

INTERNATIONAL JOURNAL FOR LEGAL RESEARCH AND ANALYSIS



Open Access, Refereed Journal Multi-Disciplinary
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ACCOUNTING IN LEGAL FIRMS

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INTRODUCTION

Accounting is the system of recording financial transactions using numbers and text in the form of financial statements. It's the process of measuring, processing, and sharing financial or even non-financial information about businesses and corporates. It simply means keeping record of events happening in an entity. An entity may be of different types, such as, sole proprietorship, partnership firms. HUF, corporates etc.

The topic of this project report is accounting in legal firms. This work identifies what is the necessity of accounting in a legal firm, who are the users of such accounting information, what are the various domains of accounting in a law firm, legal aspects of such accounting process, what are the rules which are applicable solely to the accounting of legal firms etc. The importance of accountancy in a branch of study which requires expertise in numerous laws enacted by the legislative bodies are often undermined. But even though the field is entirely different from accounting, costing or even taxation, an ordinary prudent man who owns an establishment always try to reduce their expenditure, maximise the profits, and provide the best quality services to his clients. This is exactly the same objective a legal firm accomplishes through the accounting process.

The firm would be able to control and reduce their cost by analysing the previous years expenditures, designing a budget system, anticipating its expenses in the coming financial year, ascertaining the performance gaps, and adopting various methods to reduce those gaps. The firm would be able to improve its profits by analysing the receipts in the previous year, setting a performance target, and devising various policies to achieve the same. By maintaining proper accounts of each client, there won't be conflicts regarding fees receivable, the payment of court fee or anything other legally payable public duties.

CHAPTER 1

BASICS OF

ACCOUNTING

1.1 WHAT IS ACCOUNTING?

The committee on terminology set up by the American Institute of Certified Public Accountants in 1961, formulated the definition as elaborated below:

Accounting is the art of recording, classifying, summarising in a significant manner and in terms of money, transaction and events, which are in part at least as of financial character, and interpreting the results thereof.

As per this definition, accounting is simply an art of record keeping. The process starts by identifying the events and transactions which are of financial character, and then be recorded in the books of accounts. It's done in the primary books. Then, they are transferred to secondary books by classifying the information recorded in the primary books and then that information are summarised in the final accounts.

However, the above mentioned definition lacks the current view of the accounting process. Because, the definition ends with interpreting the results. But now a days, one of the most important aspects of accounting is communicating those results with the users.

Therefore, the American Accounting Association in 1966 treated accounting as :

“The process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the users of accounts.”

In 1970, the Accounting Principles Board of American Institute of Certified Public Accountants enumerated the functions of accounting as follows.

“ the function of accounting is to provide quantitative information, primarily of financial nature, about economic entities , that is needed to be useful in making economic decisions .”

Thus, combining all of the definitions above mentioned , it is concluded that :

Accounting is the process of,

- Recording, classifying, summarising, analysing and interpreting financial transactions &
- Communicating the results thereof to the persons interested in such financial information (users of financial information).

1.2 WHAT IS BOOK KEEPING?

Book keeping is an activity concerned with recording financial data related to any business operation in a significant and orderly manner. It embraces the record keeping function of accounting process. A substantial portion of the book keepers work is of a clerical nature and is increasingly being accomplished with the automation of accounting process by the introduction of electronic and computing devices.

For sole proprietorship and partnership business, there's no legislation regarding the maintenance of books of accounts. However, the Income tax Act of 1961 requires maintenance of books of accounts for certain purposes. But the Companies act and the Cooperative Societies Act contains special provisions for preparing and maintaining books of accounts.

1.3 DISTINCTION BETWEEN ACCOUNTING AND BOOKKEEPING

SL.NO	BOOKKEEPING	BOOKKEEPING ACCOUNTING
1.	It is a process concerned with the recording of transactions.	It is a process concerned with summarising the recorded transactions.
2.	It constitutes as a base of accounting	It is considered as a language of the business
3.	Financial Statements do not form part of this process.	Financial Statements are prepared in this process on the basis of the book keeping records.
4.	Managerial decisions cannot be taken with the help of these records.	Management takes decisions on these records.
5.	There are no sub fields of book keeping.	It has several sub fields of accounting like, financial accounting, management accounting
6.	Financial position of the business can't be ascertained through book keeping records.	Financial position of the business can be ascertained through accounting records.

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1.4 OBJECTIVES OF ACCOUNTING

The fundamental objectives of accounting are as follows:

1) *Systematic recording of transactions:*

When the financial aspects of business transactions are systematically recorded, it helps for the preparation of financial statements

2) *Ascertainment of results of the above recorded transactions:*

The preparation of profit and loss account from the above recorded transactions help the organisation to know whether they are running in profit or not. ie, if the revenue is more than the expenses, its profit and if its otherwise, it is said to be loss.

3) *Ascertainment financial position of the business*

Accounting helps a business man to know what he owes (liabilities) and what he owns (assets) till date. That is why the Balance sheet is prepared in accounting. It is a statement showing these two aspects at a particular point of time and helps in ascertaining the financial health of the business enterprise.

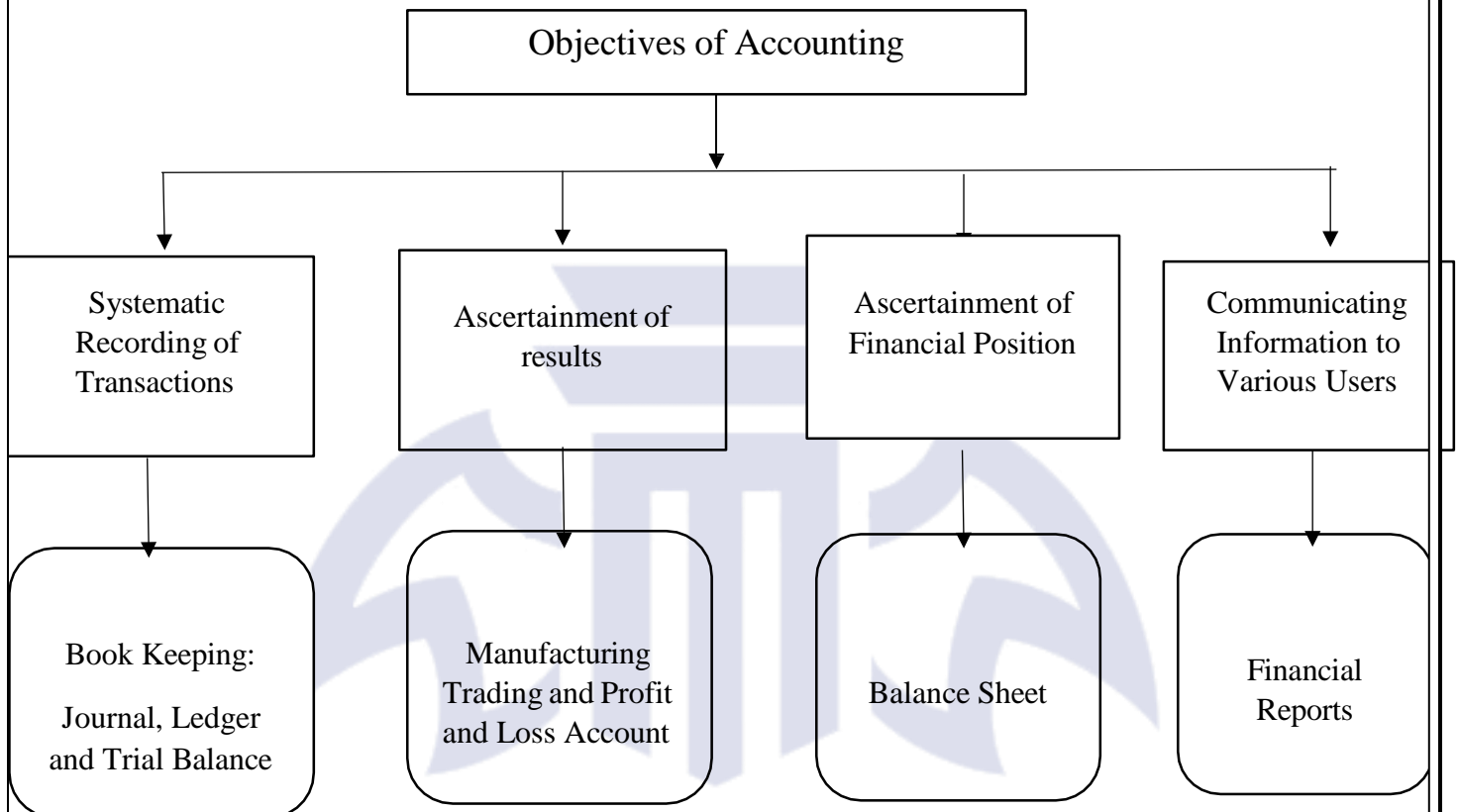
4) *Providing information to the users:*

Accounting can be considered as a language of business which communicates financial information of an enterprise to various stakeholders by means of financial statements. This helps these decision makers to make rational decisions based on the information communicated.

5) *To know the solvency position:*

By preparing the financial statements, information regarding the solvency shall also be communicated. ie, the concerns ability to meet its liabilities with its assets in the long run (solvency ratio) and in the long run (liquidity ratio)

An overview of the objectives of accounting is depicted in the following chart.



1.5 ADVANTAGES OF ACCOUNTING

The art of accounting has multiple folds of advantages. They are positive results in the firm if proper and regular accounting is carried out. Some of them are listed below.

1. *Maintenance of business records:*

The proper maintenance of financial events happening in the business organisation are recorded regularly thereby, regular business records are maintained in the organisation.

2. *Preparation of financial statements:*

Financial statements like Trading and profit and loss account, Balance Sheet can be prepared easily if there is a proper recording of transactions.

3. *Comparison of results:*

It facilitates the comparison of the financial results of one financial year with another financial year with ease. It also facilitates analysis of the systematic recording of all the financial transactions according to the policies of the entity.

4. *Decision making:*

Accounting information enables management to plan its future activities, make budgets and coordinate various activities in various departments.

5. *Evidence in legal matters:*

The proper and systematic records of the financial transactions act as evidence in the court of law.

6. *Provides information to related parties*

It makes the financial information of the organization available to stakeholders like owners, creditors, employees, customers, government etc. easily.

7. *Helps in taxation matters:*

Various tax authorities like income tax, indirect taxes etc depend on the accounts maintained by the management for settlement of taxation matters.

8. *Valuation of business:*

An entity's business accounting information can be utilized to measure the value of the entity in the case of sale of the entity.

1.6 LIMITATIONS OF ACCOUNTING

There are certain misconceptions regarding the principles of accounting and Financial Statements. A common man presumes that an income statement shows exact income and expense and the Balance Sheet shows the correct position of assets and liabilities. They are not correct and accurate to the point. The accounts are only fair. The inferences drawn from the Financial Statements are giving only a fair picture about the current status of an establishment.

Following are certain circumstances that can be considered as the limitations of accounting

- 1) The factors which may be relevant in assessing the worth of an establishment sometimes are outside the nature of accounting because of its non-monetary nature. Only those factors which can be measured in money are taken into consideration.
- 2) Balance sheet and other Financial Statement shows only current or past position and performance of an establishment. Those doesn't accurately communicate what would be its future position or what the results will be in the long run.
- 3) There are situations in which the basic theories of accounting like the accounting standards, conflict with each other.
- 4) Certain accounting estimates depend merely on the judgement of the accountant. Eg: provision for Doubtful Debts, selection of method of valuation of inventories, etc.
- 5) Different accounting policies of the same item would lead to ambiguity, confusion among the accounting professionals, it also adds to the probability of manipulations. Some efforts are being taken by the Accounting Boards , but these can't be reduced to zero.

1.7 FUNCTIONS OF ACCOUNTING

The main functions of accounting are as follows:

- 1) **Measurement:** Accounting measures past performance of the business entity and depicts its current financial position.
- 2) **Forecasting:** Even though accounting information doesn't readily contain any information about the future of the establishment, accounting data helps in forecasting future performance and the financial position of that entity.
- 3) **Decision Making:** Accounting provides useful information to the users of accounting which helps them to take effective, rational decisions
- 4) **Comparison and evaluation:** Accounting assesses performance achieved in relation based on the targets set, it discloses information about contingent liabilities etc. to help an establishment to evaluate and compare the financial results to ascertain the performance gap.
- 5) *Control:*
The accounting processes identify the weaknesses of the establishment internally and externally and provide feedback regarding the effectiveness of measures adopted to check such weaknesses.
- 6) *Government regulation and Taxation:*
Accounting provides the necessary information to the government and the tax authorities the much-needed data they require in order to impose statutory restrictions and collection of tax on revenue.

1.8 PROCEDURAL ASPECTS OF ACCOUNTING.

On the basis of the definition of accounting, the procedure of accounting is as follows in generating Financial Information:

1. Recording: This is the basic function in accounting. Business transactions of financial character, from source documents sales and purchase bill, pass book, salary slip etc. are recorded in the books of accounts This book of account in which a general detail about the daily transactions is contained is called journal. This book is further divided into various books under specified heads.

2. Classifying: Classification is concerned with the systematic analysis of recorded data, with a view to group transactions or entries of one nature to one place. The books containing this type of information is called ledger. These ledgers contain information under different account heads.

Eg: Rent Account, Salary account, Clients personal Account etc

3. Summarising: This procedure is concerned with the preparation and presentation of the data above classified in a manner useful to the internal (within the organisation) and external (outside the organisation) users of financial information. This process leads to the preparation of the following accounts

Trial Balance

Profit and loss account

Balance Sheet

Cash Flow Statement

4. Analysing: The term Analysis means methodical classification of data given in the Financial Statements. The figures in the financial statements will not help anyone help unless they are in simplifies form. It is concerned with the establishment of relationship

between related items of the Profit and Loss Account and Balance Sheet. It provides for basic interpretation.

5. Interpreting: This is the final function of accounting. It is concerned with the explanation of the meaning and significance of relationship established by the analysis of accounting data. The recorded financial data is analysed and interpreted in a manner that will enable the end users to make a meaningful judgement about the financial condition and profitability of the business operations.

6. Communicating: This stage is concerned with the transmission of summarised, analysed and interpreted information to the end users. It enables them to make rational decisions. This involves the preparation and distribution of Accounting Reports along with Final Accounts and such other communication mediums like graphs, accounting ratios, pie diagrams, etc.

1.9 SUBFIELDS / BRANCHES OF ACCOUNTING

The term accounting is not confined to a single category. The various sub fields of accounting are:

- 1) **Financial Accounting:** It covers the preparation and interpretation of Financial Statements and communicating its results to the end users. It is historical in nature as it records all the previous transactions of monetary character, which had already been occurred.
- 2) **Cost Accounting:** It is the process of accounting for cost which begins with the recording of income and expenditure or the basis on which they are calculated and ends with the preparation of periodical statements and reports for ascertaining and controlling the costs of an organisation.
- 3) **Managerial / Management Accounting:** It is the internal reporting of the managers of a business unit. To discharge the functions of planning controlling and decision

making, the management needs variety of information. The different ways of grouping information and preparing reports as desired by the managers for discharging their functions are referred to as management accounting.

- 4) **Human Resources Accounting:** It is an attempt to identify, quantify and report investments made in human resources of an organisation that are not presently accounted for under conventional accounting practice.

1.10 SYSTEMS OF ACCOUNTING

Systems of accounting refer to two systems of recording of financial transactions in the books of accounts.

There are two systems of accounting.

- 1) **Single Entry System**
- 2) **Double or Dual Entry System.**

(1) SINGLE ENTRY SYSTEM

This system is also known as the pure entry system. It does not follow the traditional dual entry system of accounting. Only one cash book will be maintained. All cash transactions will be recorded in that cash book itself. ie, all the business transactions. All other personal transactions will be recorded in another rough book. This method not being very scientific, it is not used in the modern accounting era.

Some salient features of the simple entry accounting system are,

- Since only one cash book is maintained personal and business transactions are recorded together.
- Real and Nominal Accounts are ignored in this system.
- Profit and Loss will be ascertained but we can't present the same in a financial position in the final accounts.
- Without preparing the trial balance, arithmetic accuracy of the accounts can't be verified

(2) DOUBLE ENTRY SYSTEM

This is the conventional method of recording transactions in financial accounting. This is a scientific method of accounting in which certain universally accepted rules are required to be followed. The basic essence of this method is that every transaction has two effects, that is two aspects. One debit and another one credit. ie, when one account is credited, another account is debited. It is widely used and recognised in the accounting world.

Some salient features of the double entry system are as follows:

- All three types of accounts are maintained, ie, the personal, nominal and real accounts.
- The financial and arithmetical accuracy of the accounts shall be verified while preparing the trial balance.
- The system does not have any modifications
- It allows for the preparation of the Balance Sheet which will reflect the financial position of the organisation.
- It is easy to detect mistakes and fraud in the accounts when the dual entry system is used, when both the sides of balance sheet don't tally.

1.11 **BASIC TERMS IN ACCOUNTING**

The following are some of the basic terms which are most commonly used in accounting irrespective of the nature of the entity.

- (1) **Business Transaction** – A business transaction is a financial event between two or more parties. It involves an exchange of goods, services or money and gets recorded in the books of accounts for the organisations involved.
- (2) **Capital** – Capital is a critical component of any business to run its daily operations and help its future growth. The capital for a business comes either from its owners or from outsiders (shares, debentures or bonds).
- (3) **Drawings** – Drawings refer to the withdrawals made by the owners of a business for personal use. It gets deducted from the Owner's Capital in the Liabilities side of a Balance Sheet.
- (4) **Liabilities (Non-Current and Current)** – Current Liabilities are the amount due to the creditors of a business that has to be paid back within twelve months.
Non-Current Liabilities are the long-term obligations of a company that are not due for payment before a year
- (5) **Assets (Non-Current and Current)** – Current Assets are the assets that a firm can liquidate within twelve months.
Non-Current Assets are the long-term investments of a business that they cannot liquidate within a year..
Fixed assets (Tangible and Intangible) – Tangible Fixed Assets are the long-term investments of a business that have a physical existence. Intangible Fixed Assets are the long-term investments made by a company that doesn't have a physical existence.
- (6) **Expenditure (Capital and Revenue)** – A business incurs Capital Expenditure to acquire assets for long-term income generation.
It also incurs Revenue Expenditure to run the day-to-day operations of a business.
- (7) **Expense** – Expenses in accounting refer to the cost incurred or money the business owners spend to generate revenue. A business must keep its expenses under control to generate profits both in the short and long run.
- (8) **Income** – Income is the revenue that a business earns from the sale of its goods or services. It is essential for the survival and growth of any enterprise, and the failure to generate revenue can lead to a shutdown of the business.

- (9) **Profit** – Profit is the positive difference between the income generated from selling goods or services and the Expenses incurred to perform that business activity. Profit is the excess of revenues over the expenses.
- (10) **Gain** – A Gain is an increase in the total value of an asset of a business. It takes place when the current price of the asset exceeds its original purchase price. It can occur at any time during the useful life of an asset.
- (11) **Loss** – Loss is the excess of the Expenses incurred from selling goods or services over the income generated to perform that business activity. Sustained losses over time can lead to the shutdown of a business organisation.
- (12) **Purchase** – Purchase is the activity of buying an item to either use it in the production of goods and services or resell it to another entity.
- (13) **Sales** – Sales is an economic activity where a business exchanges goods or services with another entity for money. It is the primary source of revenue for any organisation.
- (14) **Goods** – Goods are the items that a company manufactures to sell to another entity in exchange for money. When an organisation buys goods, it is known as purchases, and when it sells goods, it is known as sales.
- (15) **Stock** – A stock is a financial instrument that represents the part ownership of a company. Organisations use this instrument to raise capital for their business.
- (16) **Debtor** – A debtor is an individual or entity that owes money to a business. Companies treat it as an asset because they will get money from them in the near or distant future.
- (17) **Creditor** – A creditor is an individual or entity to whom a business owes money. Companies treat it as a liability because they will have to pay them in the near or distant future.
- (18) **Voucher** – A Voucher is an internal document that a company uses as supporting evidence for accounting entries. Businesses treat it as a redeemable transaction bond as it has a monetary value and is helpful in specific cases.
- (19) **Discount (Trade Discount and Cash Discount)** – A Trade Discount is a discount that a seller can offer to the buyer by reducing the price of an item. It helps to increase sales of a product, and it doesn't get recorded in the accounting books.
A Cash Discount is a discount that a seller can offer to the buyer at the time of payment by reducing the invoice price of an item. It helps to ensure timely payment for a product,

and it gets recorded in the accounting books.



1.12 ACCOUNTING CONCEPTS & FUNDAMENTAL ACCOUNTING ASSUMPTIONS

The concepts on which the fundamental accounting processes are relied upon are discussed in detail as follows;

1. **Entity Concept:** A business entity is a separate identity apart from its owner. In the accounting process, the accountants should treat the business and the owner as separate entities. Business transactions are recorded in the books of accounts of the organisation itself and the personal transactions of the owner are recorded in his personal books of accounts.
2. **Money Measurement Concept:** Since money is the medium of exchange and standard of economic value, only those transactions that can be converted into the terms of money are recorded in the statement of accounts. All other transactions, even if they affect the financial performance or position of the entity, will not be recorded in the financial statements.
3. **Periodicity Concept:** This concept is also called the concept of definite accounting period. According to this concept, the accounts should be prepared after every period and not at the end of the entity. Usually, this period is one year, calendar or financial year. Usually, in India, we follow the financial year from 1st April to 31st March.
4. **Accrual Concept:** The effect of transactions is recorded as and when they occur, ie, whether or not the cash is received or not, paid or not. It is done in this way to inform users about the past events involving the payment and receipt of cash and also the obligations to pay cash in the future and the resources from which the cash is to be received in future.
5. **Matching Concept:** In this concept, all expenses that match with the revenue of that period should be considered. If any revenue is recognised in the financial statements, the corresponding expenditure should also be considered.
6. **Going Concern Concept:** The financial statements are made on the assumption that the enterprise will continue to operate in the foreseeable future. ie. the business has no intention to liquidate or curtail the scale of transactions of the business in the coming years. The valuation of assets of a business depends upon this assumption.

7. **Cost Concept:** Based on this concept, the assets of the firm are valued in the historical cost. The cost incurred on its acquisition is entered as its value in the balance sheet. Accountants generally prefer this method with the intention of objectivity and this method is followed for many years. Unless the asset is actually sold, the realisable value or the current market value is just a hypothetical figure. Sometimes, it is difficult to ascertain the market value of the asset.
8. **Realisation concept:** It is closely related to the cost concept. ie. any change in the value is realised in the financial statements only when such changes are that much certain to get materialised. For example, the cost of machinery was Rs.20,000 during the time of acquisition. Later, the market value became Rs.30,000, the that extra Rs.10,000 will not be recorded unless it becomes certain.
9. **Dual Aspect:** The dual aspect concept indicates that each transaction made by a business impacts the business in two different aspects which are equal and opposite in nature. This is the core concept of the double entry system of accounting.
 - It increases one asset and decreases another asset
 - It increases one asset and simultaneously increases another liability.
 - It decreases one liability and increases another liability.
10. **Conservatism:** This concept states that the accountant should not anticipate any income and provide for all possible losses. That is, for the valuation of assets, the method that gives the least value should be chosen. On the other hand, in the case of liability, the method should anticipate all possible losses.
11. **Consistency:** The consistency principle states that businesses should maintain the same accounting methods or principles from one accounting period to another. This is done to achieve comparability of the financial statements so that users of the financial statements or information are able to make meaningful conclusions from the data.
12. **Materiality:** The concept states that if the effect of a transaction is not material, then that transaction can be ignored without recording it in the financial statements. This is an exception to the full disclosure principle. But before ignoring a business transaction, it should be ascertained that such ignorance would not materially affect the final results extracted from the financial statements so prepared.

For example, a transaction involving Rs.10 can be ignored in a financial statement of Rs.50,00,000.

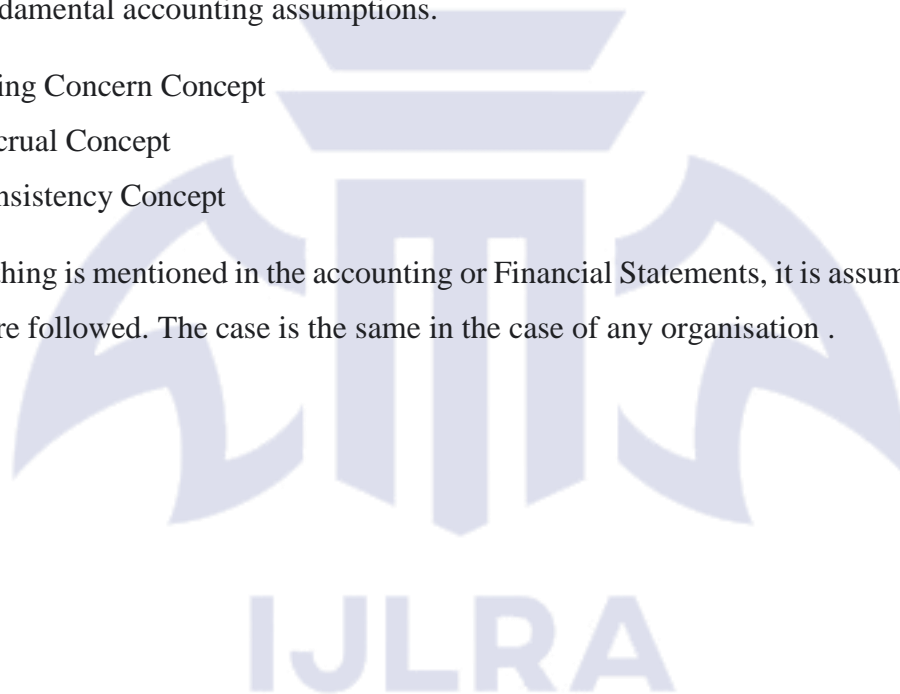
Let the business be of any nature, sole proprietorship, partnership firm, or company the basic accounting concepts should be followed. These are important in the accounts of a legal firm also.

FUNDAMENTAL ACCOUNTING ASSUMPTIONS.

Fundamental accounting assumptions are the basic assumptions that accountants follow when preparing financial statements. Among the accounting concepts explained above, the following are the fundamental accounting assumptions.

- Going Concern Concept
- Accrual Concept
- Consistency Concept

Even if nothing is mentioned in the accounting or Financial Statements, it is assumed that these concepts are followed. The case is the same in the case of any organisation .



CHAPTER 2

ACCOUNTS IN A LAW FIRM

The previous chapter dealt with basic concepts, principles and definitions in the realm of accounting. This chapter is dealing with how the aforesaid fundamentals are applied in the preparation of accounts in a law firm.

2.1 RELATIONSHIP BETWEEN ACCOUNTING AND LAW

Accounting in law firms is often challenging, even for experienced lawyers. While lawyers and law students spend years shaping the skills to become great lawyers, they don't learn about accounting or bookkeeping for attorneys at law school. But in various fields, accounting is very important for lawyers and law firms.

A legal entity often operates in an economic atmosphere. All financial transactions with clients are of a financial character. Lawyers practice for fee and earn income. In their profession they often meet with certain money transactions. Lawyers have to maintain accounts and for that they must have a knowledge in accounting due to the following reasons.

- (1) As a member of the Bar Council, he must know the Bar Council Accounting.
- (2) He should know the accounting of legal authorities and the Supreme Court legal services committee.
- (3) He should know the Accounting of Advocates as per the Supreme Court Rules.
- (4) Lawyers have to maintain accounts due to the following obligations.
 - (i) An advocate is bound to accept any briefs in courts or tribunals or before any authorities in or before he prefers to practice at a fee consistent with the standing at the bar and the nature of the case.
 - (ii) An advocate shall keep accounts of the client's money entrusted to him and the accounts should show the amount received from them or on their behalf, the expenses incurred by him, and debits made on account of fees and respective dates and all other necessary particulars.
 - (iii) An advocate shall furnish to the client a copy of his accounts on demand provided the necessary copying charges are paid etc,

All of these obligations are mentioned in the bar council rules related to accounts in the coming pages of this chapter.

Apart from these obligations, a lawyer should have knowledge in the field of accounting of the companies, partnership firms, industrial law, tax law etc. because the laws mostly control commercial transactions also. Only then the lawyers will be able to find out any financial fraud happening in the organisations they undertake to provide legal services.

ROLE OF ACCOUNTING IN LAW FIRMS OTHER THAN MENTIONED ABOVE:

- 1) Trust funding calculation
- 2) Case price calculation
- 3) Partner compensation systems
- 4) Profitability improvement studies
- 5) Mergers and acquisitions analysis
- 6) Firm restructuring and dissolution analysis
- 7) Partner withdrawal and retirement issues
- 8) Firm wide strategic planning, forecast and budget
- 9) Internal control reviews
- 10) Tax planning
- 11) Review and finalisation of financial statements

2.2 WHY BOOKKEEPING & ACCOUNTING ARE IMPORTANT IN A LAW FIRM?

Effective and efficient accounting for law firms is important for the success of a law firm whether the firm is small or large. To ensure the firm's financial statements are accurate, complete, proper, and sound, bookkeeping and accounting are used.

To get a better financial picture and meet the obligations to the firm, clients, and the state bar, a law firm needs a clear, accurate accounting system. The reasons why the above is needed are explained as under.

1. Need to stay compliant

Every law firm has a responsibility to comply with ethics regulations, and ethics rules vary in each jurisdiction. But there are some basic rules when it comes to accounting for law firms.

For example,

Rule 1.15 of the ABA's Model Rules of Professional Conduct outlines key responsibilities for lawyers regarding holding funds in trust, recordkeeping, and notifying clients of the receipt of funds or property.

Whether intentional or not, violating compliance regulations, like mishandling client funds, can lead to serious consequences, like significant financial penalties, license suspension, disbarment etc.

2. Growth of the business

Even though the organisation is a law firm, it's also a business. Accounting for law firms helps in collecting and analysing information and aids to make data-driven decisions based on how much money comes in and leaves the firm.

Knowing exactly how much the firm has coming in as receipts and going out by expenses means it is less likely to miss out on revenue by accident (i.e., due to billable hours not being recorded or missing out on tax deduction opportunities).

It is also useful to identify what parts of your practice are most and least successful—the resources can be allocated more thoughtfully.

3. Prevention from harming the reputation of both the lawyers and the law firm.

In the law, as in life reputation is everything. Accounting mistakes make you look unprofessional. Lack of professionalism can lead to losing your clients, referrals, and growth opportunities.

2.3 FINANCIAL STATEMENTS AND OTHER ACCOUNTS IN A LAW FIRM

1) Journal: this is the book in which the first hand information about the day to day financial transactions relevant to the organisation is recorded in, the entries in this book is called the journal entries.

2) Ledger: the entries in the journal are posted in respective ledgers based on the accounts in which they are to be entered. Various ledgers would be maintained in the law firm based on the size and nature of the law firm.

3) Trial Balance: The balances in ledgers would be taken and trial balance would be prepared before preparing the final books of accounts. The debit and credit side of the trial balance should tally, otherwise, it can be concluded that there are accounting or arithmetical errors in the books prepared.

4) Cash book: A law firm will be having cash, credit or non-cash transactions. The cash book is used only to account for the money coming in and going out of the firm and its bank accounts. If it is a single column cash book, then only the cash in hand would be accounted for. The balance of both cash in hand and cash at bank would be ascertained if a double column cash book is maintained.

5) Receipts and payments account: The cash received in the firm and paid out of the firm are recorded in a separate statement of accounts . Whatever amount paid, or received are recorded in this account irrespective of whether the such payment or receipt belongs to the current accounting year or not. Which means, all expenses and incomes whether paid in advance or

received in advance would be accounted for. But the outstanding expenses will not be considered.

6) Income and expenditure: The receipt and payments pertaining to the current financial year only are recorded in the income and expenditure account. This also includes the amount which are actually should have been paid, but not yet paid, ie, the outstanding expenses. This statement helps to know out of the receipts and payments in the firm , how much belongs to the current financial year.

7) Profit and loss Account: the statement which shows the operational efficiency of the organisation. After considering all the direct and indirect expenses, the profit and loss, that is both net and gross will be ascertained through the profit and loss account.

8) Balance sheet: All the assets and liabilities of the firm would be listed in the balance sheet. The assets like expenses paid in advance and liabilities like outstanding expenses not paid etc are considered in this final financial statement. The both sides should tally. If not, it is concluded that there are accounting or arithmetical errors.

9) Capital Account: The capital or initial fund invested by each partner in a law firm will be dealt under the capital accounts. Each partner will be having a capital account which contains the amount invested by him. If the capital accounts are maintained in a fixed capital system, no entry other than the capital investing entries or withdrawal from that money shall be recorded.

If it's a fluctuating capital method, interest gained on capital invested, drawings, interest on those drawings shall also be entered in the accounts, thereby the balance in the capital accounts shall always change.

2.4 VARIOUS KINDS OF LEDEGRS IN A LAW FIRM

- 1) Rent account: Recording the periodical rent paid by the firm, in the lease agreement for the lease period.
- 2) Salary Account: salary paid to the office staff, secretary, other lawyers etc.
- 3) Telephone/phone charges: in older times, it was phone bill, now it's the amount for the prepaid plan recharge, Wi-Fi connection bills, etc.

- 4) Electricity: shows how much amount was paid to electricity board for the electricity consumed by the firm and its members.
- 5) Conveyance: the expenses incurred for travelling purpose from one place to another fore representing various cases.
- 6) Repairs and maintenance: All periodical repair and maintenance expenses regarding to the building, machinery, employees and other fixed assets.
- 7) Stationary: Even though society is growing towards being cashless and having paperless transactions, in some situations, hardcopies are essential. That's the usage of the pen and paper system in the firm. The purchase of papers, pens, pins etc. are categorised as stationary. The amount paid in purchasing these articles, the amount of stationery articles used, how much is left etc. would be in the ledger.
- 8) Miscellaneous expenses: All other expenses that can't be categorised as the expenses mentioned above, will come under miscellaneous expenses.
- 9) Furniture: Purchase of valuable furniture and recording the depreciation based on the method of calculating the same.

There are many more based on the assets and liabilities of a particular firm. But in general, in all firms, the above ledger accounts would be maintained. And most importantly, separate client accounts will be maintained. The method in which the client account is maintained is depicted in the practical illustration given in the coming pages.

2.5 APPLICABILITY OF SUB FIELDS OF ACCOUNTING IN LAW FIRMS

Financial Accounting

Just like what was discussed in the above chapters, financial accounting is the most commonly used version of accounting in each and every organisation without considering the nature of that particular entity. It is generally done to ascertain the financial position and financial performance of the organisation. i.e. the number of assets owned by the entity, the liabilities owed by the entity, and whether the performance resulted in profit or loss.

But it can be used to determine the solvency, liquidity, debt coverage capacity etc of the firm. The data generated in the accounting process can be utilised to prepare a budget statement also. The ascertained results can be used to communicate to the stakeholders in the business to build an image of the organisation in their minds and the positive results can also persuade the potential stakeholders. The profits ascertained by the accounting process is used by the government for taxation purpose and by the employees also. The transparency of accounting information in the organisation will boost employee morale.

Cost Accounting

The basic objectives of cost accounting are cost reduction and cost control. By various tools in costing like standard costing, marginal costing, budgeting etc, the firm can track the expenses of the firm. Then the actual cost can be compared to the desirable cost, analysing deviations, and then, the firm can take measures to reduce the gap between actual expenses and expected expenses.

By using the budgeting mechanism in costing, the firm will be able to identify the costs which has incurred in the current financial year, then calculate the anticipate costs for the coming years also.

Human resource accounting

It is the process of identifying and reporting investments made in the human resources of an organisation that are unaccounted in the financial accounting. This sub field takes a note of the wages, salary, training expenses, capacity, output etc of a human resource within the firm.

A law firm can make use of human resource accounting to ascertain the number of lawyers, partners or other staffs who are performing above or below the standards set by the firm. Even though some of them are performing below the set standards, they are of some value to the organisation.

Simply saying, cost accounting measures the cost and value of the people to the firm.

Managerial accounting

Managerial Accounting is the process of analysing, measuring and interpreting of accounting information to make the management take best decisions for an organisation. In the case of law firms, based on the financial reports, the senior partners can make decisions regarding which branch of law is most profitable for them and which is the least rewarding one.

They can, based on the previous results, decide, what kind of cases they should undertake. For example, based on the accounting information, if a client is neglecting to pay the professional fee for the work done by the firm in the past financial year, then the firm is at liberty to decide not to entertain the legal issues of that particular client anymore.

This is the case when the firm is being functioning like a big corporate entity.

Trust Accounting

This is not a conventional method of accounting. But this method is used in any organisation that holds the money of other people in their accounts.

Trust Accounting is keeping track of client funds that are held in trust. The consequences of mismanagement of trust accounts may cause serious repercussions to the law firm. The client accounts should be kept separately from other accounts.

The American bar Association outlines the responsibility law firms have to secure clients funds and they don't commingle with other client funds.

2.6 RECEIPTS AND PAYMENTS VOUCHER SYSTEM

It is very important that the amount of transaction entered into the books of accounts shall be supported with documents evidencing the transaction. These documents are called vouchers. They can be either in the payment transactions or the receipt transactions. These physical vouchers existed at the time when all activities were done manually. Nowadays, every accounting activity is automated. But the system remains the same.

RECEIPT VOUCHER:

It's also called a receipt. It is a document prepared for recording the transaction of receiving money into the firm by cash, or any other mode of payment. The advocate needs to issue a receipt to the client when he pays some money to the advocate. A receipt may be prepared in the following form.

GEORGE.P, M.A, LL.B		
Advocate		
Chittoor Road Ernakulam		
Receipt No:1		
Date: _____		
<u>RECEIPT</u>		
Received with thanks from _____ the sum of rupees _____ only by Cash/ Cheque/Draft		
Number _____ dated _____ on _____ Bank, subject to realisation as per the		
following details.:		
Professional Fees	Rs: _____	
Expenses for the case	Rs: _____	
Total	Rs: _____	
Signature		Revenue Stamp

When book system was being followed, the original receipt was issued to the client and the counterfoil was retained in the Receipt Book as the office copy. Nowadays, when the whole system is automated, the receipt soft copy will be generated, and kept in the system. One copy is emailed to the client. In most of the firms, only sensitive data files would be stored as hardcopy.

PAYMENT VOUCHER

These vouchers are used to record such payments that are from the firm regarding various expenses for which receipts for the same can't be obtained from the payees such as court fees, stamps, refreshments etc. In such cases, the voucher signed by the advocate showing the certificate of having paid the amount would be treated as sufficient supporting document for the payment.

The signature of the payee may be obtained whenever practicable , like in the case of salary, rent etc..

The format of such payment vouchers are as follows ,

GEORGE.P, M.A, LL. B Advocate Chittoor road, Ernakulam		
VOUCHER		
Number: _____	Date: _____	
Particulars	Amount	
	Rs.	Ps.
Total		
Paid, the sum of rupees _____ as detailed above.		
Paid Signature: _____	Received Signature: _____	Revenue stamp
George. P Advocate		

Now a days the payments are being made online, are enough proof of them being paid, but these kinds of supporting documents have much more evidentiary value if they are proven not to be false or forged.

2.7 BAR COUNCIL OF INDIA (BCI) RULES OF ACCOUNTING FOR LAWYERS

The duties of an advocate to keep accounts of the client's money entrusted to him are provided under part VI, chapter II, Section II, Rules 25 to 32 of the Bar Council of India Rules 1975 as follows:

25. An advocate should keep accounts of the client's money entrusted to him, and the accounts should show the amounts received from the client or on his behalf, the expenses incurred for him and the debits made on account of fees with respective dates and all other necessary particulars.

26. Where moneys are received from or on account of a client, the entries in the accounts should contain a reference as to whether the amounts have been received for fees or expenses and during the course of the proceeding, no advocates shall, except with the consent in writing of the client concerned, be at liberty to divert any portion of the expenses towards fees.

27. Where any amount is received or given to him on behalf of his client, the fact of such receipt must be intimated to the client, as early as possible.

28. After the termination of the proceeding, the advocate shall be at liberty to appropriate towards the settled fee due to him, any sum remaining unexpended out of the amount paid or sent to him for expenses or any amount that has come into his hands in that proceeding.

29. Where the fee has been left unsettled, the advocate shall be entitled to deduct, out of any moneys of the client remaining in his hands, at the termination of the proceeding for which he had been engaged, the fee payable under the rules of the Court, in force for the time being, or by then settled and the balance, if any, shall be refunded to the client.

30. A copy of the client's account shall be furnished to him on demand provided the necessary copying charge is paid.

31. An advocate shall not enter into arrangements whereby funds in his hands are converted into loans.

32. An advocate shall not lend money to his client for the purpose of any action or legal proceedings in which he is engaged by such client.

Explanation. An advocate shall not be held guilty for a breach of this rule, if in the course of a pending suit or proceeding, and without any arrangement with the client in respect of the same, the advocate feels compelled by reason of the rule of the Court to make a payment to the Court on account of the client for the progress of the suit or proceeding.

The rules which mention about professional fees (dealing with duty to clients) are contained in Part VI, Chapter II, section II, Rules 11,12,20,23 dealing and Section IV, Rule 38 dealing with the duty to colleagues, of the Bar Council of India Rules, 1975

11. An advocate is bound to accept any brief in the Courts or Tribunals or before any other authorities in or before which he proposes to practise at a fee consistent with his standing at the Bar and the nature of the case. Special circumstances may justify his refusal to accept a particular brief.

12. An advocate shall not ordinarily withdraw from engagements, once accepted, without sufficient cause and unless reasonable and sufficient notices is given to the client. Upon his withdrawal from a case, he shall refund such part of the fee as has not been earned.

20. An advocate shall not stipulate a fee contingent on the results of litigation or agree to share the proceeds thereof.

23. An advocate shall not adjust the fee payable to him by his client against his own personal liability to the client, which liability does not arise in the course of his employment as an advocate.

Section IV, Rule 38

An advocate shall not accept fees less than the fee taxable under the rules when the client is able to pay the same.

In the case **Harish Chander v. Suman Dondey (1)** the court held that the disciplinary committee of the Bar Council of India could not have held the advocate guilty of charge of misappropriation especially without going the whole of accounts.

Commissioner of income tax Vs Tanu Bai D. Desai (2)

The assessee is a practicing solicitor and in the course of carrying his profession used to deposit money in a separate bank account, received by his clients. The income tax officer and the appellant assistant commissioner held that the interest earned by the advocate on fixed deposits earned out of money paid by the client should be considered as and should be included in the personal assessment of the assessee aggrieved by the tribunal appellant preferred this petition before the High Court.

After thoroughly discussing the law, high Court held that the tribunal judgement is correct and interest earned by an advocate on fixed deposit maintained in client's name need not be considered is that assessment of an advocate personal account.

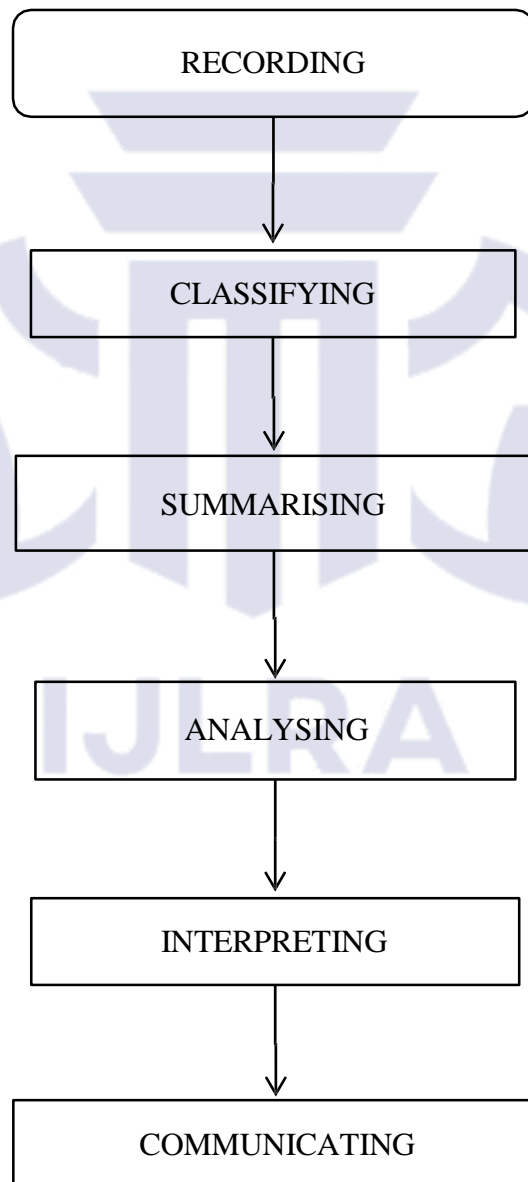
(1) 1999 (2) SCC 215

(2) 1972 ITR 713 BOM.

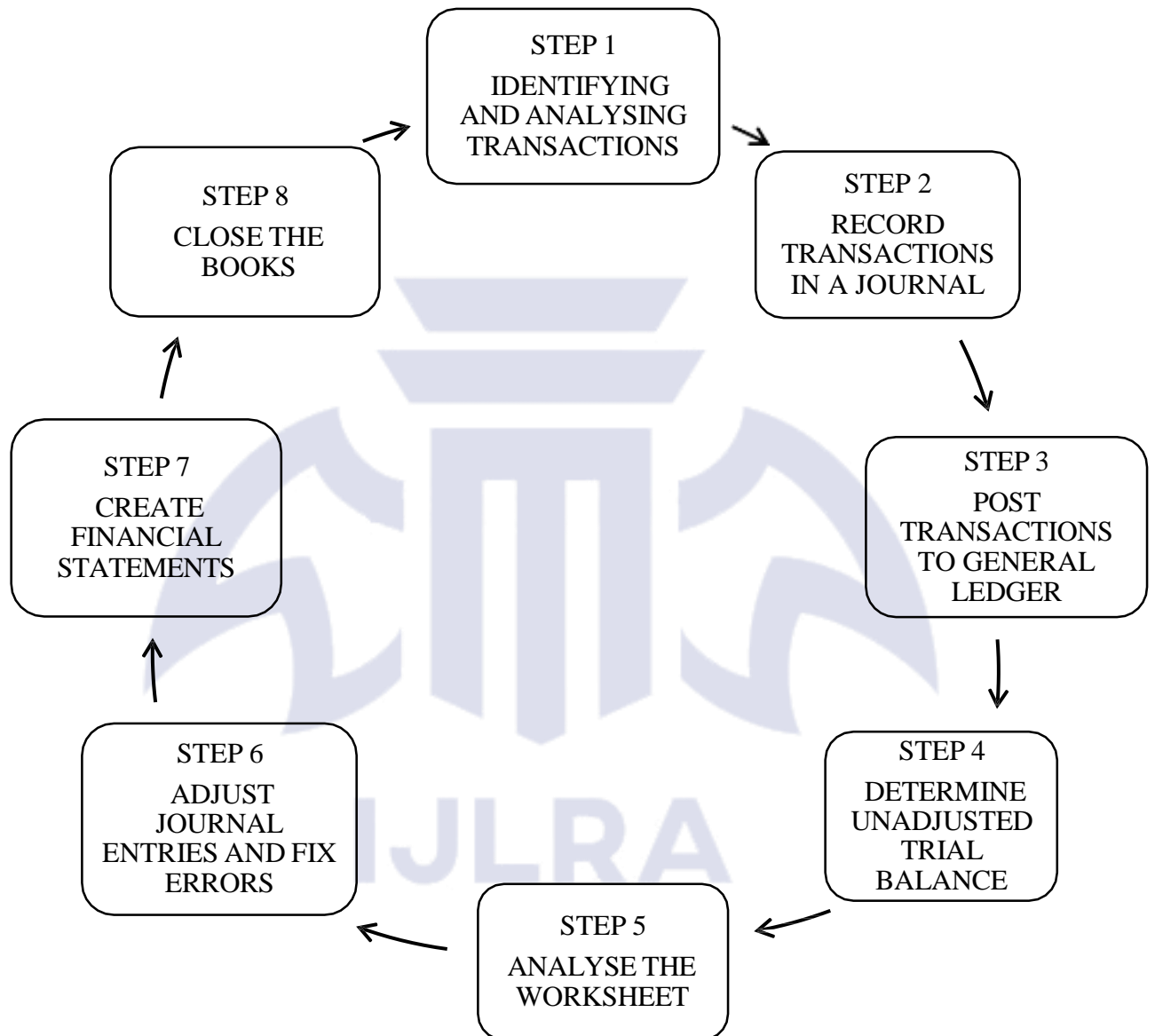
2.8 ACCOUNTING PROCESS IN A LAW FIRM

The accounting process in a law firm is similar to that of other firms. The process and steps involved are the same, but extra care would be given to the client’s accounts. That is the trust accounting. A separate account must be maintained for each client. Other than that, the accounting process is the same as the topic of procedural aspects of accounting in chapter 1.

That is ,



In simpler terms, the accounting cycle is as follows:



2.9 USERS OF ACCOUNTING INFORMATION OF A LAW FIRM

There are various users of a financial statements. The stakeholders who depend upon or rooting for the law firm may require the data generated in the financial accounts for various purposes. Such users of the accounting information are elaborated as follows.

1. Owners/Shareholders

One of the primary object of accounting is to provide necessary information to the owners/shareholders invested in the business. Even though a legal firm is not a company, there may be investors who are interested in such a type of entity and its operations. They provide risk capital to the firm. They are interested in the ability of the firm to survive, grow and they use the accounting information to decide whether they should keep or divest from the legal firm they invested in. This is in the case of huge firms that operate with invested capital of third party investors.

2. Managers

In the case of a legal firm, the lawyers or the senior partners are often managers. They are more concerned with the accounting information because they are responsible to the owners. Also, they are the connecting element between the clients and the top management, if there's any. They are primarily responsible for the smooth functioning of the firm and responsible to the investors and senior management when something goes wrong. They need the accounting information so that they could understand the current financial position and performance of the firm, the result of previously implemented policies and then they can implement further policies to improve the same.

3. Prospective Investors

The persons who are interested to make an investment in the firm will like to know about its profitability and financial position. Thus, they derive this information from the accounting reports of the business.

4. *Creditors, Bankers, and other Lending Institutions*

Trade creditors, bankers, and other lending institutions would like to be ensured that they will be paid the principal amount along with the interest on time. . Moreover, the financial reports help them in judging such positions. Thus, Banks and other lending agencies rely upon accounting statements for determining the acceptability of a loan application.

5. *Government*

The Government is interested in the financial statements of the business organization on account of taxation, labour, and corporate laws. Along with that, they regulate the operations of an entity due to the scarce resources and their allocation also. Just because the profession of advocates is of high public accountability, governmental control is prescribed.

6. *Employees*

The growth of the firm is directly related to the growth of the employees. They are interested to know about the stability, Employees are also interested in financial statements because an increase in their salaries, incentives, wages, retirement benefits, payment of bonus etc. depends on the size of the profit earned.

7. *Regulatory Agencies*

Various Government agencies and departments like the Registrar of Companies, Company Law Board and Tax Authorities, etc. use accounting information.

They not only require it as a basis for tax assessment but also in evaluating how well various businesses are operating under law related requirements.

In the case of a legal firm, the Bar Council of India and the Bar Association are also interested regulatory authorities.

8. Researchers

Accounting information is also used by the research scholars in their research in accounting theory as well as business affairs and practices.

9. Customers/clients

Customers or clients (in the case of a legal firm) may also have either a short-term or long-term interest in the business entity to know the profitability, liquidity and solvency position of the business.





2.11 PRACTICAL ILLUSTRATION

JOURNAL:

The following are the transactions appeared in a law office during the month of April 2022 :

DATE	PARTICULARS	AMOUNT
01/04/2022	Amount paid by Raju	
	Towards fees	25000
	Towards expenses	5000
02/04/2022	Amount paid by Jose	
	Fees	30,000
	Expenses	6,000
06/04/2022	Expenses for court fees, vakkalath and processing fees for Raju	2035
12/04/2022	Salary paid to staff	20,000
13/04/2022	Expenses for Jose	2,557
15/04/2022	Rent paid	10,000
20/04/2022	Amount paid by das (client)	
	Towards fees	35,000
	Towards expenses	5,000
22/04/2022	Expenses incurred for das	3682
25/04/2022	Electricity bill	4560
26/04/2022	Printing, stationery and miscellaneous expenses	7,000
27/04/2022	Telephone and postage expenses	3,000
28/04/2022	Household expenses	15,000

For the above transactions the journal would appear as follows, whether manual or computerised.

JOURNAL

DATE	PARTICULARS	L/F	DEBIT	CREDIT
			AMOUNT	AMOUNT
			Rs.	Rs.
01/04/2022	Cash/ Bank a/c Dr.		30,000	
	To Raju a/c fees			25,000
	To Raju a/c expenses			5,000
02/04/2022	Cash bank a/c Dr.		36,000	
	To Jose a/c fees			30,000
	To Jose a/c expenses			6,000
06/04/2022	Court expenses a/c Dr.		2035	
	To cash/ bank			2035
12/04/2022	Salary a/c Dr.		20000	
	To cash/ bank			20000
13/04/2022	Court expenses a/c (Jose) Dr.		2557	
	To cash/bank			2557
15/07/2022	Rent a/c Dr.		10,000	
	To cash/ bank			10,000
20/04/2022	Cash/ bank a/c Dr.		40,000	
	To das a/c fees			35,000
	To das a/c expenses			5,000
22/04/2022	Court expenses (das) a/c Dr.		3682	
	To cash/bank			3682
25/04/2022	Electricity bill a/c Dr.		4560	
	To cash/bank a/c			4560
26/04/2022	Printing, stationary and misc. exp bills a/c Dr.		5500	
	To bank/cash			5500
27/04/2022	Telephone and Postage exp a/c Dr.		3000	
	To cash/bank			3000

The household expenses of Rs. 15,000 shall not be entered in the journal because that is of a personal nature, that is not directly connected with the day-to-day activities of the legal firm. The amount withdrawn by a partner for meeting his household expenses shall be deducted from his capital account or his share of profit. If a personal expense is deducted from the beginning, the profit available to be divided among the remaining partners will be reduced. That must not be the case.

LEDGERS

The upcoming ledgers are prepared based on the following ledger heads adding some more expenses which are not recorded in the journal prepared above.

Clients:

Raju, Jose, Das (separate account for each client)

Fees account

Rent account

Salary account

Library expenses account

Printing and stationery account

Postage and telegraph account

Telephone charges account

Electricity charges account

Conveyance charges account

Repairs and maintenance account

RAJU

SHREYAS, VADUTHALA, ERNAKULAM

CASE: OS NO: _____ OF 2010 SUBORDINATE JUDGES COURT ERNAKULAM

Debit

Credit

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
06/04/2022	To cash court expenses		2035	01/04/2022	By cash Expenses		5000

JOSE

ALANKAR, PALARIVATTOM, ERNAKULAM

CASE NO : OS _____ of _____, DISTRICT COURT ERNAKULAM

Debit

Credit

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
13/04/2022	To cash/ bank Court expenses		2557	02/04/2022	By cash / bank expenses		6000

DAS

ASWATHY, KADAVANTHRA, ERNAKULAM

CASE NO : _____ OF _____ MUNSIF COURT, ERNAKULAM

Debit

credit

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
22/04/2022	To cash : court expense		3682	20/04/2022	By cash: paid for expenses		5000

FEES ACCOUNT

Debit				Credit			
Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
30/04/2022	To balance c/d		85000	01/04/2022	By Raju		25000
				02/04/2022	By Jose		30000
				20/04/2022	By Das		35000
			<u>85000</u>				<u>85000</u>
				01/05/2022	By balance b/d		85000

RENT ACCOUNT

Dr.				Cr.			
Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
15/04/2022	To cash		10000	30/04/2022	By balance c/d		10000
			<u>10000</u>				<u>10000</u>
01/05/2022	To balance b/d		10000				

SALARY ACCOUNT

Dr.				Cr.			
Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
12/04/2022	To cash			30/04/2022	By balance c/d		20,000
	Salary to juniors						
	Indu		6000				
	Deepa		5000				
	Kishore		4500				
	Salary to typist		4500				
			<u>20000</u>				<u>20000</u>
01/05/2022	To balance b/d		20000				

LIBRARY ACCOUNT

Dr.				Cr.			
Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
06/04/2022	To cash (law books purchased)		2500	30/04/2022	By balance c/d		4500
13/04/2022	To cash AIR purchased		2000				
			<u>4500</u>				<u>4500</u>
01/05/2022	To balance b/d		4500				

PRINTING AND STATIONERY ACCOUNT

Dr.				Dr.			
Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
03/04/2022	To cash: legal paper		1000	30/04/2022	By balance c/d		5500
07/04/2022	Ledger paper		750				
18/03/2022	Bond paper		1500				
24/03/2022	Printer ink		2250				
			<u>5500</u>				<u>5500</u>
01/05/2022	To balance b/d		5500				

POSTAGE AND TELEGRAM ACCOUNT

Dr.				Dr.			
Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
27/04/2022	To cash		750	30/04/2022	By balance c/d		750
			<u>750</u>				<u>750</u>
01/05/2022	To balance b/d		750				

TELEPHONE CHARGES ACCOUNT

Dr.				Dr.			
Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
29/04/2022	To cash		3100	30/04/2022	By balance c/d		3100
	Telephone charges as per bill dated 02/04/2022		<u>3100</u>				<u>3100</u>
01/05/2022	To balance c/d		3100				

ELECTRICITY CHARGES ACCOUNT

Dr.				Dr.			
Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
29/04/2022	To cash		4560	30/04/2022	By balance c/d		4560
	Electricity bills dated on 08/04/2022 for the month of march and April		<u>4560</u>				<u>4560</u>
01/05/2022	to balance b/d		4560				

CONVEYANCE CHARGES ACCOUNT

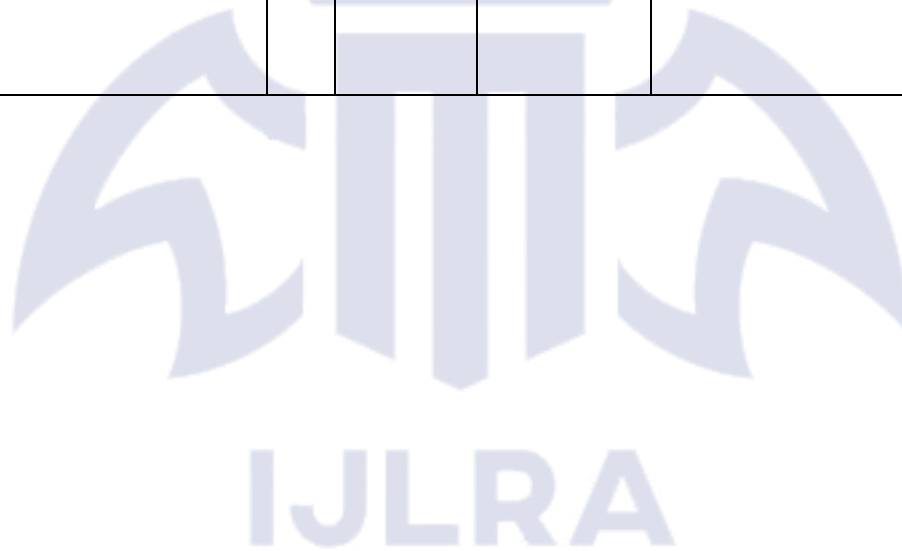
Dr.				Dr.			
Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
05/04/2022	To taxi charges		750	30/04/2022	By balance c/d		3570
11/04/2022	To train ticket		2300				
21/04/2022	To bus fare		520				
			<u>3570</u>				<u>3570</u>

REPAIRS AND MAINTENANCE CHARGES ACCOUNT

Dr.

Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	amount
04/04/2022	To cash			30/04/2022	By balance c/d		3750
	Printer repairs		1000				
	Plumbing charges		1500				
	New curtains		1250				
			<u>3750</u>				<u>3750</u>
01/05/2022	To balance b/d		3750				



INCOME AND EXPENDITURE ACCOUNT

Following is the data collected from the books of accounts of a law firm.

PARTICULARS	AMOUNT
Gross fees collection	10,45,000
Rent	24,000
Salary	1,50,000
Library	80,500
Printing and stationery	11,250
Postage and telegram	7,850
Telephone charges	11,400
Electricity charges	5,460
Conveyance charges	8,750
Repairs and maintenance	15,850
Miscellaneous expenses	12,280

When there arises a requirement to prepare income and expenditure account to ascertain the amount of surplus and deficit such financial statement will appear as follows:

INCOME AND EXPENDITURE ACCOUNT: FORMAT AS PER THE DETAILS GIVEN ABOVE

Debit

Credit

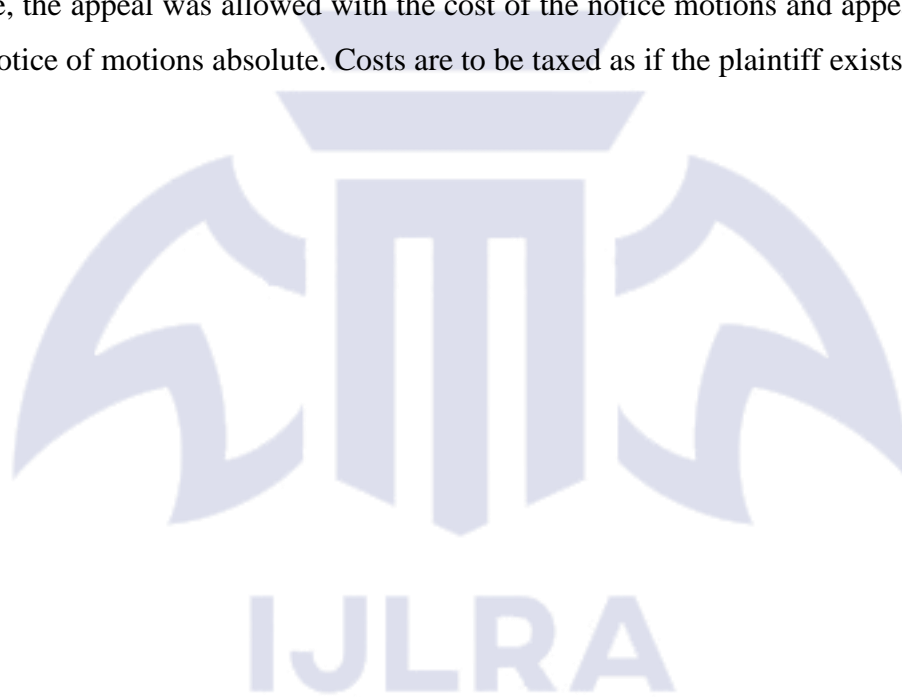
INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDING. _____

EXPENDITURE	AMOUNT	INCOME	AMOUNT
Rent	24,000	Gross fees collection	10,45,000
Salary	1,50,000		
Library	80,500		
Printing and stationery	11,250		
Postage and telegram	7,850		
Telephone charges	11,400		
Electricity charges	5,460		
Conveyance charges	87,50		
Repairs and maintenance	15,850		
Miscellaneous expenses	12,280		
Excess of income over expenditure	7,17,660		
	<u>10,45,000</u>		<u>10,45,000</u>

Dharnraj Giriji Narsingioji Vs. Dayne and Co (3)

This is an appeal from an order made by Justice Mirzaa or a motion taken out by the attorney for the defendant in a Suit against merits to the company who were solicitors for the notice asking that massive be ordered to pay the defendant's costs which the defendants cause of their suit less certain cost which the defendant had already been directed to bear.

In this case, the appeal was allowed with the cost of the notice motions and appeal. The court held that notice of motions absolute. Costs are to be taxed as if the plaintiff exists.



RECEIPTS AND PAYMENTS ACCOUNT

Dr.			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
		In Rs			In Rs.
01/04/2022	To opening balance	1000	06/04/2022	By court expenses	2035
01/04/2022	Fees Raju	25000		Raju	
	Raju expenses	5000	13/04/2022	By court expenses	2557
02/04/2022	Fees Jose	30000		Jose	
	Jose expenses	5000	22/04/2022	By court expenses Das	3682
20/04/2022	Fees Das	35000			
	Das expenses	5000			
			30/04/2022	To balance c/d	97726
		<u>106000</u>			<u>106000</u>
01/05/2022	To balance b/d	97726			

In the above receipts and payments account, only the receipts from the clients and the payments directly for the clients are recorded.

All other cash transactions are recorded in the cash account, it is also a ledger, to give more clarity.

BALANCE SHEET

The format of a balance sheet is given below with the following information:

Library : 3,00,000

Furniture and fittings :1,50,000

Motor car (office use) : 2,00,000

Cash in hand : 10,000

Cash at bank : 5,50,000

Outstanding liabilities :

Electricity charges : 400

Rent : 2000

Endowment fund : 10,000

Capital fund (old reserve): 3,10,000

BALANCE SHEET AS ON MARCH 2022

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
Outstanding liabilities		Cash in hand	10000
Rent	2,000	Cash at bank	520600
Electricity bill	4,00	Library books	3,00,000
Endowment fund	10,000	Less depreciation	75000
			225000
Current account opening balance	3,10,000	Furniture and fittings:	150000
+ excess of income over		Less depreciation	15000
expenditure in income and			135000
expenditure account	7,17,660	Motor car	200000
		Less depreciation	50000
			150000
	<hr/>		<hr/>
	10,40,060		10,40,060

CHAPTER 3

BEST PRACTICES AND COMMON MISTAKES

There are globally established principles, concepts and theories of accounting. Even though, with the development of technology, human sciences and automation of accounting, the latest developments in the field of accounting also affect the accounting of a legal firm also. Therefore, apart from the conventional accounting practices, we must focus on what can be done to improve the process of accounting to get best results in a economic scenario which is rapidly changing.

The following heads deal with how the modern and conventional accounting practices can be applied in its most beneficial manner.

3.1 DOUBLE ENTRY ACCOUNTING

The double entry is system of accounting is mentioned in detail in chapter. It is the best practice of accounting for every industry, every entity. In a legal firm also, the double entry system of accounting acts as an extra guard against errors when compared to the single entry system. That is because, a double entry system has two corresponding sides and creates a balance sheet consisting of assets, liability and equity.

Thereby, every financial transaction gets sorted into various specific categories. Once its completed, then the two sides should match. It is this theory that double checks the financial and arithmetic accuracy of the accounts and financial statements in a firm also. So, its best that the law firm should prefer the system of double entry over the single entry system of accounting.

3.2 INTEREST ON LAWYERS TRUST ACCOUNTS (IOLTA)

An IOLTA is a type of bank account from which any interest earned on account is collected and forwarded to state bars usually to funds for social injustice while the specifications of this

account may vary from state to state, depending on the jurisdiction. Lawyers are not allowed to collect interest on the money held in trust of the clients.

IOLTA accounts are designed to keep the client funds separate from the typical accounts of business operation. In those accounts, interest accrued can be collected by the lawyers or the firm, as the case may be. Lawyers also can't deposit their funds into the IOLTA account, which means, no other funds than the clients funds shall be deposited in IOLTA accounts.

It is wise to create a separate operating account or a designated credit card to cover fees, service charges etc. in order to avoid accidentally touching the client's money.

3.3 TRUST ACCOUNTING

Trust accounting is a method of accounting in which unearned fees paid as retainer, settlement funds, court fees, or advanced costs etc. those are given to the lawyer by the client in trust in a separate bank account from the operating funds. This is a common practice in accounting of law firms. These trust funds must be treated separately from operating accounts of the law firm while accounting also.

Law firms use trust accounts to hold client funds to keep them being tampered with by the influence of other operating funds of the firm. Firms must record each and every detail about the money going in and out of the trust accounts. The firm must track the balance in every client's account, and must also ensure that the money in one client's account is not used to pay another client's expenses.

Generally in trust accounting, some errors are there. Making a single error in managing a trust account can cost the bar license. Therefore the following errors should be avoided during trust accounting.

- The money your client pays you upfront or for a retainer is pre-paid, so it is their money until you secure a settlement or carry out all of the agreed services. It is not to be treated as the income of the firm.
- It is important to never bring the trust account balance or client or matter balances into the negative.

Good recordkeeping must be maintained to ensure that the trust account balance and other balances remain positive.

- Ensure that the deposited trust funds fully clear the trust bank account and have proper instructions from the client before making disbursements. Having the proper agreements and documentation with the clients regarding the disbursement of their trust funds will ensure that the lawyers/ firm follows the respective state bar rules
- Keeping the firm's trust account separate from your clients' accounts is crucial. For internal tracking purposes, the firm can label the client's and the firm's operating trust accounts.
Include the client's name and their ID number so that the client's account is not confused with the firm accounts.

3.4 THREE WAY RECONCILIATION

Checking and verification of financial data periodically is an essential part of accounting not only for law firms, but for other entities also. This method of reconciliation used to do manually, but with the development of technology, this process also got automated and legal trust accounting softwares are used. Three way reconciliation can be done as follows:

Bank Account Reconciliation:

Checking the banks version of the account balance against what the firm think the balance would be. Any deviations should be noted and reported.

Trust Reconciliation:

Checking how much is owed to other people , that is the firm must know how much amount is brought in by each client.

Client trust ledger.

Checking the statement of activity about the trust accounts.

3.5 BUDGETING

Every organisation should have a budget from the coming financial year. A legal firm is not an exception. Without setting a budget, the firm or a lawyer can't reasonably expect to succeed financially. It will be like going to an unknown place without directions. Preparing a budget should include:

- Set revenue benchmarks

- Create exceptions for cash flow and expenses.
- Make it easier to set aside funds for huge expenses like the annual bar dues.

While preparing a budget, the following strategy must be considered.

- Consider the mandatory expenses and resources of the firm, make a list of them and note them down
- Set goals and objectives of the firm, like, how many vacation the lawyers want to have in a year, (that much number of days the firm won't be functioning in the usual course of business) that is personal goal and also business goals, for example, how fast the firm wants to evolve into a much beneficial situation
- Honestly project the revenues. Don't over estimate any source of income and undermine the source of expenses. Those who prepare the budget must be prudent.
- Use accounting and managerial softwares to track the billable time, expenses and revenue. Along with that, keeping the accounts in regular check also aids in preparing the best budgets.

3.6 CONSISTENCY

Being consistent in the preparation and examination of financial statements and other cost and managerial statement would improve the accounting process in a legal firm to a great extent.

The habit of maintaining consistency in the accounting of a legal firm would organise the statement of accounts and every financial aspect of the firm properly. Regular maintenance of accounting would give a true and fair picture about the financial performance and financial position of the firm. Otherwise, if any problem arises regarding the maintenance of accounts to a legal firm, then the unorganised accounting information can't be considered as an evidence to prove the consistent practice of accounting.

3.7 FINANCIAL ACCOUNTING TO IDENTIFY OPPORTUNITIES.

Apart from consistency and better financial picture, another advantage of proper accounts is that it will help in identifying the beset opportunities available in the industry and can make decisions to seize the opportunity when they're available.

A byproduct of good accounting is the valuable data on the current situation of the firm and using the financial reporting information, the management or the senior partners can make a

data driven decision regarding which opportunities to be chosen and which shall not be accepted. Accounting helps to ascertain which opportunity will give the best positive outcome like, opportunities to reduce overheads, opportunities for financial growth etc.

Apart from the above points, the following steps are also worth considering:

- to bill clients via email,
- accept online credit card payments,
- simplify your billing workflow
- making collections more straightforward and secure, so your firm can get paid faster.t etc.

The online transactions would have more evidentiary value when compared to the manual operations in a law firm.

3.8 FIVE COMMON LEGAL ACCOUNTING & BOOKKEEPING MISTAKES

A lot of misconceptions can make a lawyer take bad decisions regarding the accounts of law firms. The following are five common legal accounting mistakes that lawyers should avoid at any cost when they're conducting the accounting process.

1. *Mismanaging trust accounts*

Trust accounts are one of the most common areas where legal accounting mistakes are made. The mismanagement of the accounts, putting funds in the wrong account, or failure to report correctly, trust accounting errors are a big deal in accounting for law firms. Trust accounting mistakes can lead to repercussions such as penalties, suspension, or even losing the right to practice law (falsification of accounts is an offence in the Indian Penal Code)

The money in the trust account is not the lawyers money. It is the money of the client. There can be no commingling of funds

Other things to keep in mind:

- **Keep meticulous records.** The exact requirements vary by the jurisdiction, but most state bar association rules require law firms to keep and maintain detailed records for client trust accounts
- **Keep separate accounts.** Most recordkeeping rules require attorneys to keep at least two bank accounts—an operating bank account and a separate IOLTA bank account
- **Use technology to help:** use various advanced level Softwares to :
 - Setup separate ledgers for trust and operating accounts.
 - Creating invoices that explain what funds were removed from a trust and what remains in their trust account.
 - Generating trust accounting reports.
 - Making it easier to conduct three-way reconciliations of accounts.

2. Incorrectly differentiating income and revenue

Whenever a client pays an invoice, the payment to the cost incurred to matter must be allocated first This is a golden rule of accounting in law firms. This portion is not income, so, it must be entered separately. If a firm fails to separate revenue that covers incurred costs from actual revenue, their records will be ineffective.

3. Data entry errors

Accountants and lawyers are human beings. Making errors are in the nature of mankind. There's no exception in any profession. Entering numbers manually often leads to mistakes, complication in figures of multiple digits, and duplicated data entry in various fields the accounting process. This results in waste of time, money, effort, mismatched records, billing complications, and even compliance violations.

4. Leaking money

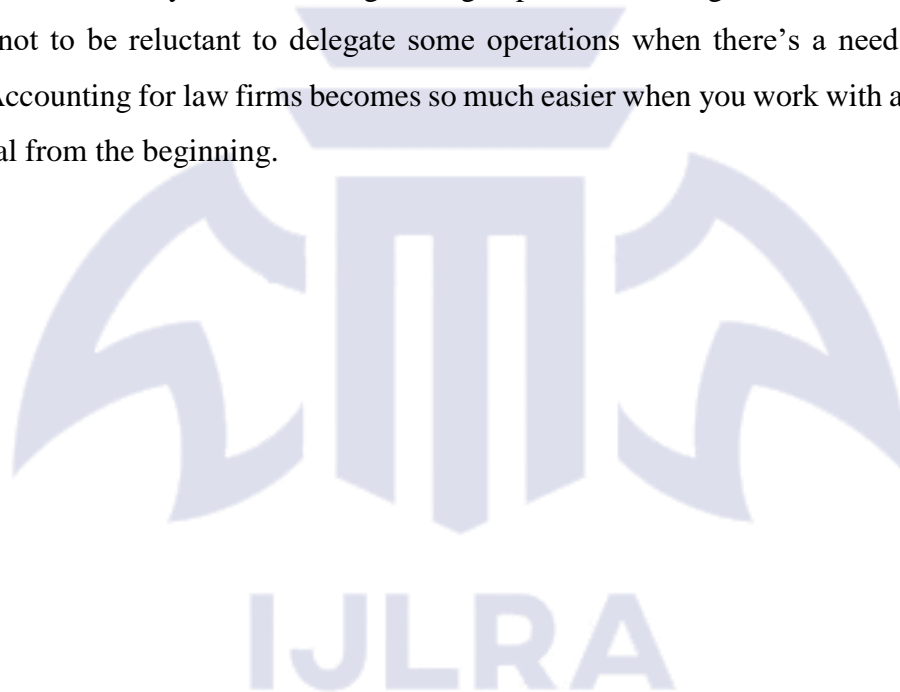
Poor accounting practices, difficulty in tracking billable hours or delay in sending out invoices can lead to leakage of money from the firm. It occurs when funds that should have come in as revenue or income are lost or not collected. According to the average collection rate reported in the *Legal Trends Report*, lawyers only collect 85% of what they usually bill, the rest 25%

they fail to bring in as the final revenue to the firms. Along with this, if the firm is not keeping good books or reviewing financials regularly, these leaks will not be noticed.

By the end of the accounting year, the firm loses out on hard-earned revenue

5. Avoiding professional help

Just as clients rely on your expertise with the law, there comes a point when the lawyers need to depend on accounting professionals. Whether it means using legal accounting software to simplify and automate your accounting, hiring a professional legal accountant, or both, its important not to be reluctant to delegate some operations when there's a need to share the pressure. Accounting for law firms becomes so much easier when you work with an accounting professional from the beginning.



CHAPTER 4

AUTOMATION AND LEGAL PROVISIONS RELATED TO ACCOUNTING

In the previous chapters, the basics of accounting, how it can be implemented in the accounts of a legal firm and the best practices in that field were discussed. In this chapter, the concept of automation is discussed, and also, the various statutes containing provisions for accounting in Indian legal system, various cases, judgements in previous cases etc are being worked on.

4.1 AUTOMATION OF ACCOUNTING PROCESS

Accounting automation involves using computers and softwares for automating essential financial functions. The processes such as updating financial data, reconciliation between the cash and bank statements etc. can be done using various free and paid accounting softwares. The preparation of final financial statements can be done through these softwares, with no human contact or interaction. Once a program is all set to run on a computer system, the whole accounting process will be carried out automatically, and periodical reports will be generated. Emerging technologies such as artificial intelligence, robotic process automation etc helps to achieve the goal of automated accounting processes. This doesn't mean that the human element can be completely eliminated. It just automates the heavy manual and time consuming tasks.

The top management and senior partners can spend their time on making crucial management decisions instead of focusing on the proper accounting process. Automation helps to improve efficiency, accuracy and compliance. Those organisations that lag behind in adopting the automation process will see low productivity and will be less efficient when compared to their competitors. Accounting softwares help in reducing multiple duplicate and complex processes thereby helping in reducing the cost of accounting in an organisation. The task of retrieving and locating data is easy when compared to manual accounting methods.

Even though automation has all the advantages aforesaid, the cost of implementing the system, employee training, time consumed to have familiarity with the user interface , etc. shall be borne by the organisation.

Some of the areas that can be automated are,

- Payroll
- Purchase management
- Accounts receivable
- Finance management
- Cash visibility and forecasting
- Expenses management.

4.2 BEST ACCOUNTING SOFTWARES FOR LEGAL ACCOUNTING.

Accounting softwares play a key role in the automation of the accounting process in a firm. A legal firm is no different. The following are some of the most modern and most commonly used accounting softwares.

1. XERO

Xero is a New- Zealand based technology company. They provide cloud-based accounting solutions for small and medium sized organisations. That is the system is online. They have apps for expense management, inventory management, invoicing, project management and bill payment. It is the best or international law firms.

2. FRESH BOOKS

FreshBooks is another accounting software developed by 2ndSite Inc. primarily for small and medium-sized businesses. It is a web-based software as a service model (SaaS) that can be accessed through a desktop or mobile device using an internet connection. ie, this software can't be saved on a laptop or a PC. This offers invoicing, time and expense tracking, simple project management and wide range of general accounting application tools.

3. WAVE

Wave is a company that provides financial services and software for small businesses. Wave is headquartered in the East Bayfront neighbourhood in Toronto, Canada. This software helps

medium and small enterprise owners to handle double entry accounting. It offers tools for, payroll and online payments.

4. QUICK BOOKS

QuickBooks is an accounting software package developed and marketed by Intuit. First introduced in 1983, QuickBooks products are geared mainly toward small and medium-sized businesses. Quick books online is the browser version of popular desktop accounting software.

Quick books latest version has the new features such as:

- Scheduled bill payment
- Automatic bill entry
- Entry of documents through mobile device etc.

5. ABACUS DATA SYSTEMS

Abacus Data Systems, doing business as Caret is an American software and private cloud services provider headquartered in San Diego, California. It is a comprehensive legal practice management solution. It has built in payments and complete legal accounting tailor made for specific practice areas. It is also able to generate professional invoices for any billing requirement. It also helps to answer all the queries of the customer spot on.

6. COSMOLEX

Cosmo Lex is a cloud-based law accounting software that's part of the Tabs3 family. It comes with built-in trust accounting tools. It is a cloud based legal management , which offers features including time tracking, billing, trust accounting. It is also an efficient law firm billing software.

7. LEANLAW

LeanLaw is exclusively designed for law firms and legal practitioners with excellent time tracking.

8. ORACLE NETSUITE

Oracle NetSuite allows to manage the fixed assets. The complete lifecycle of an asset (both depreciating and non-depreciating) can be tracked right from its purchase to disposal.

Numbers such as a change in value will come in handy when you want to calculate your law firm's overall worth and market valuation or do your taxes.

Oracle NetSuite is particularly great for large law firms as it offers such functionalities, from financial consolidation and reporting to project and asset management, and even a great CRM (customer relationship management) software for tending to clients. For day-to-day accounting, NetSuite maintains a general ledger where the transactions can be recorded along with complementary details such as transaction number, summary, and currency.

9. Zoho ACCOUNTING

Zoho Accounting stands out for its free forever plan and its dedicated customer portal. Here, the organisation can ask its customers for feedback on their experience and discover areas that could use improvement. It enables to communicate with your clients and expedite estimate requests, quote approvals, and other queries.

It's a more efficient way to deal with the clients instead of conventional routes such as emails. This portal also allows the clients to make payments, either in bulk or individually, so that they don't have to depend on the firm's team for any transaction, which is also a benefit for your team. Zoho Accounting also provides a similar portal for vendors, which has the same features as the customer portal.

10. TURBOTAX

Strictly speaking, turbotax is not an accounting software. It is more like a virtual tax advisor or guru. Its only one software that provide an all in one, centralised tax solution for a law firm. It gives you the option to either have its in-house experts do your taxes, or you can do it yourself with help from them – it all depends on the plan you choose.

4.3 PROVISIONS UNDER VARIOUS ENACTMENTS:

The following are the various provisions and punishments given in different enactments under the Indian legal system regarding the preparation, and keeping of books of accounts, persons responsible for the same etc. and they also discuss what happens in case these provisions are not followed. The realm of accounting is not only limited to law firms, but the statutory provisions of each type of entity would be applicable to the legal organisation depending on what type of organisation is being constituted for providing legal services.

When the organisation is a law firm, then the provisions of the Indian Partnership Act would be applicable, then in the case if it's a company, the provisions regarding the books of accounts of a company would be applicable. But in any case, the provisions given in the Income Tax Act of 1961 are applied. That is because, the Income Tax Act covers all types of entities like individuals, Association of Persons, Body of Individuals, firms, body corporates and even artificial juridical person.

Some of the important statutes which cover the provisions regarding accounting and maintenance of books of accounts are mentioned below.

4.3.1 INCOME TAX ACT 1961

Section 44AA of Income Tax Act and rule 6F of Income Tax rules deal with the provisions regarding maintenance of books of accounts under Income tax Act.

As per section 44AA(1) read with rule 6F the persons carrying on any of the profession as mentioned below are required to maintain books of accounts and other documents as may enable the assessing officer to compute his total income, if yearly gross receipts of the profession exceeded Rs 1,20,000.

- 1) Legal
- 2) Medical

- 3) architectural
- 4) engineering
- 5) accountancy
- 6) technical consultancy
- 7) interior decoration
- 8) Authorized representative
- 9) film artist
- 10) any other profession is as notified by the board.

When no books of accounts are required to be maintained by professionals covered u/s 44AA(1):

Proviso to Rule 6F (1) provides that if the gross receipts of a profession do not exceed Rs 120000 in any one of the three years immediately preceding the previous year or where the profession has been newly set up in the previous year, his total gross receipts in the profession for that year are not likely to exceed the said amount, then such professional need not to maintain any books of accounts as mentioned in sub rule 2 of rule 6F.

It means that if the gross receipts of a profession exceeds Rs 1,20,000 in all the three years preceding the previous year, only then the books of accounts will be required to be maintained, if the gross receipts exceed the limits in any two previous years, but not the third preceding year, then there will be no need to maintain books of accounts as contemplated in sub rule 2 of rule 6F.

Maintenance of Books of accounts by other Persons covered u/s 44AA (2):

In relation to any other persons engaged in any other profession or carrying on any business other than section 44AA (1), the requirement of compulsory maintenance of books of accounts applies if- either the income from business or profession exceeds Rs 120000 or the turnover or gross receipts exceed Rs 10 Lakhs in any one of the three years immediately preceding the previous year.

When no books of accounts are required to be maintained by other persons covered under section 44AA (2):

If the Income or the gross receipts or gross turnover of a person carrying on business or profession other than profession as mentioned u/s 44AA (1) do not exceed in any one of the three years preceding the previous year then no books of accounts will be required to be maintained u/s 44AA (2).

Presumptive Income scheme:

The persons who are filling their return of income under the presumptive income scheme like under section 44AD or 44ADA or 44AE or 44AF etc are not required to compulsorily maintain books of account u/s 44AA. However, where the profits and gains from the business are deemed to be profits and gains u/s 44AD or 44ADA or 44AE or 44AF or 44BB or 44BBB as the case may be, and the assessee has claimed his income to be lower than the profits or gains so deemed, then the books of accounts will be required to be maintained u/s 44AA.

Maintenance of books of accounts in case of 44AD section:

Sub section 2 of section 44AA provides that where the profits and gains from a business are deemed to be profits and gains of the assessee under section 44AD and the assessee has claimed such income to be lower than the profits and gains so deemed i.e. below 8%/6% and the income of the assessee exceeds the maximum amount which is not chargeable to income tax during previous year then in such case such person shall keep and maintain such books of accounts and other documents as may enable the assessing officer to compute his total income.

Thus it means that if a person declares his income below the 8%/6% of his total turnover or gross receipts as required u/s 44AD and his income is above the exempted limit then he will have to compulsorily maintain his books of accounts. But if his total income is below the exempted limit and profits are also declared below 8%/6% of gross turnover or gross receipts then he will need not to maintain compulsory books of accounts.

What books of accounts are required to be maintained by persons covered u/s 44AA(1):

As per Rule 6F(2) the following books of accounts and documents are required to be maintained:

- 1) cash book,

- 2) Journal, if the accounts are maintained as per mercantile system of accounting,
- 3) ledger
- 4) carbon copies of bills, serially numbered and carbon copies or counterfoils of receipts issued in respect of sums exceeding Rs 25,
- 5) original bills for expenses exceeding Rs. 50 and payment vouchers for petty expenses. However in a case where the cash book maintained by the person contains adequate particulars in respect of the expenditure incurred, then vouchers are not necessary in respect of expenses upto Rs 50.

Books or books of accounts have also been defined u/s 2(12A) as including ledgers, day-books, cash books, account-books and other books, whether kept in the written form or as print-outs of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device.

Document has been u/s 2(22AA) as including an electronic record as defined in clause (t) of sub section (1) of section 2 of the Information Technology Act, 2000.

For how many years books of accounts are required to be preserved:

Every year the record of books of accounts grows up and the cupboards filled up more and more. Every assessee wants to know for how many years he should keep the records of his books of accounts.

Rule 6F(5) provides that the books of accounts and other documents are to be kept for at least 6 years from the end of relevant assessment year. That means from the assessment year 2020-21 one should keep books of accounts upto the assessment year 2014-15 i.e. books of accounts of financial year 2013-14.

The time limit for issuing notices for assessment or reassessments have been prescribed u/s 149, after the end of such prescribed time no notice can be issued and no assessment can be framed, therefore the assessee will not need books of accounts of the concerned year. Keeping in mind the time limit as provided u/s 149 for issuing notice the following suggestions are made regarding preservation of books of accounts:

- 1) If the assessee has made an appeal against any assessment order of any year then the books of accounts of such year should be preserved until the final decision of such appeal.

2) Where the assessment in relation to any Year has been reopened u/s 147 within time u/s 149, in such case all the books of account and documents shall continue to be kept till the assessment so reopened has been completed.

3) Books of accounts for only 7 financial years should be preserved. Therefore, the taxpayers should keep books of accounts of only financial year 2013-14 and onwards.

Where the books of accounts should be kept:

The current year's books of accounts should be maintained and kept at the principal place of business or profession as per Rule 6F(3). There is no specific rule as to where the books of accounts of earlier years should be kept.

Consequences for failure to maintain books of accounts:

Failure to maintain books of accounts and other documents or to retain them as required u/s 44AA attracts penalty of Rs. 25000 u/s 271A.

The penalty can be imposed by the assessing officer or the commissioner of Income Tax (Appeal).

4.3.2 COMPANIES ACT 2013

Section 128 of the Companies Act, 2013 provides for Maintenance of books of accounts under the new Companies Act. The erstwhile corresponding section 209 on "Books of accounts to be kept by company" of Companies Act, 1956 dealt with the books of accounts required to be maintained to give a true and fair view of the state of affairs of the company or branch office and to explain its transactions and also specify the place of keeping and period for which such books to be kept by the company. The responsibility for maintenance books of accounts was also fixed by this provision.

The significant changes introduced in this section are as follows:

- a) books of accounts may also be kept in electronic form

b) a director of the Company can inspect the books of accounts of the subsidiary, only with the authority of the Board of Directors.

MAINTENANCE OF BOOKS OF ACCOUNTS

Maintenance of books of accounts would mean records maintained by the company to record the specified financial transaction. It has been specifically provided that –

1. Every company shall keep proper books of accounts. This clause specifies the main features of proper books of accounts as under –

(i) The company must keep the books of accounts with respect to items specified in clauses (i) to (iv) of sub-section 2(13) which defines “books of accounts”.

(ii) The books of accounts must show that all money received and expended , sales and purchases of goods and the assets and liabilities of the company.

(iii) The books of accounts must be kept on accrual basis and according to the double entry system of accounting.

(iv) The books of accounts must give a true and fair view of the state of the affairs of the company or its branches.

2. What is required to be prepared and kept are books of accounts, other relevant books and papers and financial statements. Books of accounts are defined in clause 2(13) , ‘books and papers’ in clause 2(12) and ‘ financial statement’ in Clause 2(40). Both are required to be prepared and kept.

3. Books of accounts, books and papers and financial statements should explain the transactions effected at company’s registered office and any branch(es).

4. Records, books, papers and financial statements must relate to any specific financial year only.

5. A company engaged in production, processing, manufacturing or mining activity, is also required to maintain particulars relating to utilization of material, labour or other items of cost as the Central Government may prescribe for such class of companies.(Section 148)

6. The branches of the company, if any, in India or outside India shall also keep the books of accounts in the same manner as specified in sub-section (1), for the transaction effected at the branch office. Further the branch offices are required to send the proper summarized return

made up-to-date to the company at its registered office or the other places as decided by the board.

7. Books of accounts of the company shall be kept at the registered office of the company.

8. In case of Books of accounts being maintained at any other place other than registered office in India, as may be decided by resolution of Board of Directors, company shall be required to intimate full address of such place to Registrar of Companies within 7 days.

9. The maintenance of books of accounts and other books and papers in electronic mode is permitted and is optional. (Second Proviso to Clause 128(1)).

The person responsible to take all reasonable steps to secure compliance by the company with the requirement of maintenance of books of accounts etc. shall be: (sub-section 6)

- i) Managing Director,
- ii) Whole-Time Director, in charge of finance
- iii) Chief Financial Officer
- iv) Any other person of a company charged by the Board with duty of complying with provisions of section 128.

PENAL PROVISION

In case the aforementioned persons referred to in sub-section (6) (i.e. Managing Director, Whole Time Director, Chief Financial Officer etc.) fail to take reasonable steps to secure compliance of this section and thus, contravene such provisions, they shall in respect of each offence, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakhs rupees or both.

4.3.3 INDIAN PENAL CODE 1860

477A. Falsification of accounts-- Whoever, being a clerk, officer or servant, or employed or acting in the capacity of a clerk, officer or servant, wilfully, and with intent to defraud, destroys, alters, mutilates or falsifies any ²[book, electronic record, paper, writing] valuable security or account which belongs to or is in the possession of his employer, or has been received by him for or on behalf of his employer, or wilfully, and with intent to defraud, makes or abets the making of any false entry in, or omits or alters or abets the omission or alteration of any material

particular from or in. any such ²[book, electronic record, paper, writing] valuable security or account, shall be punished with imprisonment of either description for a term which may extend to seven years, or with fine, or with both.

Explanation. --It shall be sufficient in any charge under this section to allege a general intent to defraud without naming any particular person intended to be defrauded or specifying any particular sum of money intended to be the subject of the fraud, or any particular day on which the offence was committed.]

4.4 ACCOUNTING SCAMS

Accounting is a tool by which the true financial position and financial performance of an organisation can be ascertained. But sometimes, the process of accounting goes wrong, either intentionally or wilfully. The biggest accounting scams take place when there is no compliance with the basic accounting principles and standards, which may often have a negative impact. The following are some of the accounting scams that happened in India and other foreign nations.

1. THE SATYAM COMPUTERS SCAM. (2006-2008)

B Rama Raju, chairman of Satyam Computers, manipulated the books of accounts by not entering certain receipts and payments. resulting in an overall misstatement of 12,318 cr. Merely, through fake invoices, the company's financial statements reported around 4,783 crores rupees excess income over a period of 5-6 years. The scam broke in 2009 when he disclosed that a 7000 Crs rupees scam took place in his company with his knowledge. In April 2009, Ramalinga Raju was convicted with 10 other members for the offence of tampering with accounts. Under the Indian Penal Code, 1860, the Raju brothers were charged with criminal breach of trust, cheating, criminal conspiracy, and forgery.

2. ENRON SCANDAL (2001, USA)

Enron Corporation was an energy, commodities and services company based in Texas. It was discovered in 2001 that, the company used loopholes in the accounting process to hide billions of bad debt, and inflated the company's earnings. As a result, the shareholders lost over \$74

billion as the market price of the shares of the company fell from \$90 to \$1 within a year. On investigation, it was found out that, the company's CEO, Jeff Skillings, and former CEO, Ken Lay, kept billions of dollars of debt from the company's balance sheet. In addition, they had pressured the company's auditing firm, Arthur Andersen, to ignore the issue. The scandal led to the conviction of both Jeff Skillings and Ken Lay. The company was bankrupted and the auditor Arthur Anderson was dissolved.

3. WORLDCOM (2002, USA)

Just one year after the Enron scandal, in the year 2002, it was found that the American telecommunications company based in Virginia, inflated the amount of assets in the balance sheet by around \$11 billion, and also undermined various expenses by capitalizing them without expensing them. The internal audit department of the company found out fraud of \$3.8 billion in the fraudulent accounts of the company. The CEO of the company was sentenced to prison for 25 years and around 30,000 people lost their job.

4. THE CLERANCE HATRY SCAM (UK)

Clarence Charles Hatry (16 December 1888 – 10 June 1965) was an English company promoter, financier, bankrupt, bookseller and publisher. The fall of the Hatry group in September 1929, which had been worth about £24 million (equivalent to £1,550,000,000 in 2021), is cited as a contributing factor to the Wall Street Crash of 1929. Hatry asserted that in late August 1929, he had made a secret visit to the Bank of England to appeal to Montagu Norman for financing to allow him to complete a merger with United Steel Companies, a UK firm. Norman had adamantly refused Hatry's bid for a bridge loan.

By 17 September, when Hatry stock began to fall on the London exchange, Hatry had liabilities of £19 million and assets of £4 million. Norman informed the chairman of the London Stock Exchange that the Hatry group was bankrupt. On 20 September 1929, the London Stock Exchange committee immediately suspended all shares of the Hatry group, which had been worth about £24 million (equivalent to £1,552,250,000 in 2021). On that day, Hatry and his leading associates confessed to fraud and forgery in the office of Sir Archibald Bodkin, the Director of Public Prosecutions and, after lunching at the Charing Cross Hotel, were jailed. The Wall Street Crash began late the following month.

5. IL & FS SCAM (INDIA, 2018)

Infrastructure Leasing and Financial Services Limited which was formed in 1987, was set up with an objective to provide funding for huge infrastructure projects within the country. The problems arose in 2018 when two subsidiaries of the company failed to pay back loans and the company has defaulted on multiple loan payments.

In essence, IL&FS scam involved:

- Giving out loans for long term projects from short term resources and some of these long term projects were stuck in litigation or went bad
- Mr. Ravi Parthasarathy, Chairman of IL&FS Group & his coterie of other directors & senior employees indulged in fraudulent Accounting & Business practices like evergreening of loans to hide the real financial situation
- Auditors suppressing information on bad loans and help inflate profits to present a sense of stability
- Company not complying with the RBI regulations
- The Regulators ignoring a whistleblower complaint that had brought to light the financial irregularities as early as 2017

4.5 LATEST TRENDS IN 2022 AND 2023 OTHER THAN SOFTWARES

The following are the latest technologies that are relevant in the upcoming years in the field of accounting. They are not the softwares like the ones mentioned above, but some important innovations in the field of accounting that would help in the better performance of the accounting softwares also.

1. BIG DATA ANALYTICS IN ACCOUNTING

This technology involves the use of big (large) data, in order to identify the patterns among them that may not be ascertained using the traditional accounting methods. This helps in risk assessment, fraud detection, and financial forecasting. With the expansion of business, the amount of data that is to be processed is also accumulating. Therefore, this technology will gain more importance in the future.

2. PROACTIVE ACCOUNTING

This is also known as continuous accounting using machine learning and RPA to reframe the approach to accounting. This enables the organisation to do the tasks that are normally done on a periodical basis on a day-to-day basis. This improves the efficiency of the accounting system and data integrity. It also saves time of accounting professionals. Thereby, routine monitoring for detecting inefficiencies in the system will be conducted smoothly.

3. ARTIFICIAL INTELLIGENCE AND CLOUD-BASED ACCOUNTING

Cloud technology continues to be recognised and will continue to be highly recommended in the field of accounting. It allows 24/7 access to the data entered in the database through the online platform. They are highly flexible. Artificial intelligence clubbed with cloud-based accounting software provides advanced analytics and predictive capabilities. These aids improved decision making capacity.

4. DATA SECURITY.

Accounting is becoming more and more automated on a daily basis. In this circumstance, it's highly essential to ensure that the data and other sensitive information entered into the cloud-based accounting software are secure and they are private. Here comes the relevancy of the technology of data encryption to prevent the unauthorized access of sensitive information. Multi-factor authentication is implemented to protect the data from hacking and other cyber criminals.

5. BLACKCHAIN TECHNOLOGY

It is a decentralised function that provides enhanced transparency and security for all types of monetary transactions. It aids in accurate record keeping, simplifies audits, and reduces fraud risk.

6. INTEGRATION

In a sense, it is the bringing together of all modules like Customer Relationship management, supply chain management, enterprise resource planning etc. under one roof for much efficient operation of a commercial solutions package. It helps to manage business smoothly.

CHAPTER 5

COMMERCIAL MATHEMATICS

Commercial Mathematics or Business mathematics consists of Mathematical concepts of related to business. It comprises of financial formulas, measurements which helps to calculate profit and loss, discount, percentages, the interest rates, tax etc.

Business Mathematics is highly related to statistics concepts which give solutions to business problems. These formulas usually delas with financial transactions, which deals with something of a monetary value. Even though, the requirement of this field is not pure mathematics, it needs basic mathematical understanding.

Business mathematics is used by each and every entity which keeps a regular account of their financial transactions. Its also useful in the process of inventory management, marketing, sales forecasting and financial analysis.

The most important topics covered in business mathematics are:

- ❖ Profit and Loss
- ❖ Statistics
- ❖ Simple and Compound Interest
- ❖ Interest rates
- ❖ Loans
- ❖ Markups and markdowns
- ❖ Taxes and Tax Laws
- ❖ Discount Factor
- ❖ Annuities
- ❖ Insurance
- ❖ Credit
- ❖ Depreciation
- ❖ Future and Present Values

Apart from the above, the most important equation in accounting or business mathematics is:

$$\text{ASSET} = \text{LIABILITIES} + \text{CAPITAL.}$$

$$\text{Ie, Liabilities} = \text{Asset} - \text{Capital}$$

$$\text{Capital} = \text{Asset} - \text{Liabilities.}$$

This accounting equation came into effect from the assumption that , the left hand side(Assets Side) and the right hand side(Capital+ Liability) of the Balance Sheet would always tally, which means, the amount on both sides would always be equal.

Some of the important equations in the realm of commercial mathematics are mentioned below.

PROFIT AND LOSS

There are two types of profit in a business entity:

- 1) Net Profit
- 2) Gross Profit

The method of finding the profit percentage is as follows:

$$\text{Profit \%} = \frac{\text{net profit}}{\text{gross profit}} \times 100 \text{ Sales}$$

$$\text{Net profit (NP)} = \text{SP} - \text{CP}$$

S.P = Selling price

C.P = Cost Price

INTEREST

It is the computation of what amount would be the return if a certain amount is invested for a particular period of time with a financial institution.

The equation to find out interest is as follows:

SIMPLE INTEREST:

$$I = p \times n \times r \% \quad \text{OR} \quad \frac{P \times N \times R}{100}$$

Here,

P = Principal Amount

N = Number of years/time period

R = rate of interest.

For example, if the amount invested is Rs. 1,00,000 /- for 2 years with a 5% rate of interest, then the interest would be,

$$I = \frac{P \times N \times R}{100}$$

$$I = \frac{1,00,000 \times 2 \times 5}{100}$$

$$= \underline{\underline{\text{Rs. } 10,000.}}$$

COMPOUND INTEREST

$$A = P \left(1 + \frac{r}{n}\right)^{nt}$$

Where,

A = Final Amount at the end of the investment period

P = Initial Principal Amount

r = Rate of interest

n = Number of years/ time period

t = Number of time periods elapsed.

In this method, different from simple interest, interest is calculated on interest amount + principal amount.

For example, 1,00,000 is the principal amount, considering 5,000 is the interest, then, the next 5% would be calculated over 1,00,000 + 5,000 ie, on 1,05,000 then the amount of next interest would be 5,250, not 5,000.

ANNUITY

The calculation of an annuity follows a formula:

$$\text{Future Value of an Annuity} = C \left(\frac{(1+i)^n - 1}{i} \right)$$

Where,

C = regular payment

i = annual interest rate or discount rate in decimal

n = number of years or periods.

TAXES

The calculation of taxes is done to comply with the taxing statutes implemented in the country.

For example, if the income of Rs 2,50,000 is taxable at the rate of 5%

Then the tax would be Rs 12,500

RETURN ON INVESTMENT

$$\frac{\text{Investment gain} - \text{Cost of Investment}}{\text{Cost of Investment}} \times 100$$

Calculating return on investment is important in the case of each and every business institution to know about which investments are profitable and which are not. this information helps to decide whether to invest further, or divest.

DISCOUNT

The reduction in price given to a customer/ client on purchasing or availing, goods or services is called discount. To find the discount percentage, the following formula is applied :

$$\text{Discount percentage} = \frac{\text{Discount}}{\text{Market price/service cost}} \times 100$$

For example, the fee usually charged from a client is 25,000. Even though, only Rs 20,000 is charged. Then, the discount given to him is Rs. 5000

Then the percentage of discount

$$= 5000 / 25000 \times 100$$

$$= 20\%$$

DEPRECIATION

A law firm may own various fixed assets. The concept of depreciation helps to ascertain the actual value of the fixed asset by the end of its useful life. Therefore, each year, the depreciation shall be deducted from the main fixed asset account, that is, from the cost price. The most common method to calculate depreciation is straight line method.

Straight line method =

$$(\text{Asset value} - \text{salvage value}) / \text{useful life}$$

For example :

$$\text{Value of the asset} = 500000$$

$$\text{Scrap value} = 100000$$

$$\text{Useful life} = 10 \text{ yrs}$$

$$\text{Depreciation} = (500000 - 100000) / 10$$

$$= 400000 / 10$$

$$= 40000.$$

BUSINESS STATISTICS AND GRAPHICS

Business statistics is a fundamental tool of business analytics. Business analytics helps companies to understand the present situation of an organisation and predict the future tendencies also. The various statistical tools that can be utilised in the organisation accounting and communication are ,

- Mean
- Median
- Mode
- Standard deviation,
- Variance etc.

GRAPHICS

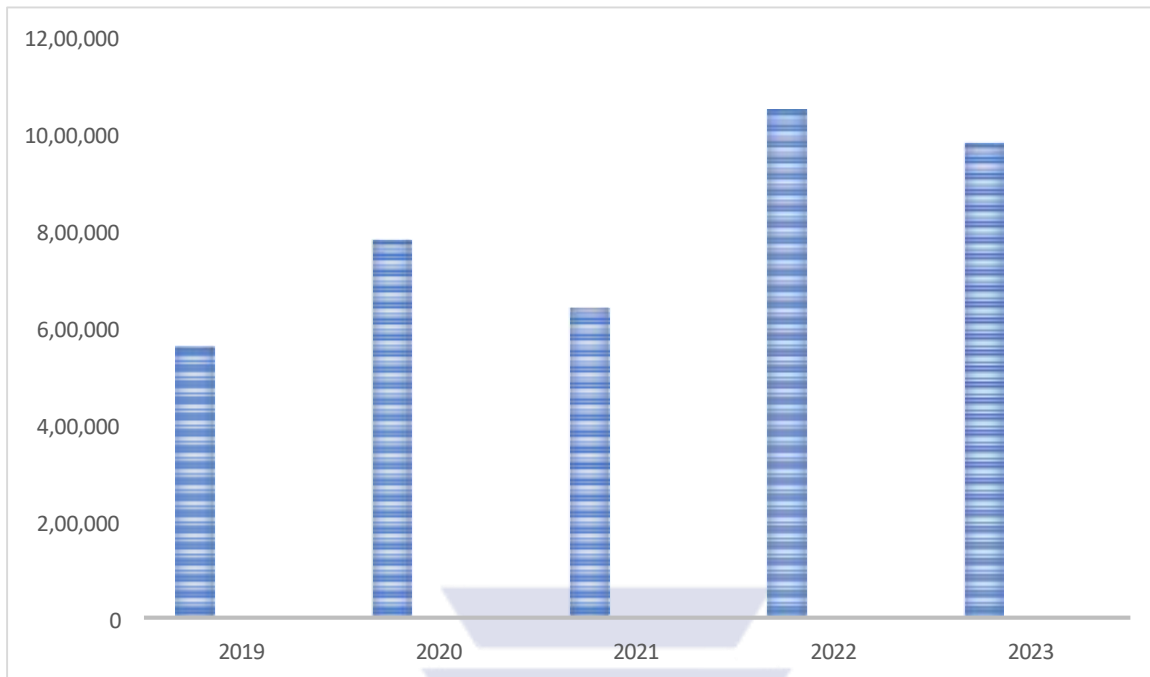
The most relevant tools in business graphics are

- Pie diagram
- Bar diagram
- Graphs
- Histogram
- Line diagram etc

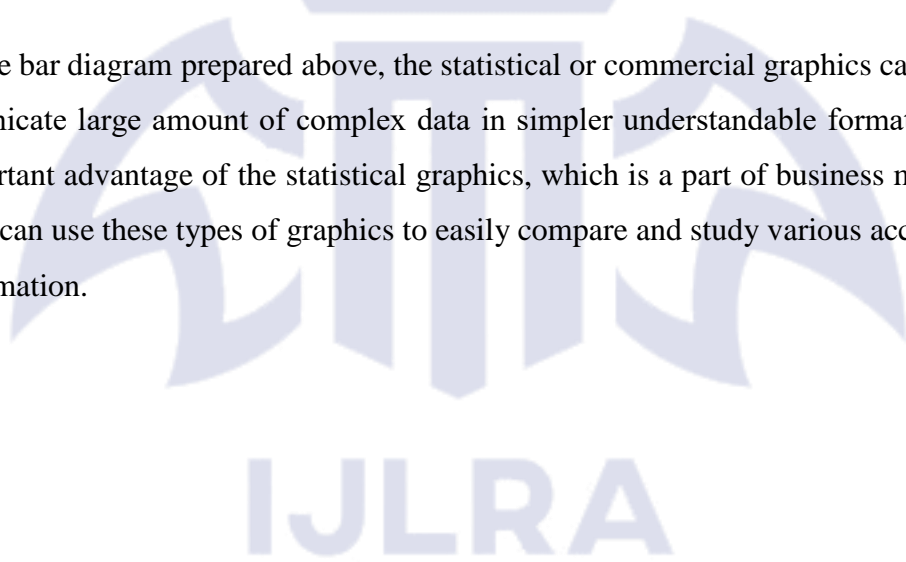
ILLUSTRATION:

Preparing a bar diagram to communicate the fees received by the law firm in the previous 5 years:

YEAR	FEES RECEIVED
2019	560000
2020	780000
2021	640000
2022	1050000
2023	980000



Just like the bar diagram prepared above, the statistical or commercial graphics can be utilised to communicate large amount of complex data in simpler understandable format. That's the most important advantage of the statistical graphics, which is a part of business mathematics. Law firms can use these types of graphics to easily compare and study various accounting and legal information.



CONCLUSION

In conclusion, accounting in legal firms plays a crucial role in ensuring financial transparency, regulatory compliance, and efficient management of client funds. Unlike ordinary business accounting, legal accounting requires strict adherence to professional ethics and legal standards, particularly in handling client trust accounts, billing practices, and expense tracking.

Proper accounting systems help law firms maintain accurate records, avoid legal liabilities, and build trust with clients. It also supports better financial decision-making, profitability analysis, and long-term sustainability of the firm.

With the advancement of technology, modern accounting software has made it easier for legal firms to streamline their financial operations, reduce errors, and ensure compliance with applicable laws and regulations.

Overall, effective accounting is not just a support function but a fundamental pillar for the success, integrity, and reputation of any legal firm.

