Industry insights

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Streamlining the year-end compliance process from a CPA perspective

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For most law firm administrators, an unavoidable but critical part of law firm management is coordinating with your CPA to meet the compliance and due diligence requirements associated with your year-end reporting. Whether that includes complying with federal, state and local taxes, and/or meeting the financial statement requirements of your firm, it can be a time-consuming process. Upfront planning and preparation can go a long way toward helping streamline this process and make it smoother for both you and your CPA. Below are several insights into common compliance complexities for law firms based on our experience and observations.

> **Be prepared.** In advance of the year-end work, spend time with your CPA to understand their documentation requests and explain your expectations for completion of the work. Allow adequate time for you and your accounting personnel to prepare and review account reconciliations for all significant accounts, including cash, fixed assets, accounts receivable, and payable. In particular, ensure that bank reconciliations (including trust accounts) are prepared and reviewed in a timely manner. This will be vital in catching errors and avoiding any unexpected adjustments. Your time spent reconciling and reviewing will improve your documentation and pay dividends through a quicker turn-around from your CPA, thus helping reduce costs and energy throughout the process.

> **State tax nexus.** As your firm increases and begins to perform services in other states, notify your CPA of these new activities to ensure that you understand the potential filing requirements or other obligations for those jurisdictions. Some important questions to answer include:

1. Where are attorneys working,
2. Where are your largest clients located, and
3. How is this data captured?

States are becoming increasingly more aggressive and sophisticated in their pursuit to capture additional revenue from the professional services industry. Additionally, states continue to create new rules and regulations, such as economic nexus rules, which could create a tax filing requirement for your firm even if you never set foot in the state and simply have a large contingent of clients that benefit from your services there. The state rules regarding filing requirements are sometimes unclear, so it is advisable to seek guidance for navigating these issues. The earlier you can identify your potential exposure, the easier it will be for you in the long run should tax compliance issues arise.

> **Unapplied cash.** Given the high volume of invoices issued by law firms, cash received from clients that cannot be directly associated with outstanding invoices can easily accumulate in your general ledger. This trend has increased in the past decade, largely due to the prevalence of electronic billing. Many law firms report on the modified cash basis of accounting for financial reporting, thus it is important to review and reconcile your unapplied cash account both during the year and especially at year-end to ensure the proper allocation of these unapplied funds and proper recognition for income tax purposes.

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- > **Property and equipment.** The tracking of significant purchases and disposals, as well as the proper calculation of depreciation and amortization of those assets, is a common trouble spot for law firms, often requiring accounting assistance and reconciliation. If disposals are not removed from the records in a timely manner, the firm could potentially pay too much personal property tax as a result. The tax code in recent years has only complicated this matter, with often different, complex calculations required for state versus federal depreciation. Properly training the accounting staff responsible for this recordkeeping and regularly reviewing and reconciling their work can help reduce much time and cost at year-end.
- > **Accounting process documentation.** Turnover within your accounting department can greatly impact the year-end process. Maintaining written documentation of the accounting processes within the firm, especially for month and year-end close procedures, helps employees understand their responsibilities and protects the firm from a system process breakdown when turnover does occur. It can also help you develop stronger internal controls and thus reduce the risk of fraud and other irregularities.
- > **Going paperless.** Technology continues to improve at a tremendous rate and many documents formerly stored in boxes at an offsite storage location are now maintained in electronic format. In some instances, however, rather than serving to improve the availability of source documentation, this process has reduced the level of documentation retained by accounting personnel and thus reduced the audit trail available for CPAs to follow. Related to the previous paragraph, it is important to adapt your accounting procedures to ensure the current technology is incorporated and a proper level of documentation is maintained, which in turn helps to create a smooth audit process at year-end.
- > **Managing alternative fee arrangements.** With increased competition and fee pressure, many law firms are being forced to provide clients with deep discounts, fixed fee, or capped fee arrangements. This trend continues to cause issues for law firms especially when there is a lack of communication between firm management and those agreeing to the arrangements. Success comes when law firm administrators are able to adapt to this trend and create formal procedures to fully vet and consider the profitability of these arrangements. Additionally, we recommend regular communication of the status of these alternative fee arrangements to all affected parties and management, to help further maintain transparency and oversight.

Whether the above tips and observations apply to your firm's circumstance or not, communicating with your CPA throughout the year regarding the firm's business can greatly enhance and improve the year-end process. It can help to control compliance costs and allow opportunities for your CPA to help serve you better as a business advisor to your firm.

About the author

Benjamin Wilhelm is a partner in Baker Tilly's professional services practice and is located in the Tysons, VA office. He has been with the firm for fifteen years, performing financial statement audits, reviews, compilations, internal control reviews, and tax services. Ben also has extensive experience performing employee benefit plan audits for a wide range of defined contribution and defined benefit plans.