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# Accounting and Office Management for Law Firms

BY JOHN L. HARVEY

## INTRODUCTION

It is recognized that a description of an accounting system is usually of limited interest. This interest may extend to those who are concerned with the business to which the system may specifically apply and to accountants in general who, because of limited experience, may find something to add to their store of knowledge through a study of the descriptive matter presented.

In planning this article it was the endeavor to enhance interest in a subject, which gave promise of being rather dry, by broadening its scope to include, not only a description of the accounting records and routine, but also certain aspects of management and control which seemed to have special appeal. It was decided to avoid the purely theoretical, which might indeed produce a better system on paper at least, and to treat of a practical case as exemplified by a programme developed for a large law firm and introduced long enough ago to have had the benefit of those modifications the expediency of which was demonstrated by experience.

## DESCRIPTION OF THE FIRM

The law firm for which this system was developed is composed of numerous partners, employing a large number of staff lawyers, secretaries and office assistants.

It is, in effect, a continuing entity represented by a succession of partnerships. The custom of the lawyers associated in this way has been to form a new partnership, usually to take effect as of the beginning of each calendar year. This has been done because, in an organization of its size, it is necessary to make changes in the personnel of the partnership and to alter the basis for the distribution of profits. In some respects each partnership has been distinct from every previous partnership but at the same time the firm name has not been changed and to the outsider it has been a continuation of the same partnership which was begun many years ago.

The very size of the firm renders it essential that financial information be properly collated and presented to the partners as promptly as possible. An organization of this character is somewhat loosely constructed, and such things as accounting and office matters may be neglected because the responsibility may not have been delegated to one or more of the partners with authority to act. In other words, what is everybody's business is nobody's business.

The system devised to meet the requirements of an organization of this size must provide answers to most of the problems which can arise in a law office, whether it is composed of many partners or consists of an individual lawyer carrying on alone.

For convenience of reference the successive partnerships are given consecutive numbers and are indexed by such numbers, together with the names of the partners composing the several firms and the bases for the division of profits among them.

#### PROBLEMS ARISING FROM SUCCESSION OF FIRMS

Problems arise from the fact that the affairs of the old firms are not settled at the close of the terms of the respective partnerships so that certain of the assets continue to belong to the members of those firms and certain assets are, in effect, purchased by the latest partnership.

There remain bills to be prepared and recorded for services rendered in whole or in part by the old firms, deferred income, as represented by clients' unpaid accounts, to be collected, securities to be realized, etc.

These services are undertaken by the latest partnership which acts as custodian of the assets of the old firms and as agents for the collection of income. In fact, the relationship which arises is that of trustee and, as such, the current firm is charged with the duty of rendering a faithful account of its stewardship to the members of the old firms.

The problems are aggravated by the fact that the partners of several successive firms may have worked on the same case, and some method must be adopted for the equitable distribution of profits eventually realized when the case is closed and billed. The accounting system must provide the mechanics whereby each of the partners of the several firms may receive proper credit for his rightful share of such profits.

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PRO-FORMA BALANCE-SHEET

At this point it seems advisable to introduce a balance-sheet which is a reflection of the combined financial condition of all firms at a given date.

The figures, of course, are fictitious. This balance-sheet contains the assets and liabilities of several distinct partnerships and must, therefore, be considered as a composite statement; but, after all, it sets forth within certain limitations the financial condition of this somewhat fictitious entity known as the firm.

COMPOSITE STATEMENT OF ASSETS AND LIABILITIES—ALL PARTNERSHIPS

<i>Assets</i>			
Trust fund assets (contra) . . . . .		\$	55,000
Cash in banks and on hand . . . . .			65,000
Advances to employes . . . . .			2,000
Deposit . . . . .			200
Advances in hands of foreign representatives (to be accounted for)			5,000
Accounts receivable—clients:			
Fees and disbursements billed . . . . .	\$271,000		
Disbursements not billed . . . . .	23,000		
			294,000
Securities (book value) . . . . .			8,000
Furniture and fixtures . . . . .	\$39,000		
Less reserve for depreciation . . . . .	9,000		
			\$30,000
Library . . . . .	\$21,000		
Less reserve for depreciation . . . . .	8,000		
			13,000
			43,000
<b>Total assets . . . . .</b>			<b>\$472,200</b>
<i>Liabilities</i>			
Trust funds (contra) . . . . .		\$	55,000
Accounts payable:			
Credit balances in clients' accounts . . . . .	\$ 2,500		
Other . . . . .	1,600		
			4,100
<b>Total liabilities . . . . .</b>			<b>\$ 59,100</b>
Capital:			
Deferred income . . . . .	\$299,500		
Working fund . . . . .	100,000		
Partners' drawing accounts . . . . .	13,600		
			413,100
			<b>\$472,200</b>

#### OWNERSHIP OF ASSETS

Assuming that this balance-sheet had been prepared as of the date of the beginning of a new partnership, the cash, furniture and fixtures, library, advances and deposits are the property of the current partnership, subject to the other liabilities and to the credit balances in partners' drawing accounts. These assets were taken over from the preceding partnership at book values as set forth in the partnership agreement. They represent the necessary working fund contributed by the partners and fixed in this case at \$100,000. The accounts receivable from clients and securities, however, were not transferred and remain the property of the partners of those partnerships which rendered the services resulting in the billing to clients. The total of the book value of accounts and securities, less the credit balances in clients' accounts, is reflected on the credit side of the balance-sheet under deferred income, which is the aggregate of the recorded deferred income of all past partnerships.

As the activities of the new partnership reflect themselves in financial transactions, the accounts become somewhat mixed, inasmuch as deferred income accrues to the credit of the current partnership and is reflected in client's accounts receivable and, possibly, securities account. In addition to the asset shown on the balance-sheet, there is the value of the services rendered to clients which has not been billed.

It should be noted that the accounts are kept on a cash basis and that income is credited to the respective partnerships only when collected. It can readily be recognized that it would be impracticable to attempt to value accounts receivable so that the partners of the new firm could be charged with a fair amount for this asset. It is much fairer to credit the partners of the old firms as collections are made on these accounts receivable. No recognition is given in the statement to the value of unbilled services, because even the lawyer in charge of the case can not foresee what turn of events may make it desirable to bill a fee much higher or lower than was contemplated until the very close of the case. A strict control, however, is maintained over unbilled services.

In the case of securities, in some instances it may be practicable to transfer the ownership of these to the incoming firm, if the securities have a marketable value, but usually securities come into the possession of the firm as compensation, in whole or in part, for services rendered in the organization and reorganization

of corporations; their value is, to say the least, often problematical; and it has been considered advisable for the firms rendering the services resulting in the receipt of compensation in this form to retain the ownership of the securities and to receive the distribution of proceeds when the sale or other disposition is effected.

#### WORKING FUND

Though capital may not be an important factor in the production of income in a law firm, as has been recognized by the commissioner of internal revenue, it is nevertheless essential in the conduct of the business of the firm. It is wise to set up on the books that amount which experience has indicated is needed to provide for equipment and current working funds.

Upon the formation of a new partnership, the drawing accounts of the partners of the old firm are credited and the drawing accounts of the partners of the new firm are charged with the amount of the fund. It should be remembered, of course, that the personnel of the partnerships does not radically change with the formation of each new partnership or, in other words, that most of the partners of the preceding firm become partners in the new firm. Therefore, this charge and credit to the partners' drawing accounts does not have very much effect upon the lawyers who continue as partners unless their percentages are radically altered. With regard to the drawing account of the incoming partner, however, it has the effect of creating a debit balance. The new partner may pay into the firm his pro-rata share of the working fund if he so desires but, in actual practice, this is not usually done and his drawing account is shown as an overdraft until his contributions to the fund out of income are sufficient to meet the charge. Under this plan, of course, the fund is temporarily reduced by the amount of the overdraft.

It is clear that the firm must have working capital, and the method adopted provides an equitable assessment against each partner in order to provide this most necessary fund. Before this method was adopted it was found that frequently the funds of the firm became so low, by the withdrawals of partners, that it was necessary to seek contributions from those partners who had already drawn the money. This was an unsatisfactory situation. No one likes to pay back funds that he has already received and made disposition of, and, further, it is practically impossible to

recover from all partners their just proportions of the amount needed. Under the scheme of setting apart the working-capital fund in a separate account, the balances in the partners' drawing accounts show exactly what the partners may draw without crippling the operations of the firm; and a valuable control of the drawing accounts is obtained.

#### SECURITIES

A law firm which does a large amount of corporation work, particularly in the formation of new companies or the reorganization of others, may find itself in possession of securities of the corporations for which it acted. Securities may, of course, be purchased as an investment, but that is unusual and the only question involved in that case would be the disposition of such securities at the time of the organization of a new partnership. If they had a market value they would probably be charged to the new partnership at that value, the difference being credited or charged, as the case might be, to the partners of the firm making the purchase. It is more usual to find that securities come into the possession of the firm as a payment for services rendered. In one instance, a block of securities was received partly in payment for services and partly for a cash payment made by the firm.

Securities accepted from clients in payment of fee may be recorded on the books in one of two ways: a cash fee may have been determined and the securities accepted in lieu of this, or the fee may be said to have consisted of so many shares of stock or other securities at no stated value. In the latter case, for the purpose of record, a value must be placed upon securities and if this value is indeterminate a nominal value of \$1.00 can be used. In either case the valuation will be offset by a credit for the same amount to deferred income. Some time may pass before the securities can be marketed to advantage, and it is, therefore, important to see that the extent of the interest of each partnership in these securities is determined when they are received. It is well that a memorandum be prepared by the partners or those responsible for the distribution of fees among partnerships setting forth the interest of each partnership in the securities. Any sums received either on account of the sale of these securities or on account of the income from them will, of course, be credited to the appropriate partnerships as their interests may appear.

An interesting situation arises in case a partnership receives securities in part as a payment for services rendered and at the same time pays cash for part of the securities acquired. To illustrate it may be assumed that partnerships Nos. 2 and 3 assisted in the organization of a corporation. This work is billed by partnership No. 4 at \$75,000. The client corporation makes an offer to deliver to the firm 1,000 shares of its capital stock, which has no ascertainable value, in full payment for all services rendered and for a cash payment of \$25,000 by the firm. The offer is accepted. Such a transaction is susceptible to various methods of treatment and it is, therefore, important that an agreement be reached as to the respective interests in the securities of the various partnerships concerned. In the case used for illustration, it was decided that the \$25,000 payment was an investment of partnership No. 4, represented by one-fourth of the stock acquired, or 250 shares. This ratio was determined by valuing the total stock acquired, 1,000 shares, at \$100,000, or the sum of the fee for services and the cash payment. The other three fourths, or 750 shares, were allocated to partnerships Nos. 2 and 3 as payment for their fee of \$75,000 on the basis of \$50,000 to No. 2 and \$25,000 to No. 3. The latter transaction was reflected on the books by a charge of \$75,000 to securities and a like credit to deferred income, the \$25,000 having been charged to securities account direct from the cashbook.

Under these conditions, any income from or profit or loss on the disposition of the 250 shares would accrue to the partners of No. 4 partnership. The partners of Nos. 2 and 3 would be entitled to any income arising from the 750 shares and would receive credit for the proceeds from sale in proportion to their respective interests.

If it were decided that the cash payment was made to protect the interests of partnerships Nos. 2 and 3, then, of course, No. 4 should be given the benefit of any amount received in realization up to \$25,000 and Nos. 2 and 3 should bear any loss or receive any profit when the shares were sold.

As a matter of bookkeeping, when these securities of partnerships Nos. 2 and 3 are sold an entry must be made clearing from the securities account and from deferred income the book value of the securities sold. It should be remembered, however, that it may be agreeable to all concerned for the succeeding partnership to take over any or all securities at an agreed valuation.



PARTNERS CLASSIFIED AS TO BASIS OF COMPENSATION

The division of profits or compensation to the partners is, of course, to be found in the partnership agreement. Compensation varies considerably and the partners may be classified as follows:

- Partners sharing profits or losses on percentage basis;
- Partners sharing profits on a percentage basis but guaranteed a fixed compensation from all partnerships for a specified period, whether earned or not, through the application of the percentage to which they are entitled;
- Partners sharing profits on a percentage basis but guaranteed a fixed compensation from a specified partnership, whether earned or not, through the application of the percentage to which they are entitled;
- Active partners drawing a fixed amount without relation to the profits;
- Inactive partners receiving a fixed allowance for the privilege of using their names.

PARTNERS' GUARANTEES

It has already been pointed out that it is sometimes customary to give a junior partner a guarantee. In the firm whose affairs are the basis of these notes, the partnership included three partners who were each given a guarantee of a fixed amount. It was stipulated in the agreement that "all amounts drawn by them hereunder shall be repaid to the partnership without interest, out of their respective shares of the partnership profits, as and when collected and distributed and not otherwise." It should be borne in mind that income is credited to the partners' accounts only upon the collection of cash and that the earnings of any one partnership may not be collected in total for a number of years. It is possible that the share of the total earnings of a guaranteed partner on the basis of his percentage, as set forth in the agreement, may not equal the amount which he may draw under this guarantee. If, in the first year of the partnership, the income on a cash basis is not sufficient to meet the guarantee, as is usually the case, the best method of handling the situation is to charge the excess to the other partners immediately. In other words, the income of the partnership is distributed first to guaranteed partners to the extent of their guarantee and then to the remaining partners. Any subsequent income of the partners re-

ceiving the guarantee from the particular partnership will go to the credit of the other partners until the excess is liquidated.

It is very important that the partnership agreement should clearly express the intention of the partners in respect to these guarantees.

#### PARTNERSHIP AGREEMENT

It should be unnecessary perhaps to point out that the partnership agreement should be carefully drawn and should cover all matters which may occasion misunderstanding among the partners when put into effect. The agreement, of course, will state the names of the partners, the duration of the partnership, the proportionate share of each partner in the profits and losses, the compensation to partners who are to receive fixed compensations and the amounts of the drawings of those partners who, while receiving a fixed percentage of the profits, have been guaranteed a minimum compensation. The amount of the working fund as well as the method under which the business affairs of the partnership are to be conducted should be set forth. The question as to the termination of the partnership in the event of death or retirement of a partner should be answered. Another item which might properly be included in the partnership agreement is a provision that all the partners should devote all of their time to the interest of the firm and that all remuneration received by them should be turned into the firm as part of its income. It has been found, particularly in the case of corporation work such as promotions and mergers, that after the fee has been paid to the firm the client will sometimes donate to the individual lawyer handling the work some personal remuneration which may take the form of stock of the corporation. Likewise, the individual partners frequently act as directors in corporations organized by the firm and receive fees for their services. In these instances there seems to be little question that the remuneration received by the individual partners belongs to the firm.

It is not necessary to discuss all the questions with respect to partnership agreements, as it is recognized that this is largely a legal matter, but it is well to point out that partnership agreements should cover, in a way which can not be misconstrued, those points which have a distinct bearing on accounting matters and may, if not clearly defined, cause some disagreement among the partners.

### BUSINESS ORGANIZATION

In a large organization it is necessary to delegate to certain persons authority to conduct the business of the partnership: that is, to keep the books, to pay the bills, to collect fees, to hire and discharge employes and to render other similar duties. A good many of these duties, of course, can be delegated to an office manager. It is wise, however, to arrange that partners may oversee the work of the office, direct the business activities, decide questions of policy and maintain supervision over finances and accounts.

#### EXECUTIVE OR MANAGEMENT COMMITTEE

One firm has solved its problem of management by means of an executive committee composed of four partners who determine all ordinary questions of office management and procedure. The partnership agreement states that the committee shall have power to decide all matters relating to

- (a) The employment and discharge of associates and other employes and the fixing of their compensation;
- (b) The adequacy, operation, management and conduct of all office departments and services, including the assignment of associates to work;
- (c) The division between different firms of fees for professional services extending over a period of more than one firm; and
- (d) Any other matters expressly referred to it by a majority in interest of the partners.

All other questions of policy and management are determined by the majority in interest of the partners.

It is obvious that, inasmuch as the outside accountant must rely on the decisions of this committee in many cases, such as the distribution of fees among partnerships, approval of financial transactions, etc., the executive committee should keep a record of its proceedings. In a partnership consisting of many partners, if every partner, individually, is permitted to have full power to make important decisions, sign cheques, approve bills, etc., it is plain that the decision of one partner can hardly be accepted as expressing the approval of all other partners or the majority of them. The method of placing authority in a small executive committee makes it possible to accept the decisions of this committee as indicating the wishes of at least the majority of the partners in interest.

DISTRIBUTION OF FEES

It frequently happens that succeeding partnerships may carry on the work of preceding partnerships in a case, and at the conclusion of the whole matter it becomes necessary to distribute equitably the resulting fee over the partnerships which did the work. To make an equitable distribution involves careful consideration in order that no injustice may be done as among partners of the various firms. If the time element were the only one involved, of course, it would be possible to distribute the fee on a time basis. Fortunately for lawyers their fees are not always based on the time employed at specified rates but may be rather calculated on the basis of the value of the services rendered. Therefore, when the bill is prepared the question of distribution should be settled, while the matter is fresh in mind. If the distribution be left until the fee is collected and this collection be somewhat deferred, the whole matter becomes obscure and it is more likely that there will be an unfair distribution than it would have been when the matter was closed and the bill rendered. The accounting system should provide for recording on the duplicate copy of the bill the distribution of the fee, which should be approved by the authority designated.

This whole question of authority for the distribution of fees had given trouble prior to the installation of a new system and the partners were of the opinion that this matter merited the approval of the executive committee in every case. The system as originally installed did provide that although the partners might make the distribution of the fees themselves, the final approval of the executive committee for all distributions so made was required. In practice, however, it was found that too much time was being given by the executive committee to this work, and it was decided that in cases where the fee covered work performed by more than one partnership the partner in charge of the work should have full power to decide the appropriate distribution, subject to whatever adjustment might be made by the committee should it at any time see fit to review the original distribution.

Although there are numerous instances in which the time spent on a case does not afford a basis for an equitable distribution of the fee, there are other cases in which it does. In the instance under consideration it was decided that where the partner in charge considered it fair, the distribution should be made by the book-

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keeper on a basis of an approved formula. This formula was based on an hourly unit plan, partners and clerks being rated as follows:

Senior partners . . . . .	6 units
Junior partners . . . . .	4 "
Senior clerks . . . . .	2 "
Junior clerks . . . . .	1 unit

Junior clerks are those receiving up to \$5,000 a year. Junior partners are those specifically designated as such.

It was agreed that in order to assist in the work of the outside audit any partner wishing the distribution to be made on this basis should indicate his intention on the billing form.

CHEQUE SIGNING AND APPROVALS

Sometimes it is the practice of firms to permit cheques to be signed by any partner and to have the bills and payrolls approved in like manner. This practice, of course, not only wastes the time of partners but also the time of the office employes who seek to obtain approvals or signatures and must find a willing partner before these can be obtained. Experience demonstrates that the authority to sign cheques should be delegated to one partner or to a trustworthy employe who would be instructed to draw cheques for duly authorized payments only. A complete schedule of approvals may be drawn up and approved by the executive committee, so that it will be clear who should approve payments and the limits of these approvals. The following schedule adopted in the firm whose affairs are the basis of these notes may be of interest:

Nature of expenditure	Approval
Original salaries and adjustments:	
Lawyers, law clerks, etc. . . . .	Management committee
Clerical and executive staff . . . . .	" "
Stenographic staff . . . . .	Chief clerk
Boys . . . . .	" "
Current and normal office expenses—stenographic costs, stationery, telephone, repairs, water, ice, lighting, periodicals, carfares, etc. . . . .	
	" "
Extraordinary expenditures (contributions, entertaining, purchases of furniture, etc.):	
Up to \$25 . . . . .	" "
\$25 to \$200 . . . . .	A partner
Above \$200 . . . . .	Management committee
Disbursements for clients (except expense reports <i>re</i> trips, etc.):	
Up to \$1,000 . . . . .	Chief clerk
Above \$1,000 . . . . .	A partner

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Nature of expenditure	Approval
Partners' expense reports:	
Up to \$250 . . . . .	His own signature
\$250 to \$500 . . . . .	Another partner
Above \$500 . . . . .	Management committee
Other expense reports:	
Up to \$1,000 . . . . .	A partner
Above \$1,000 . . . . .	Management committee

### TIME RECORDS

Each lawyer is required to enter in a diary the time spent on each case, together with a description of the work performed. These are forwarded periodically to the clerk in charge of the time records. These records are loose-leaf sheets, the original and duplicate being of different colors, which are kept in a loose-leaf binder. They are headed with case number, name and number of the client, brief description of the matter, date begun and date completed. They contain space, in columnar form, in which to type particulars of the work done by each lawyer, his initials, the date and the time in hours. It is a rigid rule that the original sheets shall never leave the files, the duplicates being provided for the use of lawyers and others in the preparation of bills or for any other purpose. As bills are rendered, the fact is noted on both the original and duplicate by means of a rubber stamp indicating the date and number of the bill. This information, of course, comes from the accounting department and should be brought up to date each day.

No value is entered on the books of account for unbilled time—that is, no attempt is made to value work in process. However, a strict control is kept over time. This is done by means of a monthly summary which contains columns enough to provide for each day in the month. The lawyers' names appear at the left margin. The hours are summarized under each lawyer's name each day on this summary sheet, the time having been assembled from the lawyers' diaries. The time spent on the various duties each month is assembled and against this total there is credited the time billed each month and the time written off as unbillable. A trial balance of the time records is taken periodically and on this trial balance the total unbilled time of each lawyer on each case is shown. The trial balance is brought periodically to the attention of the executive committee which is thus afforded information about the work in process and the unprofitable time spent. In

order that this accumulation of unbilled time may be kept at a minimum, action is taken by the executive committee to see that time which can not be billed is eliminated from the records.

#### CLIENTS' BILLS

Clients' bills are prepared by the lawyer in charge of the matter to be billed. They are prepared in duplicate, the original for the client and the duplicate for the permanent office file. The time record contains the information necessary for the preparation of the bill.

The duplicate copy of the bill should provide a space in which to record the distribution of the credit among partnerships. It is essential that this information be recorded when the bill is prepared. The lawyer who makes the distribution should initial the duplicate. This record, of course, greatly facilitates the determination of the correctness of credits among partnerships by the outside auditor.

Details of disbursements made for the account of the client and stenographic charges are furnished by the accounting department upon receiving advice that the bill is in course of preparation.

After the bill has been prepared it is returned to the accounting department for review, the original is mailed or delivered and the duplicate, from which entry is made in the clients' charge journal, is filed.

#### STENOGRAPHIC CHARGES

It is the practice of the firm in question to bill clients for services of the stenographic department at a price per folio. Whether this practice is advisable or not, of course, is open to question, on the theory that a client is far less apt to dispute a bill for \$25,000 than one for \$24,000, plus a relatively small charge for stenographic services. However, it may be of interest to review the system.

Each stenographer is required to fill out weekly a form showing the number of folios and copies made for clients each day and specifying the clients to whom these are chargeable. These forms contain a weekly summary classified according to clients. The totals of the folios and copies made for each client are posted to his account in a ledger known as the "stenographic ledger." At this time no charge is made on the general books but reference is made to this ledger when the invoice is prepared. When the

charges are billed to clients, notation to this effect is made in the stenographic ledger.

#### DISBURSEMENTS FOR THE ACCOUNT OF CLIENTS

There is a separate ledger to which are posted from the cash-disbursement book all disbursements for the account of clients. This ledger is, of course, controlled by an account in the general ledger, to which postings are made in total. When the client is billed, reference is made to this ledger and the total amount of the disbursements, in most cases, is added to the bill. The total of each bill is charged to the client's account in the clients' ledger and proper credit is made in the disbursement ledger.

#### IDENTIFYING AND INDEXING CASES

The number of cases and the diversity of clientele of a large law office make it essential that each new case be identified promptly. This can be done by using an established description and a uniform number for each case, which will make it possible to classify accurately all matter relating to a particular case, such as time spent, bills rendered, disbursements made, stenographic services, correspondence, documents, etc. By the use of standard numbers the time records, disbursement ledger, stenographic ledger, clients' ledger and files are coördinated and cross reference is expedited.

The description of the case is established by the lawyer in charge, who prepares a set of slips on which is set forth the title of the new work about to be undertaken. These slips are forwarded to the time ledger clerk who indexes and numbers them before they are distributed to the various departments interested. The numbers are noted on all ledger sheets, time records and files and consist of a primary number for the client and a secondary number for the particular matter handled for him.

#### PERIODICAL REVIEW OF ACCOUNTS AND RECORDS BY MANAGEMENT COMMITTEE

Too great emphasis can not be laid on the necessity of having either the partners themselves or the executive committee, for them, review the accounts, so that they may be kept free from deadwood.

A trial balance of unpaid charges made to clients for fees and disbursements should be prepared and submitted to the com-



mittee each month. If this is done the committee is in a position to take whatever steps may be considered advisable to collect those balances which are due and to write off the balances which have become uncollectible.

Disbursements not billed should also be reviewed periodically and, where such disbursements are not to be billed, formal action should be taken to remove them from the accounts. Likewise the balances of the time accounts in hours should be scrutinized and the time control relieved of charges which will not result in fee. For the convenience of the outside auditor who may audit the books, all charge-offs should be supported by formal authorization of the management committee.

#### TRUST FUNDS

Money in the nature of trust funds which may come into the hands of the firm should never be merged with the funds of the firm but should be kept distinct and deposited in separate bank accounts. It sometimes happens that the aggregate of these funds results in the accumulation of a bank balance sufficiently large to be credited with interest by the bank, although, possibly, no individual item would be sufficiently large. The problem then arises as to the proper distribution of the interest credited. It may be argued that this amount should be distributed pro rata to those having title to the trust funds which caused it to arise. In the case in mind, however, this interest was credited to the income of the partnership, perhaps on the theory that it may have represented some small reimbursement for the expenses involved in the handling of the funds. However, it may be advisable to keep separate any large amount which may be received and either place it in a separate bank account or invest it in securities which are legal for trust funds, so that the earnings from this fund may go to the proper beneficiary.

#### VOUCHERS SUPPORTING DISBURSEMENTS

Disbursements made by the firm either for its own account or for the account of clients, should be supported by properly approved vouchers. These vouchers may take the form of invoices, payrolls, receipts or requests by the partners for cheques. The approvals should, of course, conform to the programme laid down by the management committee and should be registered on the

voucher by the use of a rubber stamp which may be designed somewhat like the following:

Footed and ext. . . . . Inv. No. . . . .  
Charge account. . . . .  
Charge client. . . . . No. . . . .  
Case. . . . . No. . . . .  
Approved. . . . .

A form is provided to meet the case when a partner requires a cheque and does not offer a supporting voucher. These applications for cheques, of course, are governed by the rules of the executive committee.

All vouchers are numbered consecutively and entered in a register. While the accounts are kept on a cash basis, it has been found advisable to register invoices. The register provided is a simple form having columnar divisions from left to right as follows: date, voucher number, name, amount, payment date, cheque number and remarks. This record is not controlled by the general ledger.

When an invoice is paid, the invoice number is entered in the cashbook and the date and cheque number are entered in the register so that at all times a record of the unpaid invoices is available.

If the invoice is incurred for the account of a client, the client's name, or, if this is unknown at the time, a warning notation is entered immediately in the register in the column headed "remarks." If it becomes necessary to bill a client for disbursements before actual payment has been made, the register can be consulted and the information as to the unpaid bill can be obtained from it.

#### BOOKS AND RECORDS

The books in use are as follows: general ledger, private ledger, clients' ledger, disbursement ledger, cash receipts book, cash disbursements book, petty-cash book, general journal, private journal, stenographic journal, stenographic ledger, clients' charge journal, register of vouchers, expense distribution book, time ledger and time and stenographic controls.

The private ledger and journal are not essential, but were introduced in this particular concern so that the individual accounts with the partners could be kept in confidence.

The general ledger will contain, in addition to any assets and liabilities not enumerated, the following accounts:

*Accounts usually with debit balances:*

Cash  
Petty cash  
Trust fund assets  
Clients (control for clients' ledger)  
Disbursements not billed (control for disbursements ledger)  
Securities  
Expenses (control for expense distribution book)  
Advances (to be accounted for)  
Furniture and fixtures  
Library

*Accounts usually with credit balances:*

Trust funds (contra to trust fund assets)  
Accounts payable  
Deferred income  
Interest income  
Income accounts (one for each partnership)  
Private ledger (control for private ledger)  
Reserve for depreciation  
Working fund

Deferred income account will be credited in monthly totals with fees and stenographic charges billed to clients, as disclosed by the clients' charge journal. It will also be credited with the total disbursements made for the accounts of clients, as disclosed by the cash disbursement book. It will be charged with the total amount collected from clients each month, as disclosed by the cash receipts book. If securities are accepted in payment of fee and these securities are carried as deferred income until sold, this account will also be credited with the value of such securities when received and debited with the same value when they are sold. The balance in the account, therefore, will represent the total amount due from clients, plus the book value of the securities carried as deferred income, and it should, of course, equal the aggregate of the balances in the clients' accounts, disbursements unbilled and the securities carried as deferred income.

Inasmuch as there are several partnerships for which income is being collected, it will be necessary to maintain one income account for each partnership. Each of these accounts will be credited monthly with income collected, as disclosed by the cash receipts book. The income account for the current partnership will be charged and deferred income account will be credited each month with total disbursements (excluding stenographic charges),

as shown by the cash disbursement book. These income accounts will be closed each month by credits to the individual partners' accounts in the private ledger.

It will be noted from the above that disbursements made for the account of clients are treated as deductions from income collected. There may be some argument about this, but it is felt that these charges, in effect, are expenses of operation and, inasmuch as income is determined on a cash basis and these amounts must necessarily be disbursed in cash, they result actually in reduction of cash income. Then, again, it is not always the custom to bill disbursements as such and it is often impossible to tell whether disbursements will be billed to the client or not until the time comes to render a bill. The department of internal revenue has taken no exception to this procedure with reference to income taxes, in the case of the firm whose accounts form the basis for this article.

The expense distribution book is a simple columnar book having columns to accommodate the various expense accounts. The individual expenses are posted from the cash disbursement book, in which the account number and amount of each expense payment is recorded.

The account classification in use is as follows:

100	Salaries—lawyers
101	“ —office staff
102	Stenographic department—salaries
103	“ “ —rent
104	“ “ —stationery
105	“ “ —repairs and upkeep
106	“ “ —miscellaneous
107	Rent
108	Light and heat
109	Cleaning
110	Water, ice and towels
111	Time-clock service
112	Dues
113	Charity
114	Telegrams and cables
115	Telephone
116	Traveling expense
117	Stationery
118	Periodicals
119	Library upkeep and expense
120	Repairs to furniture and fixtures
121	Publicity



122	Bank charges
123	Interest
124	Paris office expense
125	Depreciation—library
126	“ —furniture and fixtures

A copy of the form for the cash receipts book is submitted on page 189.

The total of each column will be posted as follows:

- (A) To the debit of the trustee fund account and to the credit of the account showing the liability of the firm as custodian of the funds of others.
- (B) To the debit of the general cash account.
- (C) To the credit of the control account for clients' accounts and to the debit of the deferred income account.
- (D, E and F) The collections made on clients' accounts will be distributed in these columns and the totals posted to the income accounts of the various partnerships. The aggregate, of course, will equal the total of column "C."

In effect a journal entry will be made each month in which the total of "C," representing total income collected, will be charged to deferred income account, which will have been previously credited with the fees and disbursements billed clients, and the totals of "D," "E" and "F" will be credited to the respective income accounts of the various partnerships. The items in column "G" will, of course, be posted individually.

With reference to the cash disbursement book, form for which appears on page 189, it should be noted that the disbursements recorded therein for the account of clients should be posted to the individual accounts in the disbursement ledger and the total to the account in the general ledger controlling the former. It must be emphasized that the individual postings should be made daily so that when the occasion arises for bills these charges may be a matter of record in the disbursement ledger.

The clients' ledger is kept on the loose-leaf system and is a simple debit and credit ledger, except that it provides information as to the division of the charge as to its elements, fee, stenographic charges and disbursements, and also as to partnerships which receive credit. The case number and invoice number are also entered for reference purposes. Reference to this ledger will show to what partnership or partnerships a fee received shall be credited and it affords the basis for an analytical trial balance of

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C L I E N T S   L E D G E R											
DATE	CASE NO.	INVOICE NO.	FOL.	TOTAL CHARGE	D I S T R I B U T I O N			C R E D I T			
					PART NO.	FEE	STENO.	DISB.	DATE	FOL.	AMOUNT

deferred income classified as to partnerships and the composition of the balances due from clients.

A copy of the form in use is shown above.

The clients' charge journal follows the form of the clients' ledger except, of course, that the credit columns are omitted.

**REPORTS**

The final test of any system is that it produce promptly and accurately such information as may guide the management of the concern. It is essential, of course, that the management committee, and through it the partners, be kept advised from time to time of the financial condition of the firm and, if one may use this term with reference to lawyers' accounts, the results of operation.

In the case under review the reports were designed so that they could be inserted in a loose-leaf binder which was of the flexible type for ease in handling. It was decided that these reports should not be prepared for each partner but that they should be limited to three copies, two of which are furnished to the management committee and one for the office file. The copies in the hands of the management committee are open for inspection by the partners and, if the management committee is functioning correctly, it will see to it that each partner reviews the reports.

The forms may be described as follows:

*Issued weekly:*

Cash receipts and disbursements—in detail as to the week with cumulative totals for month and year.

*Issued monthly:*

Composite statement of assets and liabilities of all partnerships.  
 Accounts receivable from clients, showing date of billing.  
 Advances.

Income and expense, showing gross income classified as to partnerships and expenses in total supported by detailed schedule. These statements contain transactions for the year to date and include a comparison with the transactions of the previous year to the same date.

Partners' accounts—the left column on this sheet is a total column and provides for the following:

Balance beginning of period.

Add net income of partnerships, shown separately by partnerships.

Deduct withdrawals.

Balance end of period.

Columns to the right headed with the name of each partner provide the means of showing the spread of the above totals among partners.

Bills rendered to clients during the month—analyzed as to fee, disbursements and stenographic charges.

Statement of collections by month—in detail, classified by partnerships.

*Issued quarterly or oftener as required:*

Disbursement ledger balances—analyzed by year of origin.

Stenographic ledger balances.

Time ledger balances—shown by partners.

*Issued as required:*

Schedule of securities.

Schedule of trust funds.