accomplish classification of your receipts and disbursements without it.

Every office, and every accounting system, must have a chart of accounts. This is a list of all the types of payments you expect to receive (called "receivables"), and all the types of payments you expect to make (called "payables"). Your chart can be as simple, or as elaborate, as you want to make it. For the purposes of the small firm, the simpler the better. You don't really need to keep detailed records of how much you spent on pens versus pads; you just need to know, overall, how much you spent on major expense categories, such as rent or office supplies.

Your chart will generally have two types of listings: receivables and payables. Your receivables categories are generally either fees earned or referral fees paid by other lawyers, although if you have other types of income, such as renting out excess space or making copies for others in your building, you'll want to include a category for them, too. Your payables categories (expenses) should cover the range of things you expect to pay for on a regular basis. Some of your expense categories may need sub-categories. For example, you may wish to keep more detailed information on telephone costs, so that you will have historical information to look at when judging the wisdom of switching to a new local phone carrier or changing long distance or cellular plans. A sample chart of accounts is provided below. You may, of course, combine or delete any categories you don't need, and add any new ones you do.

Whenever you make a deposit or write a check, you will need to classify it on the ledger sheet. This will allow you to go down the ledger at the end of the month and run totals for fees earned and referral fees received, and for expenses paid in each expense category. If you don't want to have to do this compilation at the end of the month, you can create a separate ledger sheet for each type of expense within your chart of accounts, and post to that special ledger at the same time you write your check and make your entry in the check ledger. For example, when you write a check for office supplies, if you go ahead and also post it to an office supplies ledger sheet, you will have a running total of office supply expenses any time you need it.

If you deposit funds of your own to open the account and to pay expenses until you begin to receive regular fee payments, this will be your capital account. A capital account is neither an income nor an expense account. Instead, it represents the amount of your own money, or capital, that you have invested in your practice. When you spend funds to acquire furniture and equipment which you will use over an extended period of time, these items will become the assets of your business. They will be reflected in your asset accounts and can be depreciated over time with the depreciation taken as a yearly tax deduction, however, capital and asset accounts are beyond the scope of this paper. You should discuss with an accountant how to properly set up and maintain capital and asset accounts for your practice, and how to properly calculate equipment depreciation and show it on your tax return. A full general ledger accounting program such as QuickBooks or Sage 50 can be used for this, if you also wish to automate your general ledger accounting.

Whether you set up a separate ledger sheet for each expense category or not, you must set up a ledger sheet for each client. This is where you will post the amounts you have billed, any expenses you advance on behalf of the client, and any fees and expense advances repaid by the client. If you also have a separate ledger sheet for earned fees received, you will need to post each payment to both the client's ledger sheet and the earned fees paid sheet.

One of the drawbacks of this type of system of manual accounting for client fees is that there is no place in it to keep up with time worked but as yet unbilled to the client (called "work in progress"). An automated time keeping and billing system can do this for you and provide you with reports on your total work in progress or work in progress for individual clients.

As you can see, a manual bookkeeping system involves a lot of thought to set up and work to maintain, even for just a few transactions. Such a system can quickly break down when there are a lot of transactions and a lot of related legal work claiming the lawyer's attention. This is why I usually recommend that new lawyers just getting set up in practice go ahead and select a computerized time and billing system, preferably one with general ledger accounting capabilities. The lawyer has a chance to learn to use the system before he or she gets too busy. Once the work starts flowing in and there is no time left for planning or execution, you will already have a good accounting system in place which can handle the load and provide useful financial information about the health of your practice.

This paper is intended to provide a simplified overview of bookkeeping for the solo practitioner or small firm. For a more detailed description of bookkeeping and accounting practices, including double entry accounting, see *Accounting and Finance for Lawyers: Basic Understandings and Practices* by Rose Marie L. Bukics, CPA, and Cynthia M. Urbani, CPA, available from the Practice Management Assistance Program Checkout Library, or consult a bookkeeping service or accountant of your choice.

Chart of Accounts

Receivables (Income)

Fees Earned (Can be subdivided by case type.) Referral Fees (Can be subdivided by case type.) Other Miscellaneous Income

Payables (Expenses)

CLE Expense

Costs Advanced

Equipment

Insurance:

 Disability

 Life

 Medical

 Premises Liability

 Professional Liability

Janitorial

Library

Marketing

 Other

 Yellow Pages

Operating Expenses:

 Client Refreshments

 Copies

 Express Shipping

 Office Supplies

 Postage

 Rent

 Repairs

 Travel

Professional Dues and Licenses

Professional Service Fees

Utilities:

 Electric

 Gas

 Garbage

 Internet

 Telephone

 Mobile

 Land Line

 Long Distance

 Water

Capital (Your money invested in the practice)

Draw (Profits you take out of the practice to pay yourself)

**John Q. Lawyer
Profit and Loss Statement
November 30, 2013**

Income:

Fees Earned	\$5,500.00
Referral Fees Collected	<u>\$650.00</u>
Total Income	\$6,150.00

Expenses:

Expenses for November	<u>\$ 534.89</u>
Total Expenses	\$ 534.89

Net Profit (or Loss) \$5,615.11

[This simple profit and loss statement shows the fees earned and the expenses paid in November, as taken from the sample check ledger. The draw taken by the lawyer is not included in the expense total because it is a payment to the lawyer of part of the profit earned and is not an expense. If the lawyer had an employee, his or her salary and the employer's portion of the taxes paid on that salary would be includable expenses.

