

SPOT AUDIT: Your Practice - Financial Issues

As in any business, maintaining adequate books and records is an important control practice in the management of funds. It can prevent problems from occurring by identifying issues before they adversely affect your practice.

"Ultimately, maintaining accurate and current financial records for your trust and general operating accounts not only makes good business sense, but is required under the Law Society By-laws," says Leslie Greenfield, Manager of the Law Society's Spot Audit program.

The Spot Audit program's objective is to support and promote high quality law firm record-keeping practices that comply with Law Society By-laws. Designed as a pro-active compliance measurement and problem detection tool, the program:

- provides on-site and ongoing guidance and recommendations
- addresses members' questions and concerns
- shares information, knowledge, and best practices with members
- provides members with resources to assist in understanding and complying with By-laws 18 and 19

"One of our primary goals is to take a remedial approach by providing on-site guidance to members aimed at helping law firms correct minor deficiencies with record-keeping practices before they lead to serious non-compliance or misconduct issues," explains Greenfield.

"Over the past four years, the Spot Audit team has reviewed the books and records practices for thousands of legal firms. From this experience we've identified key areas of concern and have the following recommendations to help members properly maintain books and provide you with a starting point to perform a control risk assessment of your practice":

1. (Re)Assess Your Record Keeping Procedures and Internal Controls

Assuring compliance with Law Society standards is the responsibility of a firm's members, not its staff. If you are planning to delegate any of the responsibilities of financial reporting to non-members, you must ensure that they have access to, and fully understand By-laws 18 and 19. Internal controls should be set up to keep the members in the firm informed of financial issues and "in control" of funds held in trust on behalf of clients. These are procedures, adhered to by all staff, that designate duties and responsibilities for handling funds and preparing financial records. A good example of an internal control is a procedure that requires the signature of two members to issue a cheque from trust.

Firms should review their control procedures and make amendments on a regular basis to ensure the procedures serve an appropriate function within the firm. Spot Audit has designed a concise Internal Control Checklist, available online, that will enable you to evaluate a portion of your internal controls.

2. Organize Source Documents and Retain Records

Source documents (including, but not limited to: receipts, invoices, deposit slips, cancelled cheques and bank statements) record the firm's transactions with clients and third parties and are basic inputs in all financial record-keeping systems. An effective and efficient record-keeping system requires careful organization of these documents.

The minimum retention period of all source documents and reports produced by your firm is six to ten years (immediately preceding the firm's most recent fiscal year end), depending on the type of document/report. See By-law 18 section 6 for details.

3. Keep it Current

Current records and timely reports are a requirement under By-law 18. In any business environment, it is critical to have accurate financial information available at any given time. This requires that all transactions are recorded in your financial system as they occur, not when time

permits.

Using the information contained in the reports can help your firm prevent the occurrence of serious errors such as overdrawn client trust accounts and misapplied funds. Current records and reports can also provide early warning signals of any potential liquidity problems.

4. Understand Reconciliations

Each firm is required to produce a monthly report that compares the firm's total trust liability to clients, with the reconciled amount of trust funds controlled by the firm in bank accounts and other negotiable instruments (including GICs and estate bank accounts). According to By-law 18 section 5, this report must be completed each month within 15 days of the month's end.

The members of the firm are responsible for the amount of funds held in trust. If the report is not prepared by a member, it is essential that a member reviews this report in detail. Therefore, members should be aware of all reconciling items that appear on the report. A reconciling item is any item that causes a difference between the actual balance in your bank and the balance of your trust liability to clients (bank errors, service charges, outstanding cheques and receipts).

All reconciling items should be listed in detail, showing the amount, the date and a brief description. Members should question all items that seem odd, or that are carried on the report for more than one month. Members should ensure their accounting staff determine the cause of the recurring items and correct them. Some items may be as simple as bank charges, may relate to complex processing or posting errors, or could indicate a means to hide the misappropriation of funds. Cheques that have remained outstanding (uncashed) for over six months may become stale dated (not negotiable) and may have to be cancelled and reissued.

When comparing the firm's trust holdings to its trust liability, it is also helpful to skim through the individual client ledger accounts to identify debit (negative) balances, or amounts that remain unchanged for several months. Any debit balances should be investigated and resolved, either by correcting any posting errors, or by depositing the exact amount of the overdrawn accounts.

Unchanged balances should be reviewed to determine if the funds can be returned to the client or applied to billings previously sent to clients.