FM22: Sitting for the 2019 CLM Exam?

Greater Chicago Chapter
Financial Review Session

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Greater Chicago CLM Study Group Highlights

• No formal review class for CLM
• Currently the only study group available nationally
• 7 Members of Study Group passed in Fall, 2018
  • 85% pass rate for 2018 Study Group members
• Comprehensive 18 week study program
• Google Drive loaded with reference materials
• Weekly handouts and quizzes
• No cost to participants
Greater Chicago CLM Study Group Highlights

- Networking with ALA Members nationwide
- Personal attention from CLM Director
- Subject Matter Experts thoroughly cover:
  - Human Resources
  - Legal Industry
  - Ethics
  - Office Operations
  - Finance
    - Today will be our Finance Review Session

Financial Review Session

Spring 2019
Week 1

- Legal Entities
- Tax Forms
- Banking
- Separation of Duties/Internal Controls
- Retainer/Escrow/Trust Accounting
- Hard & Soft Costs
- RULES
- Payroll/Flex Spending/401(k)

### Legal Entities

<table>
<thead>
<tr>
<th>Entity Type</th>
<th>Pass-Through?</th>
<th>Tax Form</th>
<th>Personal Liability?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sole Proprietorship</td>
<td>Yes</td>
<td>1040</td>
<td>Yes</td>
</tr>
<tr>
<td>Partnership</td>
<td>Yes</td>
<td>1065</td>
<td>Yes</td>
</tr>
<tr>
<td>S-Corp.</td>
<td>Yes</td>
<td>1120-S</td>
<td>Some</td>
</tr>
<tr>
<td>LLC (Partnership)</td>
<td>Yes</td>
<td>1065</td>
<td>Some</td>
</tr>
<tr>
<td>LLP</td>
<td>Yes</td>
<td>1065</td>
<td>Some</td>
</tr>
<tr>
<td>C-Corp.</td>
<td>No</td>
<td>1120</td>
<td>No</td>
</tr>
<tr>
<td>Professional Corp.</td>
<td>No</td>
<td>1120</td>
<td>No</td>
</tr>
<tr>
<td>LLC (Corporation)</td>
<td>No</td>
<td>1120</td>
<td>No</td>
</tr>
</tbody>
</table>
# Retainers

<table>
<thead>
<tr>
<th>Retainer Type</th>
<th>Description</th>
<th>Revenue is Earned</th>
<th>Whose property?</th>
<th>Bank Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classic/Pure/True</td>
<td>Firm paid to be “On Call”</td>
<td>Immediately</td>
<td>Law Firm, non-refundable</td>
<td>Operating</td>
</tr>
<tr>
<td>Security</td>
<td>Prepayment for Future Services</td>
<td>When work is completed</td>
<td>Client</td>
<td>Trust</td>
</tr>
<tr>
<td>Advance Payment</td>
<td>Prepayment for Future Services</td>
<td>When work is completed</td>
<td>Law Firm, but refundable</td>
<td>Operating</td>
</tr>
</tbody>
</table>

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# Trust Accounting

- ABA Model Rule 1.15
- Must separate Client & Firm Funds
- IOLTA Account
  - Interest NEVER goes to the firm
  - Separate accounts for large client balances
- 3-part monthly bank reconciliations
- Consider bank “clearing” guidelines
Hard vs. Soft Costs

<table>
<thead>
<tr>
<th>Cost Type</th>
<th>Description</th>
<th>Examples</th>
<th>Financial Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hard/Direct</td>
<td>Paid directly on behalf of client</td>
<td>Filing Fee, Transcript</td>
<td>Balance Sheet</td>
</tr>
<tr>
<td>Soft/Indirect</td>
<td>Allocated Indirectly</td>
<td>Photocopies, phone calls</td>
<td>Income Statement</td>
</tr>
</tbody>
</table>

“RULES” for Profitability

- Realization
  - Billing, Collection, and Total
- Utilization
- Leverage
- Expense Management
- Speed of Billing & Collections
Week 2

• GAAP & Accounting Methods
• Financial Statements
• General Ledger, Trial Balance, Journal Entry
• Debit & Credit Cheat Sheet
• Fixed Assets & Depreciation
• Net Income vs. Distributable

Accounting Methods

<table>
<thead>
<tr>
<th>Method</th>
<th>Description</th>
<th>Common Uses</th>
<th>Accruals &amp; Deferrals?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrual Basis (GAAP)</td>
<td>Revenue/Expense recorded as earned/incurred</td>
<td>Audited Financial Statements</td>
<td>Always</td>
</tr>
<tr>
<td>Cash Basis (Tax)</td>
<td>Revenue/Expense based on cash inflow/outflow</td>
<td>Small companies and tax returns</td>
<td>Never</td>
</tr>
<tr>
<td>Modified Cash (Management)</td>
<td>Hybrid, used by most firms</td>
<td>Most law firms</td>
<td>Sometimes</td>
</tr>
</tbody>
</table>
Financial Statements

- Balance Sheet (All Firms Use)
  - Snapshot of Firm’s financial position at a specific date
- Income Statement (All Firms Use)
  - Accounting for revenues/expenses over a period of time
- Cash Flow Statement (Many Firms Use)
  - Accounting for cash in/out over a period of time
- Statement of Changes in Equity (Few Firms Use)
  - Accounting for changes in Capital over a period of time

Building Financials

- Financial Statements made by Chart of Accounts
- Accounts are built on individual transactions
- Transactions are recorded as Journal Entries
- Journal Entries are recorded as Debits & Credits
  - Debits are shown as positive number
  - Credits shown as negative number
- JE’s have equal and offsetting Debits/Credits
Debit/Credit Cheat Sheet

<table>
<thead>
<tr>
<th>Account</th>
<th>Financial Statement</th>
<th>Increase</th>
<th>Decrease</th>
<th>Example Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset</td>
<td>Balance Sheet</td>
<td>Debit</td>
<td>Credit</td>
<td>Cash</td>
</tr>
<tr>
<td>Liability</td>
<td>Balance Sheet</td>
<td>Credit</td>
<td>Debit</td>
<td>Accounts Payable</td>
</tr>
<tr>
<td>Equity</td>
<td>Balance Sheet</td>
<td>Credit</td>
<td>Debit</td>
<td>Capital</td>
</tr>
<tr>
<td>Revenue</td>
<td>Income Statement</td>
<td>Credit</td>
<td>Debit</td>
<td>Fee Receipts</td>
</tr>
<tr>
<td>Expense</td>
<td>Income Statement</td>
<td>Debit</td>
<td>Credit</td>
<td>Salaries</td>
</tr>
</tbody>
</table>

• Receive a $1,000 Fee Payment from Client
  • Debit Cash $1,000
    • Credit Fee Receipts ($1,000)

Depreciation Terms

• Asset Cost
• Residual Value
• Depreciable Life
• Mid-year vs. Mid-month
• Straight-Line Method
• MACRS
• Sum-of-the-Years-Digits
• Section 179 Election
Week 3
• Budgeting & Variance Analysis
• Leases
• Equity Financing

Types of Budgets
• Revenue
• Expense
• Operating
• Capital
• Cash
• Master
• All of these can be built 3 ways
  • Top-Down
  • Bottom-Up
  • Zero-Based
Variance Analysis

- Static vs. Flexible/Variable Budgeting
  - Static – Single Budget
  - Flexible – Multiple “What-If” Scenarios

- Single Period vs. Multi-Period vs. Rolling
  - Single Period – Budget for 1 month/quarter/year
  - Multi-Period – Budget for several cycles
  - Rolling – Constant process, dropping off most recent period and adding one more future period

Lease Classification

<table>
<thead>
<tr>
<th>Lease Type</th>
<th>Financial Statement</th>
<th>Cancelable?</th>
<th>Payments Fully Tax Deductible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating (Financial)</td>
<td>Income Statement (And Footnote Disclosure)</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Capital (Financial)</td>
<td>Balance Sheet</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>
4 Part Lease Test

- **Capital Lease** if ANY of the following is “Yes”
  1. Is Ownership transferred?
  2. Is there a Bargain Purchase Option?
  3. Is lease term >= 75% of asset’s useful life?
  4. Is Net Present Value of lease >= 90% of asset cost?
- **Operating Lease** if ALL of above are “No”

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**Week 4**

- Financial Ratios
- Financial Statement Analysis
- Fixed vs. Variable Costs
- Alternative Fee Arrangements (AFAs)
- Other Accounting Terms
- Allocating Firm Time & Resources
### Key Financial Ratios

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Category</th>
<th>Purpose</th>
<th>Formula</th>
<th>Typical Use</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quick (Acid Test)</td>
<td>Liquidity</td>
<td>Quick Debt-</td>
<td>(Cash + AR) / Current Liabilities</td>
<td>Will firm run out of $</td>
</tr>
<tr>
<td></td>
<td></td>
<td>paying ability</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current</td>
<td>Liquidity</td>
<td>Short-Term</td>
<td>Current Assets / Current Liabilities</td>
<td>Will firm run out of $</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Solvency</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt</td>
<td>Debt</td>
<td>Financing Strategy</td>
<td>Total Debt / Total Assets</td>
<td>Bank loan analysis</td>
</tr>
<tr>
<td>Equity</td>
<td>Equity</td>
<td>Long-term solvency</td>
<td>Owners’ Equity / Total Assets</td>
<td>Merger analysis</td>
</tr>
<tr>
<td>Gross Operating</td>
<td>Profit</td>
<td>Value of a client</td>
<td>Gross, Operating, or Net Profit /</td>
<td>Should firm keep a client or matter or timekeeper</td>
</tr>
<tr>
<td>Net</td>
<td>Margins</td>
<td>or timekeeper</td>
<td>Revenue</td>
<td></td>
</tr>
</tbody>
</table>

### Types of Analysis

- **Cross-Sectional**
  - Compare Firm’s performance to peers
- **Time-Series**
  - Compare Firm’s performance to itself over time
- **Cross-Sectional, Time-Series**
  - Compare Firm to peers over time
AFAs

- Hourly Billing does not incentivize efficiency
- AFAs can benefit clients and/or firms

<table>
<thead>
<tr>
<th>AFA Type</th>
<th>Description</th>
<th>Firm Benefits If:</th>
<th>Client Benefits If:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flat/Fixed Fee</td>
<td>Set charge no matter hours</td>
<td>Takes fewer hours than budgeted</td>
<td>Takes more hours than budgeted</td>
</tr>
<tr>
<td>Capped Fee</td>
<td>Hourly billing until cap is hit</td>
<td>Never</td>
<td>Takes more hours than budgeted</td>
</tr>
<tr>
<td>Contingent Fee</td>
<td>Fee earned if outcome achieved</td>
<td>Fee is earned and takes fewer hours than budgeted</td>
<td>Outcome is not achieved</td>
</tr>
<tr>
<td>Risk Collar</td>
<td>Hourly Billing within a budget</td>
<td>Takes fewer hours than “collar”</td>
<td>Takes more hours than “collar”</td>
</tr>
</tbody>
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Study Group Checklist

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<tr>
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<td>General Ledger</td>
<td>Financial Analysis</td>
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<td>Retainer / Trust</td>
<td>Debit &amp; Credit Cheat Sheet</td>
<td>Fixed &amp; Variable Cost</td>
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<td>Fixed Assets &amp; Depreciation</td>
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<td>RULES</td>
<td>Net vs. Distributable Income</td>
<td>Accounting Terms</td>
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<tr>
<td>Payroll / 401(k)</td>
<td>Budget &amp; Variance Reports</td>
<td>Allocating Resources</td>
<td></td>
</tr>
</tbody>
</table>
Questions?

Interested in Joining?

Greater Chicago ALA CLM Study Group sessions run twice yearly
Contact: Rita R. Nielsen, CLM, PHR, SHRM-CP
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Phone: 312-201-2220

“The Greater Chicago Chapter CLM Study Group Program was indispensable to my success in passing the exam. It was extremely well thought out and covered every necessary component for the certification.”

Amy L. Kempster, MBA, CLM
Support Administrator at Davis Graham & Stubbs LLP, Denver, CO