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Your Guide to Legal Accounting Software

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What is law firm accounting?

Most law firm leaders do not enter the legal industry with an [accounting](#) background, but a basic understanding is important to inform decisions about [billing processes](#), the acceptance of payments, and trust accounting.

Simply put, you need to know about your law firm's financial performance. But, you also need to be able to meet your legal, regulatory, and ethical obligations, such as preparing your federal and state income tax returns and managing your clients' money. Accounting practices enable you to prepare financial statements, capture expenses, and [create budgets](#) and forecasts. The better you understand your [law firm's finances](#), the easier it will be to make smart decisions for your business and avoid legal and ethical headaches.

A lot goes into navigating the world of [law firm accounting](#). Let's explore some of those vital components:

Choosing the Right Bank

The wrong bank could create financial complications for your firm and result in serious legal problems.

When choosing a bank, consider the following:

- Is the bank approved to handle client trust and IOLTA accounts under applicable state guidelines and regulations?
- What security and fraud protections does the bank have in place to protect firm and client funds?
- What fees and limitations are associated with the banking accounts and related credit cards, including ATM, minimum balance requirements, and transfer fees?

Law firms typically need a business checking account for the management of general business revenue, a savings account to set aside money for taxes or emergencies, and an IOLTA account for holding client funds in trust.

Some law firms also choose to open a money market account to take advantage of a higher interest-earning rate, as well as a business credit card for strategic practice growth.

The Intricacies of Trust Accounting

For law firms that hold client funds in trust, the [IOLTA trust account](#) comes with its own set of detailed accounting rules and risks. Noncompliance can result in severe penalties, so it is important to understand the complexities of trust accounting.

With so many different rules in place, it can be challenging to stay on top of all of them. Even still, some mistakes show up more often than others, with the most common stemming from these IOLTA rules:

- No commingling of trust and business account funds
- No borrowing of money from the IOLTA account
- Avoid misapplying service fees
- Keeping inaccurate records
- Maintaining adequate reconciliations

Tax Obligations

As businesses, law firms must stay on top of their federal, state, and local [tax obligations](#). The specifics vary based on the type of practice, but most firms have a responsibility to pay the following types of taxes:

- Income taxes on law firm profits
- Payroll taxes for all firm employees
- Federal self-employment tax for attorneys who are self-employed

This is not an exhaustive list and firms may have a variety of additional tax obligations. As such, firms need a tax professional in their corner to help them navigate these vital responsibilities. For firms that do not have an accountant on staff, a contracted Certified Public Accountant (CPA) can offer valuable guidance for limiting tax liability.

Payroll

[Legal time tracking](#) is not an easy task, so law firm payroll poses challenges that do not exist within other industries. Firm members may have varied pay structures, which requires a payroll process that offers flexibility.

Payroll accounting includes components such as:

- Federal, state, and local payroll requirements
- Employee withholdings
- Reporting and depositing payroll taxes
- Disability and worker's compensation insurance
- Employee benefits

The rise in outsourced legal work adds another layer to payroll duties. Law firms should carefully categorize employees and independent contractors for taxation purposes.

Payment Processing and Collections

Once the invoices have been sent out, law firms need processes in place to actually receive

payments and manage collections. After all, there is nothing to manage if revenue is not going into the firm!

While most firms still accept cash and checks as payments from clients, online payment methods have become more common within the legal environment. This requires having a system in place to accept these payments, and the choice of provider could mean the difference between accounting success and failure.

Invoicing

Invoicing is arguably the most important part of law firm accounting, as it is the mechanism by which firms bill for the legal services they provide. Improper invoicing can have many negative consequences, including unbilled tasks, sporadic billing, and unpaid invoices.

Law firms can choose an independent legal billing system to handle invoicing tasks, but the most streamlined option incorporates [legal billing into a legal practice management system](#). With these platforms, firms benefit from advantages such as simplified approval processes, tracked invoice changes, and the ability to process numerous types of fee arrangements.

Some [legal practice management](#) software options include extensive data reporting capabilities so firm leaders can quickly access financial reports with just a few clicks of the mouse.

Should my legal practice management software include accounting features?

There's no doubt that your legal practice management software should include accounting features within the larger platform. In fact, this is one of the most common reasons that law firms choose to implement cloud-based software.

Legal professionals spend [time tracking billables and nonbillables](#). Management spends time reviewing revenue statements, budgets, pricing, and law firm expenses. Billing administrators spend time generating invoices and following up on delinquent accounts. By having legal practice management software that includes both billing and accounting features, you can streamline some of the most time-intensive, manual processes at your law practice. This software also lets management review billing and accounting data within the larger context of other law firm metrics.

Legal practice management software without any billing or accounting features leaves a gaping hole that management usually needs to fill with multiple platforms. This can confuse the data and your employees, and it typically creates more work for everyone. Plus, it usually results in an added expense for the law firm.

What are the most important features that law firm accounting software should have?

As you've probably gained from this post, law firm accounting can be challenging. But, it doesn't have to be another headache on top of the stresses of your law practice.

The first step is to put down the pencil and paper - or even the Excel spreadsheet. If you want to get really serious about your accounting, you need to ditch small business accounting platforms, like [QuickBooks that aren't designed specifically to meet small law firms' needs](#).

You need a [legal practice management platform](#) that includes full billing and accounting capabilities, making sure that you're able to track every last penny and satisfy your ethical obligations to your clients. To find a tool that's able to resolve your biggest accounting challenges and meet your firm's needs, look for a platform that is equipped with the following accounting features:

Organize the chart of accounts and trust accounting

Given the number of financial accounts in a law firm's financial ledger and the potential number of firm clients, it can be daunting to track them all in a standard bookkeeping system. Law firms must track assets, retainers, receivables, revenue, equity, expenses, and much more. A centralized repository that puts all of your bank accounts, operating accounts, and related information at your fingertips in real-time is essential.

Every lawyer knows that closely managing client trust accounts is an integral part of ethical (and legal) law firm billing. Billing and accounting software must be able to effectively manage [lawyer trust accounts that hold clients' funds](#) before they are earned. This includes tracking interest-bearing accounts (IOLTA) and three-way reconciliation with the asset sheet, trust asset account, and trust liability account.

Facilitate timekeeping and billable hours

Legal accounting and billing software must be able to accurately track billable hours and support [LEDES e-billing](#) practices. It's even better if the software has features to automatically detect timekeepers' billable hours, such as the ability to capture time for appointments or communications sent through the same platform.

Support flexible fee arrangements

Some law offices use flexible fee arrangements, depending on the client or type of case. To be effective, the accounting software should recognize various fee arrangements like fixed fees, contingent fees, and subscription-based payments.

Generate automatic invoices and payment collection

Generating invoices and collecting payments is one of the most time-consuming parts of legal billing. Software that can automate the billing process by automating and sending invoices to clients, facilitate edits and changes to bills directly within the system, and collect credit card payments through a secure system will cut down on the time that administrative staff spends on billing.

Prepare Billing and Accounting Reports

It's important for billing and accounting software to synthesize data and generate [reports](#) that give law firm management insights into the efficacy of billing procedures. These reports may include billable and nonbillable hours per timekeeper, client, or case as well as measures of attorney profitability.

Track expenses

Law firm billing and accounting are important because they tie directly to the financial success of the business. Legal practice management software must be able to track metrics related to big-picture finances like expenses, overhead, and cash flow so that management can pinpoint areas of success and opportunities for improvement.

Provide customizable features

Perhaps the most important feature of legal billing software is that it can be customized to support your unique business goals. For example, a legal billing solution might offer add-ons like billing templates, an app, a customizable dashboard to track relevant billing and accounting metrics, or the ability to create one-of-a-kind financial reports.

Features like these can make the difference between an inefficient accounting process that's prone to errors and bookkeeping and accounting systems that run like clockwork, enabling you to meet your ethical obligations and client trust account reporting requirements.

Takeaway

Mastering law firm accounting is no easy feat. However, the right legal accounting software can help you streamline these critical accounting functions.

If you keep the above components in mind and put them into practice, you'll be well on your way to navigating your firm's finances successfully and without penalty.

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