Speaker 1 (00:03):

Welcome to Vandenack Weaver legal visionaries podcast brought to you by interactive legal here's your host Mary Vandenack

Speaker 2 (00:12):

Welcome to today's episode of Vandenack Weaver, legal visionaries, a weekly podcast discussing updated legal news, evolving methods of providing legal service and law practice issues. My name is Mary Vandenack founder and managing partner at Vandenack Weaver, LLC. I'll be your host. As we talk to experts from around the country about closely held business tax trusts and estates, legal technology, law firm, leadership, and wellbeing. Before we start today's episode, I want to thank our sponsor. Here's the message from interactive legal.

Speaker 3 (00:51):

There's always a resistance to change, particularly with attorneys, attorneys like to look back at what's worked in the past, and that makes a lot of sense. But when you realize that with a good automated drafting system, you can do a better job for your clients. Deliver documents on a timelier fashion in a more consistent, in a more costly manner. If you're not a subscriber to interactive legal, I urge you to go to interactive legal.com and click on requested demo. And you'll be contacted about having a demonstration of interactive legal for you, which can be done right over the internet. Don't have to leave your office. No salesperson will call. We can arrange it at a time and convenient for you. So please go to interactive legal.com and click on request.

Speaker 2 (01:40):

Today's episode is going to be talking about financial controls for law firms. My guest today is John Bowers, John, and I go back a few days now and John's got a solid background in law practice. Having worked at a variety of firms that I'm proud that John has recently agreed to join our firm, but can you fill us in on your background, John?

Speaker 4 (02:03):

Yeah, absolutely. Thank you for having me, Mary. I'm excited to be here. Yeah, my background is not usual, but I did start in finance, that's the only place my heart lies. But 21 years ago, if you can believe that I, I joined the accounts payable department of a firm and have been in law ever since 100 massive firms to, the small law as I like to call it. And, business development has been a big portion of my background with leadership responsibilities all the way up through, um, and most recently, serving in an operational role and now serving in a strategic role with your firm.

Speaker 2 (02:54):

And so, we're going to talk today about financial controls in law firms. Now let's find it interesting, not just in law firms, that business, that the financial controls, which, you know, my, as you know, my background is accounting and finance. So that seems really basic to me, I'm surprised by the number of times that we talk to somebody or have a business or the number of times I've watched a bookkeeper or a business and had to say, do you guys have any financial controls here? And so that's where it, so can you just describe generally what we mean by financial controls?

Speaker 4 (03:28):

Yeah, I mean, in a nutshell, you know, I'm talking the standard operating procedures, that law practices use to monitor and protect how their financial resources are utilized now. that sounds boring, but it's quite interesting. And before we get into the specifics of the strategies and tactics, it's important to remember that every law practice is made up of people. And so, a very primary piece of the pie when it comes to financial controls is people management, more on that in a bit., but in short, I'm talking ensuring good financial stewardship of your law practice.

Speaker 2 (04:18):

So, in the technology arena, we have this concept called double factor authentication, right? Aren't essentially financial controls in part about the same type of thing. It's let's have a double factor authentication and finances. And that's a challenge, particularly in some of your smaller firms where you might have one person who's opening the mail, receiving the checks, things like that, is that kind of a basic of financial controls?

Speaker 4 (04:47):

Yes, very precisely put, um, because I think folks don't have the opportunity necessarily nowadays to get away from multi-factor authentication, but that is really at the heart of what we're talking about in terms of financial controls.

Speaker 2 (05:04):

And why does it matter so much? I mean, I think, you know, in my practice, the amount of theft that I see internally is downright frightening. And is this like, sometimes the it's not going to happen to me thing going on that it's not taken with the seriousness that maybe it ought to be.

Speaker 4 (05:25):

Yeah, I think that's part of it. I think its amount and amount of overwhelming responsibility that folks have. A friend, a lawyer friend of mine who runs say malpractice boutique, in St. Louis, always says that financial fraud, 95% of the time are the people where he at is caused by the people working at the place. So, yeah, the, the important part of this is to understand that the right hand knows what the left hand is doing to protect people, and of course the resources as well from fraud. The other part of it that that should be very compelling is that maintaining cash flow performance is also at the heart of this again, if, if you have a variety of people touching the money coming in or going out the door, the efficiency slows down, which of course Ben has a problem when it comes to profitability.

Speaker 2 (06:36):

Can you just explain, so you and I both have the financial backgrounds and understand what cashflow performance means, but some listeners might not? Can you just clarify what you're saying when you use the term cashflow performance?

Speaker 4 (06:49):

Absolutely. Yeah. So what you want ideally is for as soon as the work is performed in law practices, that's time being entered not necessarily, the finish of a case or a transaction, but the time from the time that the work and the time is entered into a billing system to the time that the money is coming into the door should be as optimized as possible. Some sometimes that's just not the case. And, and we'll talk about that in a later podcast in terms of billing policy The cash optimization also is a function of not just decreasing expenses but making sure that if you don't have to pay a big bill right now, you're holding onto it as long as you can, um, on the going out the door. So that's my take on it. What would you say, Mary? I'm sure you've got your opinions on that.

Speaker 2 (07:56):

Well, I kind of agree with what you just said in that, you know, there's a couple things, so we have like, and again, we're going to do billing on a different podcast, but a contemporary time entry policy, because you've got to get the time in. And I think the stats are, if you don't enter that time, contemporary, obviously you lose some large percentage. But the other thing that we do is we tell everybody the last week of the month that enter all client disbursements, get them all in because you know, there's nothing that's more annoying because we close our period at the end of the month. There's nothing more than an annoying. Then we get this pile of client dispersant requests that are, you know, can be significant amounts of money on the first after we've just closed our cycle. So, we kind of have a policy where we do a cutoff a few days ahead, and then we only make payments a couple of times.

Speaker 2 (08:44):

And we have a process where we review and say, exactly what you said is does that, when does that expense have to be paid and make sure it fits within that policy? Those are some of the things. What would you say are some of the basic financial controls? And what I'm hearing is we're talking this isn't all about the financial controls are kind of all-encompassing with respect to a law firm. And I think sometimes we think about it as financial controls to prevent theft on the checking account, but it's really, let's make sure that we don't have fraud and that we don't get, you know, money stolen out of the checking account. That's one, let's make sure we don't have the bookkeeper stealing funds. Let's make sure we don't have somebody who's setting checks on their desk or shoving them in a desk drawer, which I've had happen rather than getting those deposited. And then as saying, the resources in the law firm is the time. So, we need to get that time entered. We need to figure out how to make sure the expenses are getting paid. It's, it's a big picture thing. But if we start with just some, you know, basic, what would you identify as the top three financial controls or, you know, whatever number you might want to recite a standard. These are like, if you don't have financial controls in place, this is what you ought to do today.

Speaker 4 (10:00):

Yeah, definitely, and primarily, and this is where it gets a little bit uncomfortable for the firm owners, is that there must be a periodic review of financial statements. Yeah, that's boring and many lawyers sometimes are very uncomfortable when it comes to looking at that sort of thing. But that level of financial literacy is unbelievably important. Because like for your example of the client advances, if on the same amount of cash flows, I end the balance sheet for that matter. Client advances just continue to add up. All that means is the firm is acting as a bank holding company holding on to more cash. It's like, a manufacturing company, not caring about the amount of inventory that it was carrying on the shelves rather than simply selling it. We're not building it in the first place.

Speaker 2 (10:58):

And I think sometimes some firms forget the IRS says that to the extent you're advancing funds on behalf of a client, that's a, an asset it's not an expense, so you can't even deduct it. So that becomes particularly important. If you get to the end of a tax period and you've written a bunch of checks, you can expense it. You might be out cash and not be able to take any deductions for that. Right.

Speaker 4 (11:23):

Exactly and we have a little party that I start every year in September to try to rush those things through and or say, Hey, we might as well write this off now so that we aren't getting taxed on it the other another really practical thing that seems basic, but people have to revisit it at least annually is who has check signing authority. Oftentimes the old named partner has check signing authority and is in Barbados for most of the year so you have to make sure banks still are checking that you have to make sure that the person who is handling the money when it comes in, does not have check signing authority on any money that's going out. The another basic, thing that is often overlooked or just isn't formal enough is that bank reconciliations are for both operating and trust accounts are, are reconciled monthly. It’s amazing to me again, how cash will we can become with the firm's money, but also when it comes to trust other people's money and so it's deeply, deeply important to just have some really formal measures in place to make sure that you're being a good steward,

Speaker 2 (12:50):

See you on the check signing authority. One of the cases I had for a client was the officer, the trusted office administrator, who I'd been warning them about for about five years, had this policy where, so they had three partners and each of the partners had the authority to sign checks. And that was so that if one of them was in Barbados, somebody else could sign a check, right? No, what the office administrator did was to go around and she would write a check to American express and have partner one sign it, she would write another check to American express and she would have partner to sign it. But the second check was for her own account to which she was charging, you know, trips to, uh, Spain and such. And so that, you know, I run into that and I will tell you how we've addressed that we've addressed that, that any requests for checks of a certain amount copy all of the partners and that we have an authority that if I'm available, I sign, I approve and sign the check and if I'm not available. So, we kind of have an order on that to prevent that type of theft. Are there any other thoughts that you might have on that one?

Speaker 4 (14:02):

Well, I love that because again, everybody is aware that that's what it is, is everybody's just aware that we've got these matters in place and people are playing by those roles.

Speaker 2 (14:14):

We are going to take a brief break from our episode for a word from one of our sponsors, Carson, private client

Speaker 5 (14:21):

Wealth planning focuses on liquidity management and charges you a fee based on a percentage of your assets. But entrepreneurs typically invest in their business resulting in light liquidity. That requires a unique strategy at Carson private client. We provide a proactive and holistic strategy for building and protecting your wealth. Our mission is to alleviate the stresses and the burdens of coordinating all those financial strategies. Carson, private client will work with your current team of advisors to customize a strategy that manages all aspects of your life and wealth, giving you back the time to focus on what matters most complex needs require sophisticated solutions. Reach out to our office at 4 0 2 7 7 9 8 9 8 9 to schedule your consultation. Investment advisory services offered through CWM LLC, and sec, registered investment advisor.

Speaker 2 (15:21):

Okay. Let's continue our episode and the whole issue of bank reconciliations. And I know like, you know, I have a 26-year-old son who doesn't even know how to reconcile a bank account. He just looks on, I think the whole online thing is part of that, right? It's how do you, you know, they just look at my son, looks at his account and says, oh, I have a hundred dollars. And then I guess I can go to run a hut and have a run it today. Right. But in a law firm that just doesn't make sense. So, what do you think it is? Why does a basic like that couldn't or ignored?

Speaker 4 (15:53):

Because everyone's busy doing higher order things and usually if there's a controller or at, you know, say mid-sized firms and accounting department they're all scurrying doing these things that are the finesse pieces that do need to get done in order to affect positively the bottom line profitability, but the building blocks get overlooked because it's far more interesting to, you know, research transactions that haven't gone through that are big dollar amount than it is to just run the racks from lab. So, there's certainly there certainly is an age aspect to it as well. Some people of a certain generation have never actually had a checkbook and gone line by line to make sure that everything that they paid out of their checkbook, it was in fact what has come out of the checking account and you know, there's a variety of reasons for that, but that's where, you know, leadership has to come in and it's a very simple way to measure, Hey, have we closed the books in the last month yet?

Speaker 2 (17:18):

So, you know, one of the things that's gotten common is the electronic banking. And I will tell you that that's one place where I have not yet gone to as much as I'm paperless and tech oriented in every other manner. I have not yet loud electronic payment of expenses, because I don't know how you control that once you have a login and password and you have the ability for somebody to transfer funds. So, what is, how can you control that

Speaker 4 (17:49):

Important to have multiple people have access to the same account and accounts? Let's be honest because usually there's at least an operating and a trust account. Um, and so you got to make sure that you have more than one person having, access to that. Additionally, you've got to make sure more than ever that the bank recs are being done, because if it's out of sight, it's out of mind and the pace that that picks up with digital banking becomes obscene. And so, again, it, that's why it's so important to have the building blocks, select check bank rec done every month. So, you, you have multiple people who have access to each account. You have one person that has overarching authority on , you know, the, let's say a releasing of money of funds who has to again be different than the same than the person who is scanning in the funds or making deposits in some way.

Speaker 4 (18:59):

A great example of that and in a lot of intellectual property practices are the foreign counsel transactions where you've got, you know, a law firm in Italy making putting together, invoices for work that you've asked them to do for a given client. They go ahead and do that. And when they invoice you've got one person who's on the intake side and making sure that, you know, all of the payments lined up entering it into the electronic banking system in one way or another, and then a different person who is scheduling it for payment. Again, you know, there, there's probably some way coming down the pike that is going to optimize all of that but clearly a, the safest way is always to have multiple people involved again, not, it does make it less efficient, but it's, uh, it's that that's kind of the spectrum when it comes to financial controls. Um, the more people you have involved, it's less efficient, but certainly it's safer. And so, you want to try to find that good balance between efficiency and security

Speaker 2 (20:17):

I have until recently; we'll admit that I've continued to force myself to sign all the checks. And I have to tell you that part of it's not about financial control, well, not financial control in terms of you're not paying to American express accounts, but in terms of it gets me to look at the amount we're spending for each thing and sending questions back, like, why are we paying this pillow, right? And that's, you know, that's best done by somebody else at the law firm now, but historically that was, you know, founded the firm in 20 0 5. And that was always what really helped. And, you know, I found just simple things. Like I found, you know, I had a gal who was ordering supplies and I think she just liked to shop online. And we are just this small firm and our supply budget was getting outrageous. And so, then I set a budget for supplies and I think it was like 500 bucks a month. And that has been my budget all these years later. And we never go over. It's like, here's the maximum you can spend on supplies, but signing those checks does that for me. So, what type of like, you know, we've talked about some obvious financial controls, what would be some examples of some less obvious that people don't think about as much,

Speaker 4 (21:29):

The gold standard, which is hard for, especially for smaller practices to wrap their brains around it, certainly having credit, worthiness checks done on clients before engaging them. There's a reason why, the big law firms getting taken for a ride by bad clients, makes headlines, but that's literally only the dollar out quantitatively in terms of how often that happens. You probably have way more smaller firms been taken for a ride it's just less money. And so it's really important for firms to, you know, hire one of these outside, institutions like a Dun and Bradstreet and others who can run, weekly, if not more often, clients and their credit worthiness through the chipper and spit out a bill of health because it's just, again, good stewardship secondarily, in this digital world, it's easy for us, um, just like bank recs to get away from the building blocks of good compliance.

Speaker 4 (22:52):

So, you know, many law firms, again, to speed up, to optimize the cashflow have begun, accepting each check as well as, credit cards. And that's great. I'm a huge believer in it but depending on your acceptance program you may or may not be asked to, do a PCI compliance payment card industry, I think is PCI, compliance check every year which is really a function of how you're collecting the information, what you're doing with it, who has access to it, et cetera. And what's important about that is you should never, ever write down anyone's credit card information, much less email it, even just to yourself so that you can run the transaction biter. It literally is a function of you do it real time on the system where you call the person back and when you can get to the system, um, but too many places are sending around their client's credit card information to a variety of folks within their practice.

Speaker 4 (24:14):

And then secondarily, just because you accept credit cards doesn't mean it shouldn't mean that every single person in your practice is able to, run the credit card transactions. I mean, again, that would be the equivalent of everybody being able to sign checks. It's obvious for those of us who have been in the industry long enough to realize that's a stupid mistake, but we have people say, well, you know what, whoever happens to be around can buy, if we all know how to do it and have access to the system should be a huge warning sign to folks. And so, you know, it seems like it's far-fetched and say, you're right in the crossheads and you got nowhere to go.

Speaker 2 (24:59):

So, a lot of times what I see and working with clients is that there's a problem that exists with financial controls and it takes a long time to figure it out. What is the kind of the early warning signs? How do you know when there's a problem?

Speaker 4 (25:15):

Well, I would say primarily, and just kind of goes back to one of those initial basic things is review of financial statements on a periodic basis. Hey, look, if you can't come up with a financial statement, let's say even just monthly, then, then there's probably an issue and this, the stank starts to pervade the REM, right. And so, that is one of the foundational reasons it's not to try to make, lawyers feel like they don't know what they're doing by looking at financial statements. It's more to be able to demonstrate the fact that yeah, the financial statements are in order and thus, so as the house. And so when, when, there's a delay on those it's time to start digging, in exactly the same context as we've discussed before, when, when you have yearend closing in and in order to get taxes done, you've got somebody staying late to nudge, nudge, wink, blink, to do all of the bank recs for past months, like six to eight at a time, six months at six to eight months at a time, uh, in order to close out the year properly and then file taxes by April 15th.

Speaker 4 (26:34):

There's definitely a problem and then I, I would say in a frankly more offensive vein when you have the folks at our practice who are making the most money, in terms of draw or salary those people having an exorbitant, we all have it, that that is a very subjective term on purpose, but exorbitant reimbursements, that none of the other folks who share equity in the firm are aware of that are running through, that that's a problem. And so, it shouldn't be so much a function of, Hey, you know, let's, let's all review each other's expense receipts, et cetera but it should be okay at the end of the year everybody who's an owner and owner. And if there's, if there's trust, let's at least just say, here's what the totals are in terms of expense reimbursements for the year. Now, if you have some person whose client in Europe, is having them come over four times a year, well, that explains what the issue is, and that's not exorbitant necessarily you know, I think we all have a decent gauge on what that threshold of exorbitant city has , and I think, you know, that those are good conversations to have a lot of practices, though. They are unbelievably outcome,

Speaker 2 (28:08):

They are unbelievably uncomfortable. And one of the things that we design into our agreement share our member agreements is that generally any reasonable expense can be run through, but, you know, if does ever get disallowed by the IRS, you're paying the expenses of the audit and you're reimbursing for the cost of it. And there's been some changes in the rules about how expenses can be run through and the impact if it, especially if it's a partnership that we won't cover today, but is worth just knowing well, John's, you know, I'm a freak about financial controls always have been, you know, watching businesses that I represent and the lack of control, and then a couple of law firms that I had had exposure to. So, if there's a law firm who says, Hey, you know, we really do need to dig into having some better financial controls. Are there some good resources?

Speaker 4 ([28:59]()):

Absolutely you know, just, just stuff that you can dig up online for starters is really simple and, you know, oftentimes it can be helpful to have resources that are not, you know, legal related. And so corporate finance Institute is, is an obvious and basic one, but it's still very rich in terms of content local business schools. I mean, they're all over the country, obviously but I think that there are, there are absolutely, you know, good courses that they offer even online nowadays, that could be extremely helpful for owners of law firms and others when it comes to legal, luckily ABA does a fabulous job with, webinars and education, especially, you know, the law practice division that Mary and I both belong to a little advertisement for the American bar association but in addition to that, the practicing law Institute and competitor, frankly, probably of the American bar association they do an annual if not more often, presentation on financial statements for lawyers and yeah, may get a little boring, but it's good to know, and a good refresher.

Speaker 4 ([30:30]()):

And then finally, in terms of in terms of items, you know, we always are thinking, well, you know, how do we educate the lawyers? Look, there's no reason why your financial staff also couldn't, attend either the ABA programs or the PLR programs, but specifically, there are some great programs on financial management and controls that are offered by the association of legal administrators. In fact, there is a, there are two multiples, um, session courses that they offer on, uh, financial management. I've been through it twice, because it's so good and it's taught by folks in the profession for the profession and they're all non-lawyers. Not that lawyers couldn't get something out of that as well, but there's plenty of,

Speaker 2 ([31:22]()):

And I'm pretty avid about having those that are involved in the financials that are non-lawyers get a lot of training, but I do also think there's can be a tendency to over delegate and not pay close enough attention by the owners of the firm sometimes. So, I think it's super important that those financial discussions, financial statement reviews occur well, John, thanks a lot for being on the podcast today. I really appreciate your presence

Speaker 4 ([31:49]()):

There. You're welcome. Thanks so much

Speaker 2 ([31:52]()):

As we get to the end of our episode, I want to thank our sponsors, interactive, legal, and Carson, private client. That's all for now. Thanks for listening to this week's episode and stay tuned for our weekly releases,

Speaker 6 ([32:09]()):

Hurrdat media production.