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Closing the Books for the 2021 Fiscal Year

developers · Tuesday, December 21st, 2021

Every law firm should start 2022 with accurately balanced [accounting](#) that is ready for all that the new year will bring. However, doing so requires the complete closure of books from the 2021 fiscal year.

While this annual process is typically easier for firms that have consistently updated their books monthly, those that wait until year's end can still complete this important task successfully. This year-end closing process comes together through reconciling bank accounts, adjusting entries, and preparing financial statements for analysis.

The following are some annual bookkeeping processes to help your law firm set the foundation for financial success in the coming year. Like what you're reading? We've also prepared a handy checklist for you to follow to ensure your books are up to date as 2022 approaches.

Process Final Client Billings

Settling invoices and outstanding client accounts will make it much easier for your firm in the coming year by bringing all income up to date before the year's end. If any invoices for completed work are yet to be issued, you should create and send them immediately.

Outstanding invoice payments also require prompt follow-up. An abundance of unpaid invoices can result in decreased revenue and [law firm cash flow](#), impacting a firm's ability to meet its financial obligations at the start of 2022. Firm administrators should run an accounts receivable report for an up-to-date listing of all unpaid bills.

The firm can then take the following steps to settle the accounts that firms deem collectible:

- Send payment notifications to clients as a reminder that their invoices are overdue with instructions for quickly completing a payment.
- Run payments for any clients with payment agreements and methods on file with the firm.
- Use strategies to encourage and promote payment, such as offering a discount for full payment by the end of the year.

For any seriously past due accounts that cannot be settled, firm leaders must decide whether or not they are ultimately collectible. The likelihood of collection decreases significantly over time, so for accounts that will likely never be paid, it may be appropriate to write them off by December 31st.

Record Expenses Constantly and Accurately

Expense tracking must be a part of the year-end closing process. It is equally as important to account for money going out of the firm as it is to track revenue coming into the firm. Without this information, attorneys and firm administrators lack a true picture of the practice's financial well-being. Don't go into 2022 believing that your firm is more financially viable than it actually is, which could potentially lead to problems like inadequate cash flow and the inability to cover firm overhead.

For firms that do not track expenses monthly, it is useful to conduct an audit of all 2021 expense records to ensure that every cost is included in the year-end closeout. This not only helps with financial analysis and [budgeting](#) for the new year but also benefits the firm's accountant as they work to identify expenses that may be tax-deductible.

Settle Outstanding Debts

If possible, aim to settle all outstanding debts before closing out the yearly books. This includes all vendors that provide services or equipment to your firm, as well any contractors that the firm has outsourced duties to throughout the year. By settling these debts, firms benefit from a fresh start for the new financial year without residual expenses.

Perform a Bank Reconciliation

After all revenue and expenses are recorded, law firms should perform bank reconciliations to ensure that all financial records line up with bank statements. Any discrepancies need to be reviewed and investigated.

The best practice for this task is to reconcile monthly as soon as bank statements arrive. Otherwise, firms must contend with 12 months of bank statements in a short period of time, making it more challenging to identify errors.

Trust Account Reconciliation and Retainer Reviews

Most jurisdictions require law firms to reconcile client trust accounts on a monthly, or at least quarterly, basis. However, this does not negate the duty of completing year-end trust account and retainer reviews. An annual review is useful for double-checking reconciliations done throughout the year to ensure that no mistakes or miscalculations were missed. The ledger sheet for each client's trust account should line up completely with the corresponding bank statements.

In addition to trust accounting, firms should also review client retainer balances to determine which retainers need to be replenished. Firms should also ensure that all earned funds have been appropriately transferred into operating accounts from retainers held in trust.

Update Fixed Assets and Run Depreciation

Another task for closing the 2021 books is ensuring accurate and updated records of fixed assets. These are long-term assets with a usage life of more than a fiscal year that law firms use in the delivery of services.

Some examples of fixed assets that your firm may have acquired in 2021 include:

- New laptop computers for firm members working remotely
- Software needed for the operation of new computers
- Office furniture to accommodate social distancing needs
- Real estate to open a new law office location

If your law firm purchased any type of fixed asset over the past year, its financial details should be recorded, and its yearly depreciable value should be reviewed by an accountant or [accounting software](#). Calculated depreciations can potentially be written off as tax deductions.

Review Payroll Taxes

Law firms withhold payroll taxes from employees' earnings to pay taxes required by the state and federal governments. The amounts deducted and sent to the government vary depending on the employee's salary and wages. As a business, it is your law firm's responsibility to manage these taxes and ensure that accurate amounts are sent. A year-end closeout should include a review of payroll taxes to make sure that these tax liabilities accurately match your firm's quarterly payroll returns.

Verify Employee Records

Year-end is also an opportune time for processing 2021 employee W-2s and contractor 1099s, so it's important that firms ensure accurate records for all members. Firm administrators should verify employee and contractor information and make any necessary changes.

Run Financial Statements for Final Review

When all revenue, expenses, and data are finalized and entered, firms should run the following financial statements:

- Prior year Profit and Loss statement for comparison with current year Profit and Loss statement
- Accounts Receivable statement to review outstanding balances per month
- Cash flow statement to analyze cash flow changes by month
- The annual budget for comparison with actual financials
- Any other statements necessary to end-of-year tax purposes
- Time tracking records through the end of November for all firm members

The annual closeout also presents a good opportunity to review some firm practices related to [legal billing](#) and firm accounting. Firms can run [reports](#) related to [time tracking](#) and billing to ensure that all firm members have been recording tasks in a timely and comprehensive manner. This data can also reveal any delays in the process of converting tracked time into client invoices.

Close Your Books Securely

When all year-end financials have been analyzed and finalized, law firms can securely close their books. **This is more than a theoretical step, it is an actual process.**

For instance, some financial experts advise setting a lock date to prevent any additional changes or edits to the closed books. Firm leaders may assign a password for admin and accountants' access to ensure and maintain data integrity.

Once the books have been closed, pat yourself on the back (you've earned it) and get ready for 2022!

This entry was posted on Tuesday, December 21st, 2021 at 12:00 am and is filed under [Billing & Accounting, General](#)

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