Attorney CLE Series

Law Firm Economics

June 11, 2015

GROSSMAN YANAK & FORD LLP
Certified Public Accountants and Consultants

Robert J. Grossman, CPA/ABV, ASA, CVA, CBA

Bob heads our firm's Tax and Business Valuation Groups. He has over 35 years of experience in tax and valuation matters that affect businesses, both public and private, as well as the stakeholders and owners of these businesses. The breadth of his involvement encompasses the development and implementation of innovative business and financial strategies designed to minimize taxation and maximize owner wealth. As his career has progressed, Bob has risen to a level of national prominence in the business valuation arena.

His expertise in business valuation is well known, and Bob is a frequent speaker, regionally and nationally, on tax and valuation matters. Bob is a course developer and national instructor for both the American Institute of Certified Public Accountants (AICPA) and the National Association of Certified Valuators and Analysts (NACVA). He has served as an adjunct professor for Duquesne University and Saint Vincent College. He has also written articles for several area business publications and professional trade journals.

After graduating from Saint Vincent College in 1979 with Highest Honors in Accounting, Bob earned a Masters of Science degree in Taxation with Honors from Robert Morris University. He is a CPA in Pennsylvania and Ohio and is accredited in Business Valuation by the American Institute of Certified Public Accountants. Bob also carries the well-recognized credentials of Accredited Senior Appraiser, Certified Valuation Analyst and Certified Business Appraiser.

A member of the American and Pennsylvania Institutes of Certified Public Accountants (PICPA), Bob has previously chaired the PICPA Pittsburgh Committee on Taxation. He has also served as Chair of the Executive Advisory Board of NACVA, its highest Board; as well as Chair of NACVA's Professional Standards Committee and its Education Board.

Bob received NACVA's "Thomas R. Porter Lifetime Achievement Award" for 2013. The award is presented annually to one of the organization's 6,500 members, who has demonstrated exemplary character, leadership and professional achievements to NACVA and the business valuation profession, over an extended period.

Bob is a member of the Allegheny Tax Society, the Estate Planning Council of Pittsburgh and the American Society of Appraisers. He has held numerous offices in various not-for-profit organizations. Bob received the PICPA Distinguished Public Service Award and a Distinguished Alumnus Award from Saint Vincent College.

Bob and his wife, Susie, live in Westmoreland County. They have two grown children.

John M. Yanak, CPA

John serves as the managing partner for the firm as well as one of two partners leading the Audit & Assurance Services Group. He has more than 35 years of experience in providing audit, accounting and consulting services to privately-held businesses in numerous industries, as well as not-for-profit organizations, including educational institutions, trade associations and community service groups.

His expertise includes significant transaction work in both the acquisition and divestiture arenas. John has assisted private equity groups and corporate entities with due diligence and structuring decisions. His experience in diligence and structuring has enabled him to guide efforts to achieve desired tax efficiencies that help reduce the cost of a transaction. In addition, he helps companies interpret the financial reporting requirements associated with M&A transactions.

John has served as an acting chief financial officer for companies during the closing of offices or operations and during periods of difficulty when the companies required expertise above that available in their own organizations. He has also assisted a number of companies through workouts and reorganizations, including formal proceedings under Chapter 11 of the U.S. Bankruptcy Code and has helped clients to obtain financing and negotiate with lenders.

John graduated from Grove City College in 1979 with Honors in Accounting and joined an international accounting firm in Pittsburgh. He later enrolled in the Graduate School of Business at the University of Pittsburgh and obtained an MBA in Finance. He returned to public accounting, emphasizing service to privately-held businesses and their owners as well as not-for-profit entities and employee benefit plans.

He is a member of both the American and Pennsylvania Institutes of Certified Public Accountants. John is involved in community and not-for-profit organizations, and he is periodically called upon to speak on various topics of interest to the local business community. John has also taught audit and business accounting courses on a regional and local level.

John and his wife, Becky, reside in Upper St. Clair. They have three adult children and one grandchild.

Melissa A. Bizyak, CPA/ABV/CFF, CVA

Melissa, a partner in the firm's Business Valuation & Litigation Support Services Group, has practiced in public accounting for over 20 years. She has significant experience in business valuation and tax-related issues for privately-held concerns and their owners.

Her business valuation experience is very diverse, including valuations of companies in the manufacturing, oil and gas and technology industries. These valuations have been performed for various purposes such as financial reporting, equitable distributions, buy/sell transactions, dissenting shareholder disputes, Employee Stock Ownership Plans (ESOPs), value enhancement and gift and estate tax purposes. Melissa also provides litigation support services including expert witness testimony.

After graduating from the University of Pittsburgh in 1994 with a B.S. in Business/Accounting, Melissa spent two years with a local accounting firm in Pittsburgh. She joined Grossman Yanak & Ford LLP in 1997.

Melissa is a certified public accountant. She is accredited in business valuation and certified in financial forensics by the American Institute of Certified Public Accountants (AICPA). She has also earned the AICPA Certificate of Achievement in business valuation. Additionally, Melissa carries the credentials of Certified Valuation Analyst.

Her professional affiliations include the AICPA, the Pennsylvania Institute of Certified Public Accountants (PICPA) and the Estate Planning Council of Pittsburgh. She is a member and serves as the Chair of the Executive Advisory Board of the National Association of Certified Valuators and Analysts (NACVA).

Melissa has written business valuation course-related materials and serves as a national instructor for NACVA. She has also authored articles appearing in professional publications.

Melissa is a graduate of Leadership Pittsburgh, Inc.'s Leadership Development Initiative. She serves on the Board of Directors of the Children's Museum of Pittsburgh and is a member of the Executive Leadership Team for the American Heart Association's "Go Red for Women" initiative. Melissa is also a mentor for women business owners through Chatham University's MyBoard program.

Melissa resides in the South Hills of Pittsburgh with her husband and their two sons.

Grossman Yanak & Ford LLP

Headquartered in Pittsburgh, Grossman Yanak & Ford LLP is a regional certified public accounting and consulting firm that provides assurance and advisory, tax planning and compliance, business valuation, ERP solutions and consulting services. Led by five partners, the 24-year-old firm employs approximately 55 personnel who serve corporate and not-for-profit entities.

Our firm was founded on the idea that the key to successful, proactive business assistance is a commitment to a high level of service. The partners at Grossman Yanak & Ford LLP believe that quality service is driven by considerable involvement of seasoned professionals on a continuing basis. Today's complex and dynamic business environment requires that each client receive the services of a skilled professional with a broad range of experience and knowledge who can be called upon to provide efficient, effective assistance.

Grossman Yanak & Ford LLP combines a diversity of technical skills with extensive "hands-on" experience to address varied and complex issues for clients on a daily basis. We pride ourselves on bringing value-added resolution to these issues in a progressive and innovative manner. Our ability to produce contemporary, creative solutions is rooted in a very basic and ageless business premise – quality service drives quality results. Our focus on the business basics of quality technical service, responsiveness and reasonable pricing has enabled the firm to develop a portfolio of corporate clients, as well as sophisticated individuals and nonprofit enterprises.

Our professionals understand the importance of quality and commitment. Currently, the majority of the professional staff in our Assurance and Advisory Services and Tax Services Groups hold the Certified Public Accountant designation or have passed the examination and need to complete the time requirements for certification. Each of our peer reviews has resulted in the highest-level report possible, attesting to the very high quality of our firm's quality control function. The collective effort of our professionals has resulted in our firm earning an exemplary reputation in the business community.

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The following courses have been presented by our professionals:

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- *Special Purpose Valuations: Estate & Gift Tax Planning*
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- *Navigating the New Tax Laws: Recent Changes & 2013 Planning*
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- *Understanding ESOPs and Their Use In Exit Planning*
- *Advising Individual Tax Clients for 2013 and Beyond*
- *Analyzing Financial Statements and Their Impact on Value*
- *Exit Planning: Considerations and Steps for Exiting a Business*
- *Planning in a Changing Tax Environment*

Handouts and slides from these presentations can be downloaded at www.gyf.com

Table of Contents

Special thanks to the following attorneys for their review of these materials:

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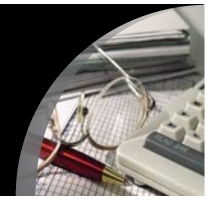


Law Firm Economics

Introduction and Background

Few people work harder than those employed in the professional services industries. Certainly, those working in the legal profession are no exception. The most critical issue surrounding most legal practitioners in the realm of public law firms is how best to monetize all of the training, experience and expertise captured in years of effort. While few attorneys would change the careers that they have worked so hard to attain, many find themselves struggling with the very concept of converting the practice of law into a viable, ongoing business.

While the practice of law was once viewed as a higher calling (above the fray relating to ordinary business ventures), a transition over the last several decades due to pricing pressures, the push by market forces to deliver legal services in a more efficient manner, an over-abundance of qualified and experienced lawyers, alternative providers and rising costs (both direct and indirect) have led the most progressive firms to look to strategic planning on a medium- to long-term basis to help identify four critical elements required for their financial well-being. These four elements are described below.

Revenue Growth Challenges

Monitoring the marketplace more carefully and tactically can provide a myriad of revenue generation opportunities that might otherwise go by the wayside. Early identification of these opportunities situates the firm for faster adaptation and "retooling," providing a longer economic window from which they might benefit. Transformation to new capabilities and ways to deliver legal services is not only critical today, but also will be an important part of the legal profession for the foreseeable future. It goes without saying that a failure to meet these necessary transformations will result in losing ground to other firms which are doing so.

Cost Containment Challenges

With greater fee pressure mounting every year since the "Great Recession," the most common, and perhaps the most logical, response is cost containment. No vendor to any law firm is the least bit concerned that the same percentage cost increases they are requesting are being passed on to that firm's clients. Moreover, there is virtually no way to make a serious difference through cost containment initiatives without attacking the cost of attorneys and the costs associated with occupancy. While periodic negotiation may have some effect on the latter, the former serves as the very lifeblood of the firm, and a failure to economically satisfy both partner and non-partner professional staff may lead to substantial defections, and worse.

Law Firm Economics

Staff Management Challenges

There is a great deal of public commentary discussing staffing strategies in traditional law firm settings. The key challenge is meeting client demands and needs in times of excessive work volume without adding additional staffing. Too often, new lawyers are hired without substantive economic due diligence and cost justification. Given the cost of adding new attorneys, it is necessary for management groups to seek alternative, lower-cost solutions to maintain profitability while still delivering quality services.

Practice Management Challenges

Practice management is, and will be even more critical in the future to every firm of every size. In terms of understanding exactly what is meant by "practice management," envision it as a four-pronged challenge. These prongs include the following (in no particular order):

- **Personnel management** encompasses the design and implementation of appropriate staffing strategies to ensure that staff additions are aligned closely with profitability and cost justification. In addition, firm leaders involved in personnel management must undertake careful consideration of all employees in the "non-equity" tier.

  Surveys, such as those prepared by Altman Weil, Inc.,[1] clearly illustrate that this is a group of employees (non-equity) that is quickly expanding and requires close attention. While there will always be a place and role for these employees, it is clear that this tier of employees needs closer attention and discipline. Many of these individuals can easily be classified as "comfort zoners." That is to say, that while these individuals are doing an adequate job in their current positions, they may be contributing little, if anything, to the longer-term growth prospects of the firm.

  Particular attention should be paid to developing exit strategies that benefit not only these individuals, but also the firm. Maintaining the status quo in employee headcount is never advantageous if that headcount proves to be a barrier to further profitability for the entire stakeholder group.

- **Knowledge management** is predicated upon collecting or capturing knowledge coming into the firm from the outside, as well as utilizing knowledge available from within the firm. Once collected and captured, that information needs to be catalogued and organized in a manner that makes the resources and expertise easily accessible throughout the firm.

[1] Law Firms in Transition 2015: An Altman Weil Flash Survey – Conducted in March and April 2015, the survey polled Managing Partners and Chairs at 797 U.S. law firms with 50+ lawyers. Completed surveys were received from 320 firms, including 47% of the 350 largest U.S. law firms and 45% of the Am Law 200. The complete report includes sections on industry trends, market demand and competition, pricing and alternative fee arrangements, efficiency of legal service delivery, lawyer staffing strategies, law firm growth and economic performance.

Law Firm Economics

Such a system, when properly managed, will lead to better professional development along with improved quality and more efficient delivery of legal services. Finally, once these goals are attained, professionals within the firm will most likely be better able to cross-sell services within the firm.

- **Legal project management** entails the design and implementation of a long-term and ongoing training program aimed at introducing and accentuating a systematic means of enhancing project delivery. No concept in firm management should be more intuitive than giving firm employees the tools and training necessary to accomplish their assignments in the operational manner designed and desired by management to achieve the firm's profitability goals and targets.

  A properly designed and implemented project management training program will not only allow for fundamental operational change when circumstances require, but it will also result in a number of economic benefits, including creating greater efficiencies for clients, improving project profitability and, ultimately, allowing for firm differentiation and competitive advantage. Such programs can also prove instrumental in supporting professional staff innovation.

- **Fiscal and economic management**, the topic of today's program, is often viewed by the leaders of legal firms as the most daunting and challenging aspect of law firm management. The logical starting point for fiscal and economic management is to align billing rates and pricing with client preferences. The fundamental precept here, which will be discussed in greater detail later in these materials, is to implement with each client a pricing mandate that meets the metrics of his or her value proposition.

  Like it or not, every client has a stakeholder position in the law firm serving it, and the relationship is predicated upon the creation and ongoing maintenance of an equally-beneficial "value proposition." Only when the client embraces the billings from the law firm as a fair bargain for the services received will the interests of both parties be fully served. To strike the proper balance in setting the value proposition, it is necessary that law firms look to alternatives to a straight hourly billing process and adapt according to client needs.

  Based on the 2015 Altman Weil survey, over 94% of law firm management respondents felt that more price competition was going to be a permanent change to the profession. This compares to only 42% who felt the same way in the first survey conducted in 2009. Nearly 90% of the 2015 respondents felt that the provision of legal work will be commoditized on a permanent basis, versus just 26% in the earlier poll. Lastly, more than 81% see the profession as being permanently afflicted with "more non-hourly billing," versus just 28% in 2009.

Law Firm Economics

Following the development and understanding of pricing is the need to facilitate an understanding of cost issues. The two primary elements of cost, as noted above, are personnel and occupancy.

Personnel

With respect to personnel, and as will be discussed further in these materials, the cost per head goes well beyond primary direct compensation. Employee benefits (particularly health insurance premiums), retirement plan profit-sharing contributions and 401(k) plan matches, payroll taxes, unemployment taxes, disability insurance, professional liability insurance, vacation, sick pay, continuing legal education and federal, state and local bar dues can all add up to a number at 30-40% of base compensation.

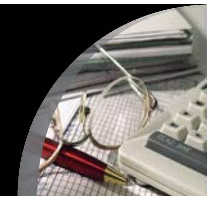
Additional direct costs of hiring a legal professional include the percentage of administrative support personnel or paralegals allocated to this professional. Direct costs also include additional software licenses, computers and office furniture.

In addition to the direct costs, there are also a number of indirect costs associated with the addition of a single legal employee. These might include lease or building costs, library, subscriptions, telephones, internet access, conference room furnishings, mailroom costs, copy room costs, etc.

Finally, law firms incur additional costs for recruiting new hires to the firm. Those expenses include out-of-pocket costs associated with recruiting (such as travel, lunches, dinners, entertainment, and promotional materials), plus the salary and benefit costs of recruiting department staff. Once the associates get hired, the firm incurs both hard and soft training costs. Larger firms have onboarding programs in which associates are introduced to firm policies, procedures, software, etc. They also periodically offer in-house continuing legal education and other programs taught by lawyers or staff in the firm or by outside consultants.

Occupancy

Occupancy and other overhead costs are oftentimes harder to control than simply deciding against a new hire or removing a "comfort zoner." However, since automatic rate and billing increases no longer provide viable fiscal and economic strategies, controlling these costs is an absolute necessity. Such strategies as reducing the space per professional, limiting the number of administrative support personnel over time and moving to a paperless document-control system can all lead to the reduction or elimination of certain occupancy and overhead costs.



Law Firm Economics

Obviously, time does not permit the discussion that each of these topics deserve. However, it is the hope of today's presenters that each of our guests will have a better sense of the economic challenges facing the independent practice of law in a public law firm environment. To accomplish this goal, the agenda and materials are divided into several main topics for consideration:

- **Introduction and Background**
- **Chapter I –** Understanding financial statements and the importance of considering and distinguishing financial reporting on the cash basis of accounting versus the accrual basis of accounting
- **Chapter II –** Financial management initiatives focusing on the identification, quantification and modification of the key components of profitability in a law practice
- **Chapter III –** Management reporting and the importance of budgeting in assessing ongoing operational performance and guiding fiscal and economic leadership
- **Chapter IV –** Law firm analytics and trends in an ever-changing marketplace
- **Conclusion and Practical Considerations**

There is no doubt that running any business in a successful manner is a difficult undertaking with a myriad of daily challenges. Certainly, managing a law firm is no exception. However, most of the economic bumps encountered in the course of the life of any business can be identified through careful consideration of the appropriate data. This process can then lead to measurable solutions as management initiatives to modify firm behaviors and performance are implemented into daily operations. There can be no doubt that law firms can benefit from the same mentality and, in fact, most knowledgeable attorneys would heartily agree that it is time to learn to run these practices like any other competitive business.

We do appreciate the support shown for our firm by all of you, and we understand that your time is valuable. We hope that today's session will prove to be of some value to you as you return to your offices, and that the information conveyed here will result in better firm practices and profitability.

As always, should you have follow-up questions, please do not hesitate to contact any of the presenters:

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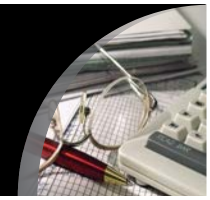
Thank you for attending today!



Law Firm Economics

I. Cash Basis vs Accrual Basis Financial Statements

Like every other business, law firm accounting records can be maintained on either a cash or accrual basis of accounting. The accrual basis of accounting provides a clearer picture of a firm's profits during an accounting period. The income statement prepared under the accrual basis will report all of the revenues actually earned during the period and all of the expenses incurred in order to earn the revenues, which is known as the matching concept. Further, the accrual basis of accounting provides a better picture of a firm's financial position at a specific point in time.

Under a cash basis, revenue is reported on the income statement in the period in which the cash is received from clients and expenses are reported when cash is paid out. This process leads to the most significant disadvantage of the cash basis system – the misalignment of revenue and expenses. Essentially, cash basis reflects the law firm's checkbook. Most small businesses will employ the cash basis of accounting due to the ease of recording transactions and the associated tax advantages.

The most significant way in which a firm is impacted by the choice of accounting method involves the tax year in which particular income and expense items will be counted. For example, if the firm incurs an expense for training in the 2015 tax year but will not satisfy the invoice issued by the provider until the 2016 tax year, under a cash basis, the firm cannot claim a deduction until it is paid in 2016. Conversely, under the accrual basis, the deduction is taken in 2015, since the transaction is recorded when it occurs, not when money actually changes hands.

In order to overcome the distortive effects of a pure cash basis accounting system, most law firms will employ a modified cash basis (or modified tax basis) system, which incorporates some accrual basis concepts. The modifications include one or more of the following:

- Recognition and recording of professional fees receivable;
- Recognition and recording of receivables resulting from disbursements made on behalf of a client of the firm;
- Advances and deposits;
- Insurance and other expenses paid in advance;
- Capitalization and depreciation of property, fixtures and equipment (fixed or tangible assets);
- Accrual of retirement plan contributions; and
- Recording of loans payable to banks and other institutions.

Law Firm Economics

Note that as of the date on which these materials were written, Congress is considering tax reform legislation that would impose new financial burdens, through increasing compliance costs, on many law firms and other types of personal service businesses. Section 3301 of H.R.1, the "Tax Reform Act of 2014," introduced by then House Ways & Means Committee Chairman Dave Camp (R-MI) during the 113th Congress, and Section 51 of a similar Senate draft bill, prepared by then Senate Finance Committee Chairman Max Baucus (D-MT), would require all personal service businesses with annual gross receipts over $10 million to use the accrual method of accounting rather than the traditional cash receipts and disbursements method. Currently, all law firms (and various other types of personal service businesses) are permitted to use the cash basis of accounting regardless of their annual revenue (unless they have inventory).

In addition to the burden caused by compliance, the increased financial pressure would force many firms charging on an hourly-fee basis to collect their fees immediately (or shortly) after their services are rendered. Further, firms may be unable to represent, on an alternative or flexible-fee basis, as many clients as they currently serve and may be forced to decrease the pro bono services they currently provide.

Elements of the Financial Statements

Financial statements are a key tool for understanding the financial health and planning for the future of a law firm. Being able to read and understand financial statements, therefore, is a valuable tool for any professional who seeks to better serve his or her firm and partners. Properly-prepared financial statements can inform the partners about a firm's ability to:

- Meet its obligations,
- Generate a profit, and
- Provide a return to its owners/equity partners.

However, developing an accurate picture of these business basics will usually require the users to gather information from a variety of places throughout the financial reports; failure to do so may lead the user to form inaccurate conclusions. The user will also need to know how to analyze the financial information in light of historical trends, budgeted expectations and comparable industry statistics.

Typically, law firm financial statements include a balance sheet, income statement, statement of cash flows, statement of changes in equity and financial statement disclosures. Note that financial reports can vary depending on the end user. Banks, other debt holders and former partners are outsiders to the firm that may require a modified cash basis of accounting and, possibly, audited financial statements with a focus on historical results.

Law Firm Economics

There are no presentation requirements for internally-prepared financial statements, which are used by partners and management of the firm for analytical and decision-making purposes. Both prospective and historical financial results are considered and analyzed and will likely be on an accrual basis. Partner focus is ultimately on distributable income. In some cases, if it is structured in such a way, the distributable net income to active partners will be after payments are made to former partners.

Balance Sheet

The balance sheet presents the assets, liabilities and equity of a firm as of a point in time. This is usually the end of a firm's fiscal year, but it could also be an interim date, such as a quarter- or month-end, or it may be as of the date of a particular event, such as the date of the firm's formation or an acquisition date.

The assets are those items that are owned by the firm. They can be *tangible*, or physical, assets, such as cash or property. They can also be *intangible,* such as intellectual property, client lists and trade names. Note that most intangible assets will not be recorded, regardless of the basis of accounting.

The assets are also described in terms of their ability to be converted into cash. Assets that are expected to be converted into cash or consumed during the firm's operating cycle (typically, one year) are called *current assets*. Common current assets include cash, professional fees receivable, client disbursements receivable and prepaid expenses. Those items typically included in client disbursements are travel, filing fees, third-party payments, document duplication, administrative and processing costs. Other assets may take a longer time to consume or convert into cash and are called *noncurrent assets*. This category would generally include fixed assets (such as real estate and personal property), intangible assets and notes receivable.

The nature and classification of assets is important for financial statement analysis. Thus, the balance sheet should be presented in order of liquidity, with current assets listed first, followed by noncurrent assets. For example, cash – generally being the most liquid asset – is usually the top line of the balance sheet.

Liabilities are those amounts that are owed by the firm. The settlement of a liability may be through the payment of cash, the forfeiture of a non-cash asset or the exchange of the liability for another liability.

Similar to assets, liabilities are differentiated by the timing of when they will be settled. Liabilities that are expected to be settled during the business cycle (typically, within one year) are considered to be *current liabilities*. Common current liabilities include accounts payable, accrued payroll and other expenses, deferred revenue and tax liabilities. *Long-term liabilities* are those that will not be settled within one year. Notes payable and capital leases are common examples of long-term liabilities.

Law Firm Economics

It is important to note, however, that long-term liabilities may have a component that will be settled within one year, and that component is considered to be a current liability. Scheduled monthly debt repayments on a mortgage that are due within one year would be considered current liabilities, even though the remaining balance of the mortgage is a long-term liability. This differentiation is important because, like assets, liabilities are presented in order of their expected settlement. Accounts payable may be the most current liability, as vendor payment terms are typically within 30 days.

The excess of assets over liabilities is the firm's equity. Equity is usually comprised of ownership units, such as stock for corporations (including professional corporations), membership units for limited liability companies or capital accounts for partnerships. The ownership structure of law firms can be very complex.

A corporation may issue preferred stock and common stock. Each class of stock can be assigned different voting rights, dividend rights, and liquidation preferences. In addition, stock options or warrants may exist and have a multi-year vesting period. Corporations may also choose to buy back their own stock. These shares may be retired and canceled or held in treasury by the company for future reissuance (treasury stock).

Partnerships and limited liability companies also have a lot of flexibility in establishing their capital structure and ownership rights. These terms will be specified in their operating agreements.

Note that other than the inclusion of a provision for income taxes in the financial statements of a professional corporation and the resulting impact on earnings of the firm, the economic substance of the financial statements should be the same for a partnership.

A firm may have more liabilities than assets and, in such case, have a deficiency rather than equity. This will generally occur when a firm has experienced losses from operations. A firm should present a capital deficiency on the balance sheet even though the owners may not be obligated to fund the shortfall (such as in a limited liability company).

Income Statement

The income statement presents the results of the firm's revenue and expense transactions. It covers a period of time (most often, one year) rather than a point in time like the balance sheet.

The income statement is basically a process of reduction. It begins with the firm's total revenue, primarily driven by professional fees, and subtracts operating expenses to arrive at income from operations. The process of determining fee revenue begins with the recording of time charges to clients, billing clients and collecting fees.

Law Firm Economics

The recording of time charges is at the heart of the law firm's revenue generation and represents virtually all of its revenue. Generally, the larger the law firm, the more sophisticated the time recording system. Firms that are segregated by practice group often will track revenue (professional fee income) by group. Also, firms with multiple locations will track revenue and profitability by location.

Operating expenses include all costs related and attributable to the firm's ongoing operations. Employee (or compensation) costs are the primary expenses of law firms. These expenses include associates' compensation, administrative salaries and benefits and other employee-related costs. Other operating expenses that are of significance include occupancy costs and professional dues, continuing education and business development.

Other income and expenses are then factored into the income statement. These items are not a part of the firm's operating process. Gains and losses from the sale of fixed assets, interest expense, miscellaneous revenue that is ancillary to the firm's business, and any unusual or infrequent income or expense items not attributable to operations are included in this section. While some of these items may be common and recurring, such as interest expense, they are not considered to relate directly to the operating process and, therefore, are excluded from operating income.

Income taxes, if applicable to the type of entity being presented, are also subtracted as a separate income statement line item to arrive at net income from operations, which may be the bottom line of the income statement. A firm may also have payments to former partners, discontinued operations or extraordinary items. Payments to former equity partners can be a fixed amount or based upon a percentage of net income over a specified period of time. In these cases, additional lines would be presented at the end of the income statement to further adjust net income (from continuing operations) to distributable income.

Statement of Changes in Equity

The components of equity can be presented either in the balance sheet, in a separate statement of equity or in the footnotes to the financial statements. As noted above, the equity structure can range from very simple to very complex. A separate statement of changes in equity is often preferred when there is a complex equity structure or numerous equity transactions. In addition to any net income or loss generated during the year, other equity transactions may include issuing partner buy-ins, redemption of partner interest, distributions or reflecting a change in accounting principles.

A firm's equity may also include a non-controlling interest in the equity of a another venture. This will occur when consolidated financial statements are presented for a parent and one or more ventures that are under the control of the parent. Control is usually, but not exclusively, achieved through voting power. The non-controlling interest represents the equity attributable to the other owners of the subsidiary based on their ownership percentages and rights. This equity does not belong to the parent company; thus, it is segregated from the other components of the parent company's equity.

Statement of Cash Flows

The statement of cash flows provides the financial statement user with information regarding how the firm generated and utilized cash. Similar to the income statement, the statement of cash flows reports on a period of time, such as one year. It separates all activities into three categories: operating, investing and financing.

Operating activities relate to the firm's ongoing current operations. This category is generally computed as the firm's net income, adjusted for transactions that are either noncash in nature or have not yet been settled in cash. Depreciation expense is commonly a significant noncash adjustment between net income and operating cash flows. Changes in current asset and current liability balances also affect operating cash, as these balances do not become cash activity until they are settled (for instance, when receivables are collected).

Investing activities relate to the use of cash for long-term investment and are typically associated with the firm's noncurrent assets. Purchasing or selling property, issuing notes receivable, and purchasing or selling investments are all investing activities.

Financing activities relate to transactions involving lenders or owners and are typically associated with the firm's long-term debt obligations or equity. Borrowings and repayments of debt, proceeds from the issuance of equity, and distributions are examples of financing activities.

Firms may engage in investing or financing transactions that are noncash and would not be included in the statement of cash flows. These transactions are reported below the statement. Examples include the financed purchase of property through the issuance of a note payable to the bank, or the conversion of debt into equity.

Financial Statement Disclosures

A complete financial report will include certain disclosures to supplement the basic information presented in the financial statements. Many of these disclosures are contained in footnotes that accompany the financial statements and are an integral part of the financial report. The footnotes provide explanatory information to supplement the raw numbers in the financial statements, frame the user's perspective and clarify areas that have historically been ambiguous.

Law Firm Economics

Disclosures accompanying the financial statements of a law firm will include the following:

- *Description of the Firm* – The first footnote should identify the legal structure of the firm, where and when it was organized, and its tax status. This could inform a reader as to where the firm is in its lifecycle as well as the legal environment in which it operates. This footnote should also describe the nature of the firm's operations.

- *Significant Accounting Policies* – The first or second footnote should also describe the firm's significant accounting policies. This is important when the policies or principles are different from generally accepted accounting principles (GAAP), such as with the modified cash basis. Financial statement users should be especially aware of changes in a firm's accounting policies, as such changes could affect comparability of the financial statements.

  The disclosure of accounting policies may be lengthy and cover a wide range of financial statement areas. Perhaps the most significant accounting policy for most organizations is the revenue recognition policy. This policy is so significant that in the event of an audit, auditors are required to consider in audit planning how fraud could be committed through inappropriate revenue recognition.

  Other significant accounting policies may include the following:

  - Method of estimating allowance for doubtful receivables,
  - Capitalization and depreciation policies for long-lived assets,
  - Whether certain assets are valued at historical cost or fair value,
  - Taxes, and
  - Equity structure.

- *Commitments to Former Partners* – Many partnership agreements will contain certain provisions with respect to payments to former partners, either those who have retired or withdrawn, or estates of deceased partners. Payments can be a fixed amount over a certain term, based upon or limited by the revenue or net income of the firm, or lifetime benefits based upon a percentage of revenue or net income.

- *Bank and Other Borrowing Arrangements* – Firms may enter into short-term and long-term financing arrangements. Short-term financing may be used to cover operating needs during the year due to the timing of collections as well as unforeseen expenses. Long-term financing may be incurred in connection with the purchases of furniture, fixtures and equipment. It is important to have an understanding of all borrowing arrangements and the timing of repayment.

Law Firm Economics

- *Lease Commitments* – Financial reports will also contain significant future commitments. A common example of such a commitment is an operating lease. The amount owed by the firm for each future year must be disclosed in the footnotes; however, these amounts are not recorded as liabilities as of the balance sheet date. Leases typically include the rental of office, equipment or other space for the storage of records.

- *Retirement Plans* – Retirement plans differ from firm to firm. The disclosure should note the type of plan (i.e., defined benefit plans or defined contribution plans). Additionally, unfunded arrangements for retired partners, as provided in a partnership agreement, should be noted.

- *Custodial Assets* – It is common for law firms to act as a custodian of assets, typically cash in the form of escrow deposits, that belong to parties that are not associated with the law firm. These amounts will not be recorded on the financial statements of the firm but rather disclosed in the notes.

Final Thoughts

The purpose of this chapter was to provide an overview of the types of financial statements that may be used by law firms. Accrual basis financial information will match revenue and expenses and provide a clear picture of how the firm is performing financially. Firms that do not monitor key metrics including fees billed, chargeable hours, collections and so forth, can easily be misled by cash basis financial reports and, therefore, miss the opportunity to take action at a critical time. Tax returns can still be prepared on a cash basis, thus, maximizing the benefit. As noted herein, the information and reports can vary depending on the user of the financial statements and the management objectives of the firm.

Law Firm Economics

II. Financial Management Initiatives

This chapter will focus on the identification, quantification and modification of the key components of profitability in a law practice.

Understanding Stakeholders

It goes without saying that fiscal and economic strength is not only vital to the ongoing success of any law firm, but it is also integral to the overall financial well being and career success of the attorneys working within the firm. In fact, these two concepts are so interrelated that, oftentimes, it becomes difficult to distinguish and separate the management thought processes specific to each.

The key element to remember is that the sphere of interest in the fiscal and economic well-being of any law firm goes far beyond the equity partners. Recognizing that each firm has a broad base of stakeholders is paramount to making management decisions that optimize the positions of the stakeholders. A point often missed by law firm management is that only when all stakeholders' positions are optimized can equity partners expect to be in the best economic position themselves.

So, who, exactly, are these stakeholders? They are everyone and anyone who has contact with the firm that has some potential economic benefit or detriment based on the firm's well-being. The list of stakeholders is extensive, but it can generally be identified in conjunction with a review of the firm's financial statements.

A good starting point for this identification process is the firm's accrual basis balance sheet and income statement. Starting at the top of the balance sheet, under assets, the firm maintains accounts receivable. Receivables are initially recorded as one side of an accounting entry with revenues being reflected on the other side. Thus, there is a financial relationship between the accounts receivable and firm revenues.

The primary stakeholder in this mix is, of course, the client. Among the most important stakeholders in the law firm, the client is tied to a value proposition that acknowledges a certain understanding of value in the services undertaken on his behalf by the firm. If the client determines that the value of the service is not commensurate with the fees charged, he will likely pursue the acquisition of these services elsewhere, to the economic detriment of the firm.

Likewise, by looking at accrued payroll and salaries on a firm's balance sheet, one can observe the amount that is owed by the firm for services rendered previously by the firm's employee (non-equity owner) group. These liabilities were initially recorded as one side of an accounting entry with the opposite side being recorded to payroll expense or, possibly, an item titled, "cost of services billed." In reality, the bulk of labor costs in any law firm rests with the professionals, paralegals and administrative personnel performing client service.

In looking at payroll the primary stakeholders are, of course, the firm personnel. This category generally does not include equity partners, but all other groups are included. These individuals embrace a value proposition as well. Their value proposition assumes fair market compensation for the services rendered. Should the firm underpay these stakeholders, it runs the risk of having those individuals change positions.

The stakeholder listing for any firm goes far beyond the two groups noted above. Vendors that provide supplies and equipment are stakeholders, as are lenders which provide equipment loans and lines of credit for operations. Certainly, the lessor of the firm's office space is another stakeholder. All of the different employee groups within the firm have a stake in it as well. Finally, even the government has a stakeholder interest in each firm, as income and franchise taxes, not to mention other types of tax, stem from the firm's well-being. All of these classes of stakeholders must be dealt with prior to the equity partners realizing any economic benefit of ownership. Understanding this simple concept allows for the design and implementation of management strategies that strike the proper value proposition with each of the stakeholder groups, thereby resulting in optimizing the equity partner stakeholder position.

The value propositions for most stakeholders are interrelated. For example, assume that a non-equity partner is underperforming. In this case, the effort, in terms of hours and cost, may exceed the client's expectation for those services. If the decision is made to bill this service at the time and cost incurred, the firm runs the risk of upsetting the value proposition for that client. The client may either refuse payment for some portion (or all) of the bill or, perhaps worse, silently pay and move elsewhere for future legal services. In either case, the result is a poor outcome for all stakeholders and, especially, the equity partners.

Alternatively, the firm can absorb the extra hours and costs, which could lead to the maintenance of the client's value proposition. While the client's value proposition survives the event, the remaining stakeholders in the firm suffer because the element of value of the non-equity partners is not properly aligned with the efficiency of the services being performed and the supporting costs incurred.

As the discussion turns to more mechanical matters, it is important that due consideration be given to the role of each stakeholder. Again, the equity partners ultimately benefit to the extent of residual income; that is, after all other stakeholders have been satisfied. It is necessary that attention to these value propositions be balanced when developing management solutions to difficult challenges presented daily.

Law Firm Economics

Profitability

Inherently, profitability, in its simplest form, is the residual difference between amounts that are recognized as revenue and amounts that are recognized as expenses incurred in connection with the conduct of the practice of law. In most firms, little or no time and effort is given to detailing how revenues earned correlate to the direct costs of producing the revenue and other indirect costs requiring allocation. Instead, most law firm financial statements include revenue as a single line item on their income statements with all costs listed below as expenses. The general thought in traditional law firm accounting is that there is a single source of income associated with the provision of legal services and that all costs are incurred in connection with the production of that income.

The Product

Most people entering the professions and the professional service industries see the provision of quality services as the primary objective. The profession of law is no different, and most partners in law firms look at the provision of quality legal services as their first and primary concern. This concept is so fundamental, and so widely held among members of the profession, that, all too often, management groups fail to recognize that the final work deliverable on any client project is, in effect, a "product." Differentiating one law firm from another requires an understanding of that basic idea so that firm management can focus on other aspects of operations.

The problem with this type of conventional thinking in today's market is that there is a competitive environment that requires that partners look beyond the provision of quality services alone and drill into the mechanics behind the processes. The current market provides an overabundance of legal practitioners offering professional services at all sizes of firms and practices. The result of this service availability and capability is that clients and purchasers of legal services have more choices than ever before, and fiscal and economic success is predicated much more upon how the services are being rendered.

A change in focus begins with acceptance of the basic premise that there are numerous alternate providers that can provide all of the services that any one firm can provide. That is not to say that one firm does not have professional service offerings beyond another. It is simply implying that competition is intense and that the services being provided by any firm must be at a high level or clients will look elsewhere for legal services.

As noted above, legal services are the product. Given the market, anything less than the provision of high-quality services (i.e., a high-quality product) will lead to client defections and a gradual and natural "weeding out" of those firms that are not providing quality services. As such, it is, perhaps, presumptuous to believe that quality alone will ensure fiscal and economic success in a law firm.

As is often the case with all types of businesses, delivery of the end product is a key ingredient in ensuring fiscal and economic success. Improving delivery can, and will, lead to enhanced efficiencies and greater firm profitability. As noted above, quality at the highest level is a basic requirement, so the development of processes intended to add efficiencies in project completion cannot be advanced without an ever-watchful eye on quality.

Key Elements

A three-pronged mechanical function stands at the center of achieving law firm fiscal and economic success, controlling firm revenue and developing strategy. While rather simple in concept, participants here today who have attempted to balance the three elements realize the challenges in optimizing all of them simultaneously. These three elements are: ***utilization***, based on chargeable hours; ***standard billing rate***; and ***realization***. Each element is manageable and can have a significant effect on firm profitability measures.

Interestingly, while each element of revenue can be addressed on a "stand-alone" basis, it is impossible to determine the impact of each on firm profitability in this manner. Each element is inherently integrated with the others to produce a controllable and manageable part of law firm economics. These elements will be addressed in greater detail in the following sections.

Chargeable Hours

In law, as is the case in public accounting, the primary measure of production has historically been encompassed in the "chargeable" hour. The chargeable hour is predicated upon the effort required by an attorney to complete a specific legal task. In most cases, law firms require different classes of employees (with different levels of experience and expertise) to generate a specifically-assigned number of chargeable hours out of all of the hours that the employee will have worked in a particular year. The point of this requirement is to ensure that there are sufficient hours worked that can be billed to clients to cover costs and a profitability expectation.

Historically, chargeable time incurred by paralegals and administrators generally does not contribute significantly to the profitability of a firm. More often, the greatest number of chargeable hours per professional are generated by attorneys in various classes within the firm, including staff attorneys, senior associate attorneys, attorneys of counsel, non-equity partners and equity partners.

Increasingly, there seems to be a movement as of late toward greater levels of chargeable hours generated by partners, and, in some cases, the chargeable hours attributable to these attorneys exceed the average chargeable hours of all attorneys in the firm. This phenomenon seems to have arisen by virtue of client demand that

Law Firm Economics

senior attorneys be involved in their legal projects. It is not uncommon to see partners with chargeable hours numbering 1,800 or more, depending on practice discipline and services demand. On the other hand, it is rare that firms can get staff attorneys and senior associates to generate significantly greater amounts of chargeable hours. As such, chargeable hours have been relatively flat across all attorney classes for an extended period of time.

The question of chargeable-hour levels among attorney classes is often a point of concern and discussion for those managing law firms. The core aspect of this concern is the need to facilitate a reasonable amount of time to accomplish a variety of tasks and endeavors in order to retain the attorney on a long-term basis and to assist with his or her personal and professional development. For example, it may be possible to get a staff attorney to generate 2,200 chargeable hours in a single year, but such a schedule will likely have long-lasting effects that work to the detriment of the employee and the firm.

In evaluating chargeable-hour expectations, it is first necessary to determine the total hours that attorneys are expected to work. A base level of 2,080 hours per year (52 weeks x 40 hours per week) is used to schedule the attorney's time requirements. In addition to the included chargeable hours, time must be allocated for vacation, continuing legal education, illness, firm holidays, administrative time (if applicable) and unassigned time.

The total amount of hours that any employee is expected to work (before projects are actually available) will depend primarily upon competitive pressures to hire and retain them. For example, societal changes have driven a movement for younger people to be more focused on work-life balance as opposed to simply working hundreds of hours of overtime in pursuit of career goals. Such shifts in expectations have led to a variety of staffing challenges, not the least of which is successfully maintaining an sufficiently-high level of chargeable hours.

Given such social dynamics, as well as practice requirements, it is the experience of the authors that staffing for long-term growth is predicated upon the following estimated averages in the Pittsburgh region.

	Equity Partners	*Non-equity Partners*	*Attorneys of Counsel*	*Senior Associates*	*Staff Associates*
Chargeable Hours	1,700	1,750	1,800	1,900	1,950
Vacation	160	160	120	120	80
Holidays (8)	64	64	64	64	64
Illness (3)	24	24	24	24	24
Training	24	24	24	32	40
Administration	48	36	18	18	–
Practice Development	120	120	36	48	–
Total Hours	2,140	2,178	2,086	2,206	2,158

Law Firm Economics

Utilization

Utilization is a management concept that compares the total chargeable hours worked in any measurement period with the total number of hours that are worked in all tasks. In other words, the relationship between the two provides a controllable element of profitability because the relationship can be managed by the partners. The relationship is generally set out as a percentage. A higher utilization percentage, as one might presuppose, can add direct dollars of profitability to the bottom line.

The utilization percentage is calculated as chargeable hours divided by total hours. As set forth below, an equity partner working 1,700 chargeable hours equates to a 79% utilization percentage (1,700 ÷ 2,140).

	Equity Partners	*Non-equity Partners*	*Attorneys of Counsel*	*Senior Associates*	*Staff Associates*
Chargeable Hours (rounded)	1,700	1,750	1,800	1,900	1,950
Total Hours	2,140	2,178	2,086	2,206	2,158
Utilization	79%	80%	86%	86%	90%

In managing utilization, think in terms of additional revenue versus fixed costs. As most costs are fixed in the short-term at any revenue level in a law practice, higher utilization simply equates to more dollars being billed. Assume that the above-noted equity partner is able to increase his or her utilization by four percentage points to 83%. In that event, the total chargeable service hours would increase by 76 hours. If that partner's realizable billing rate is $350 per hour, that increase results in an additional $26,600.

Extrapolating this concept to a larger firm, consider a firm's total service hours as illustrated in the example below. Assume a firm with 60 attorneys with a total of 102,000 chargeable hours. In this example, the average rate per hour is $240 firm-wide, and total revenue is $24,480,000. Assume further that the 102,000 hours constitutes 79% utilization, meaning that the total hours worked were 129,114 (102,000 ÷ .79). Moving the firm's overall utilization upwards to 83% would add an additional 5,165 chargeable hours (129,114 x .83). At an average billing rate of $240 per hour, the difference equates to an additional $1,239,600 of revenue.

	78%	*83%*	*Difference*
Total Practice Hours	129,114	129,114	–
Total Utilization	79%	83%	4%
Total Chargeable Hours	102,000	107,165	5,165
Average Rate per Hour	$ 240	$ 240	$ 240
Total Client Billings	$ 24,480,000	$ 25,719,600	$ 1,239,600

Law Firm Economics

An important point to be gleaned from this example is that every single (1.0%) point increase adds $310,000 to the bottom line because the costs associated with the production of that income have already been absorbed by the firm. The increase in revenue produces no direct increase in costs (or, if any, a very negligible increase).

Increasing utilization manifests from strategic firm leadership initiatives that provide a more efficient project management delivery system and a focus on tighter staffing levels for available projects. Streamlining operational aspects of client delivery within a firm can go a long way in adding the efficiencies necessary to realize improvement. Better procedures for justification of professional staff can also add to utilization improvements. In addition, educating all professionals as to the importance of maximizing utilization, and how such performance increases add to firm profitability, can lead to more focus on this important area of practice management.

Standard Billing Rates

Hourly billing rates have, for a very long time, been at the center of law firm economics. The idea of alternative billing strategies and methodologies has come into vogue only in the last 10-15 years, but, as of yet, few firms focus on nontraditional billing methodologies as the primary means of billing their clients and driving firm revenues.

Hourly billing rates most often refer to standard billing rates. These are rates that are primarily developed in any specific firm with the intent to capture all costs associated with the conduct of an individual's legal practice with a profit override included. The only costs that may generally be excluded in these determinations are those that may be billable, dollar-for-dollar, as expenses. In most cases, these costs are variable and are incurred only as a direct result of conducting the particular legal engagement.

This concept is easiest to understand when looking at a single-person law practice. Here, the operation of the law practice entails the incurrence of a variety of costs, including occupancy (rent, utilities, maintenance, etc.); library; support personnel (including salary and fringe benefits); supplies; equipment; taxes; and professional liability insurance. In addition to these costs, it is appropriate to include a profit override, which essentially measures the personal income that this individual will earn, if all goes according to plan.

The total of these items is the amount of fees that will be required to be billed to generate the pre-selected level of personal earnings. The estimated number of hours that the sole practitioner expects to provide legal services over the reporting period must be used as a divisor for the total costs to determine the necessary standard rate per hour. An example of this simple analysis is illustrated on the following page.

Law Firm Economics

In this example, the practitioner is looking to make $150,000 in the current year. To accomplish this goal, it will be necessary to bill the firm's clients at least $264,100. If all services are fully billable (which is rarely the case), the billing total can be accomplished with the provision of 1,700 chargeable hours of effort at $160/hour.

Calculating Rate per Hour – Single Attorney

Rent	$	36,000
Library		4,800
Support Personnel		44,500
Insurance		4,000
Other		24,800
Total Costs		114,100
Profit Override (Sole Practitioner Earnings)	$	150,000
Required Revenue		264,100
Estimated Chargeable Hours		1,700
		155
Standard Billing Rate Selected (Rounded)	$	160

The computational aspects of determining rates per hour for a multi-attorney firm can be more cumbersome, but, essentially, the same underlying concepts apply. For example, if the firm has 20 lawyers, the exercise may be reduced to a factor of compensation cost per hour. The following examples demonstrate the calculation.

Calculating Rate per Hour – Multiple (20) Attorneys

Rent	$	335,000
Library		18,700
Support Personnel		415,000
Insurance		42,000
Other		1,325,000
Total Costs		2,135,700
Profit Override*	$	5,000,000
Required Revenue		7,135,700
Estimated Chargeable Hours		36,500
		195
Average Standard Billing Rate Required (Rounded)	$	200

**Assumed compensation for the entire professional group ($250,000 average x 20 lawyers)*

Law Firm Economics

Assuming the staffing levels set forth below (unrelated to prior examples), the overall professional compensation can be allocated to equity and non-equity attorneys to achieve the desired financial objectives of the firm.

Compensation by Professional Class

Attorney Class	*Number*	*Hours*	*Total*	*Desired Comp.*	*Total Comp.*
Equity Partners	6	1,600	9,600	$ 270,000	$ 1,620,000
Non-equity Partners	8	1,700	13,600	220,000	1,760,000
Senior Associates	4	1,800	7,200	115,000	460,000
Associates	2	1,800	3,600	80,000	160,000
			34,000		$ 4,000,000

Final Rate per Hour Determination

Attorney Class	*Number*	*Total Costs**	*Hours*	*Rate/Hour*	*Rounded*
Equity Partners	6	$ 2,484,959	9,600	$ 259	$ 260
Non-equity Partners	8	2,699,708	13,600	199	200
Senior Associates	4	705,606	7,200	98	100
Associates	2	245,427	3,600	68	70
Average		$ 6,135,700	34,000	$ 180	

**Includes a percentage weighted allocation of all non-compensation costs*

Factoring in estimated operating costs unrelated to compensation, total expenditures related to the firm's operations for the year are $6,135,700. Of these total costs, 40% ($2,484,959) represents equity partner compensation and all related costs. The remaining 60% accounts for non-equity attorneys and associated firm costs.

Other items extraneous to the specific practice can also have a significant effect on rates per hour. The most critical of these factors is competition. Perhaps no other element of law firm economics has been hit as hard by competition than standard rates per hour.

During the Great Recession, the Altman Weil survey found that over 90% of the respondents felt that stress on rate per hour was a temporary phenomenon, and that the ability to raise rates per hour on an annual basis to exceed inflationary cost increases would return as economic pressures in the overall economy eased. In the 2015 Altman Weil survey, more than 90% of the respondents felt that the stress on rate per hour is permanent, and that law firms must now find ways to increase profitability beyond the simple increase of rates per hour.

Additional factors that work to affect standard billing rates are experience and specialization. As reason would have it, both of these attributes should allow for higher standard rates.

Law Firm Economics

Realization

Closely aligned with the profitability determination in any legal practice is the concept of realization. While many practices focus on realization as a percentage of fees incurred in connection with the rendition of any specific legal project that can be billed to a client, others expand the concept to focus on the percentage of bills rendered that are successfully collected. In a sense, the two concepts are interrelated and should result in the same effect on profitability.

Realization can be defined as a percentage of standard fees that are billable and collectible. In effect, standard fees are calculated as the number of chargeable hours accrued to a client for work performed by any attorney or group of attorneys. The standard fees are simply an extension of these hours by attorney, multiplied by the standard rate for each professional. The following example sets out this calculation:

Determination of Standard Fees

Attorney Class	*Project Hours*	*Standard Rates*	*Standard Fees*
Equity Partners	34	$ 260	$ 8,840
Non-equity Partners	12	200	2,400
Senior Associates	28	100	2,800
Associates	16	70	1,120
Realizable Billings			$ 15,160

In computing realization, it is useful to understand that the percentage adjustment is primarily judgmental in engagements that were bid on a straight hourly basis. For example, if one assumes in the prior illustration that approximately 20% of the hours incurred in connection with the provision of the legal services were duplicative, or reflective of delivery inefficiencies, the billing attorney may deem it appropriate to discount the work by that percentage. In other words, only 80% of the time incurred at standard rates is billable.

Attorney Class	*Project Hours*	*Standard Rates*	*Standard Fees*
Equity Partners	34	$ 260	$ 8,840
Non-equity Partners	12	200	2,400
Senior Associates	28	100	2,800
Associates	16	70	1,120
			$ 15,160
Realization Percentage			80%
Realizable Billings			$ 12,128

Law Firm Economics

If the amount set forth in the last example is billed at $12,128, and the billing attorney later finds that the client is dismayed and does not wish to pay the invoice at the issued amount, further reductions may occur. The billing attorney may deem it prudent to simply adjust the billing downward to allow for faster collection, less need for additional collection efforts and overall client satisfaction. If the bill is decreased by 10%, the reduced billing will be $10,915. Thus, the collection realization on the issued bill is 90%.

In assessing the adjustment to the bill, it is important that billing attorneys realize that while 90% of the bill was collected, the adjustment to the bill reduces the overall project realization to a level that may be unacceptable. To illustrate the point, a reduction in the invoice to 90% equates to an overall billing realization against standard fees of 72% ($10,915 ÷ $15,160). Care must be taken in controlling billing matters in any professional firm context, including law, to properly understand the impact of adjusting standard fees downward. A continuing practice of making such adjustments can indicate a number of problems within the firm, including non-performing personnel; inefficient delivery practices; project difficulties that are not the fault of the firm that should be carved out and billed separately; and poor project management.

Understanding the effects of realization adjustments on firm profitability is critical to optimizing that profitability. Envision the effect on the multi-attorney firm in the example on page 21. At 100% realization, expected revenues are $7,135,700. If the billing realization requires an adjustment of standard fees to 95%, the total billings would drop to $6,778,915 ($7,135,700 x .95). The difference in dollars of revenue is $356,785.

At an average firm billing rate of $200 per hour, the attorneys at the firm will have to work an additional 1,784 hours to make up this shortfall. At a head count of 20, each attorney will have to work an additional 89 chargeable hours – IF those additional are hours are billed at 100% realization. The number will be greater, of course, if only 95% of that time is realizable.

Expenses and Costs

According to the 2014 edition of the Survey of Law Firm Economics[2] published by *ALM Legal Intelligence* and the *National Law Journal*, the average total expenses for a lawyer (or law firm) range from approximately 33.3% to 45.9% of gross receipts. Almost incredibly, this is true for all regions, all urban and semi-urban areas, all firm sizes, and all practice areas! Nationally, average total expenses are 38.9% of gross receipts, or $172,000 per lawyer, in a model firm that generates $443,000 in gross receipts per lawyer. Based on an analysis of the data, there appears to be little distinction based upon firm size.

[2] Survey of Law Firm Economics – Published annually by the *ALM Legal Intelligence & National Law Journal*, the survey provides a meaningful baseline against which to assess firm performance and profitability. It is particularly useful to firms in the small- to mid-size law firm market.

Law Firm Economics

Occupancy

Undoubtedly, physical space is the most significant cost center in a law firm, excepting salaries and benefits. While everyone has observed over-the-top build-outs, it is important to remember that these costs are somewhat controllable as leases are renegotiated and building prices are negotiated.

A law practice management "rule of thumb" suggests that if occupancy expenses exceed 10% of gross income, there may be a cause for concern. At that level, an analysis should be undertaken to determine whether the unusual level of expense is attributable to bad market timing, the unusual needs of a specific firm, or an extreme build-out.

Nationally, the Altman Weil survey data indicate that the average firm spends 8% of its gross income for occupancy-related expenses, including rent, utilities, real estate taxes, insurance and operating expense pass-throughs. In this area, a true distinction based upon firm size can be demonstrated. Occupancy expenses in firms employing 75 or more attorneys are nearly 30% above the mean and more than 40% above the occupancy expenses of the average mid-size firm.

Despite this size-based distinction, occupancy expenses of 7% to 10% of gross income are by no means unreasonable and may have valid business value. It is possible that a substantial reduction in this expense category, if achievable, could effect the firm's reputation in the community or the success of the firm's recruiting and promotion efforts.

Although occupancy expenses must be reviewed periodically (and many firms spend far too little time negotiating their own leases or auditing their own occupancy expenses), unless the firm is located in a region or area in which there is substantial over leasing (in terms of physical space) or undergoes a dramatic reduction in size that results in many empty offices (and a high occupancy expense for each remaining attorney), reduction in this expense item is not likely to produce a fiscal panacea.

Personnel – Professionals

Clearly, and appropriately, non-equity compensation costs are almost always the greatest expense of a law firm, before equity partner compensation or draw. The usual construct of a non-equity associate cash compensation package is focused on four aspects of remuneration: 1) a base salary (structured to class standing in the larger law firms); 2) a bonus payment structured on one or more of the following: legal merit, contributions to firm profitability, firm economics and the origination of business; 3) a profit-sharing plan based upon the firm's success; and 4) a reasonably-comprehensive benefits program.

Law Firm Economics

In many instances, especially in the case of younger associates, the firm's management has little control over base-salary levels due to the competitive market for recruiting the best candidates. In most cases, the higher starting salaries represent an investment by the firms, as the overall cost is seldom justified by early profitability. Many articles and commentaries can be found online with equity partners eschewing the initial starting salaries as being difficult to incorporate into overall law firm profitability performance as billing pressures counter the ability to recover those costs.

To combat the phenomenon, firms are looking at different ways in which they can still meet client needs and, at the same time, enhance overall firm profitability. Some of these ideas include:

- *Hiring Lateral Associates* – The consumption of firm resources and the effort required to train new associates, as well as the inability to bill training time, has led many medium-sized and larger firms to look to lateral hires who come to the firm with a base of clients and expertise that is immediately useful to the firm's current client base and also adds to the firm's billing targets.
- *Hiring Temporary Lawyers to Lower Fees* – Many firms have moved to a more-fluid complement of attorneys by electing to add temporary attorneys on an "as-needed" basis. Though the authors have not seen widespread use of this concept in the immediate geographic region, it is common in many areas of the country, especially in projects that carry heavy document review and maintenance. Here, the economic benefits are clear, as a firm may charge lower hourly fees for a temporary associate with the same level of experience as members of the permanent staff, pay no benefits and, thus, enhance the firm's revenue and profit margin.
- *Joint Venturing with Other Firms* – A staffing idea that is gaining momentum is to enter into a relationship with other law firms to obtain resources on an as-needed basis for complex matters requiring heavy time commitments and specialized services. This method allows for stepping up to the plate when circumstances dictate without incurring the ongoing carrying costs associated with hiring full-time staff.

Personnel – Leveraging Professionals

The term "leverage" refers to using non-equity partners to complete the bulk of legal project tasks that otherwise would require equity partner time and effort. The point of understanding and managing leverage is that each non-equity attorney in a practice should be contributing to the firm's overall profitability. In that way, the equity partners leverage their time so that they can economically benefit from the efforts of less experienced, but adequate and competent, professionals within the firm.

Law Firm Economics

To understand the inherent benefit of leverage, one has to think back to the rate-per-hour calculation discussed earlier, and to the fact that it is necessary that each non-equity professional's rate per hour include a profit override. This amount, multiplied by the number of hours expected to be chargeable, demonstrates the value of adding performing professionals to the overall mix of firm resources, as proper management of these resources ultimately contributes to the compensation of the equity partners.

Personnel – Non-Professionals

Another significant expense for a law firm of any size relates to salary and benefits for its non-professional staff. According Altman Weil, nationally, staff expenses average 15.7% of gross income, or $41,225 per attorney per year. These expenses do vary somewhat with firm size.

It is difficult to conceive of many instances in law firms observed by the authors in which substantial economic benefits can be garnered from reductions in administrative personnel. That does not mean that hires and personnel count in this area should not be carefully monitored. Certainly, technology has had some effect on non-professional staffing over the last several years, but the differences have not produced significant improvements in profitability.

Despite increased pricing pressures, and despite the advent and implementation of computer technologies, personnel ratios have not changed materially in the past 15 years.

Other Expenses and Costs

The number of separate expense categories varies from firm to firm, but a listing of common expenses generally includes: marketing and promotion expenses; research, library and reference materials; various technical and administrative software and operating programs for electronic usage; internet access fees; equipment and computer expenses; malpractice and professional liability insurance policies; paralegals; and, possibly, payments to former partners. All of these items, which are beyond the scope of today's program, require careful management to properly align the costs with the real and accurate needs of the firm.

Recommendations for Expense and Cost Analysis

Firm management needs to review all new and existing expense categories to determine whether the incurrence of the expense item is valid and appropriate. The managing partner(s) must also periodically review expense "controls" to ensure that allowable expense categories are not being abused and that charges to that category are being sourced to the appropriate assignments and profit centers.

Law Firm Economics

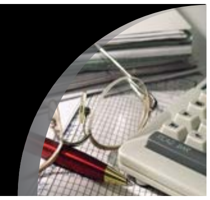
Summary and Evaluation of Profitability

Interpreting law firm profitability is a critical management task that, if undertaken properly, can (and should) greatly influence management's strategic operating decisions. The difficulty is that, while profitability is easily defined, the traditional law firm partnership financial reporting models do not lend themselves to easy analysis and comparison within the industry.

As noted earlier, profit can be simply defined as the gain earned from a business operation after subtracting expenses. With respect to basic profit (essentially revenues less expenses) under fundamental law firm accounting, net income is determined by revenues less expenses for everything other than payments to equity partners. All earnings paid or earned by equity partners come from the bottom-line net income that is available to them. Accordingly, the number of equity partners in the law firm, and how "partner" is defined for a particular law firm, greatly influences reported net income since non-equity partner pay is typically an expense that reduces net income. As a result, the comparison of profit from one law firm to another, or even the comparison of different offices of a single law firm, needs to be carefully analyzed in order to make the best and most appropriate comparisons and resultant management decisions.

Given the availability of accounting and operating ratios, such as profit per partner (PPP) or revenue per lawyer (RPL), legal practice management teams have some tools for analysis and decision-making. However, depending on how firms categorize items, especially non-equity partners, analytics can be challenging. The RPL ratio is more-often used as an indicator of financial performance because it is a cleaner calculation with less room for calculation variations.

Since profits per partner can vary greatly depending on how an equity partner is defined or based on the leverage model within a firm, many law firms measure their profitability by calculating net earnings per partnership or equity ownership share. This measure provides a balance between what is reported as net income and the change in equity ownership shares. Profitability measured in this manner is more analogous to the well-accepted price-to-earnings ratio used to evaluate public-company operating and financial results. Mechanically, this calculation means that a law firm converts partner earnings to a proportional number of shares or points for each partner. Partnership shares or points for this calculation should bear a rational relationship to compensation paid to partners. The law firm then measures this performance metric in comparison with budget and prior-year performance to determine whether strategic actions are leading to improved profitability. This profitability measure provides a meaningful method of determining law firm financial progress and reduces the likelihood of an erroneous interpretation of results.

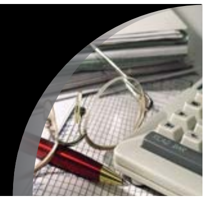


Law Firm Economics

Looking at Overall Profitability

Incorporating all of the information discussed in this chapter, a detailed look at one medium-sized firm's profitability might look like the example below:

	Equity Partners	*Non-equity Partners*	*Attorneys of Counsel*	*Senior Associates*	*Staff Associates*	*Total*
Revenue Factors						
Total Hours	2,140	2,178	2,086	2,206	2,158	
Utilization	79%	80%	86%	86%	90%	
Chargeable Hours (rounded)	1,700	1,750	1,800	1,900	1,950	
Average Billing Rates	$ 350	$ 280	$ 240	$ 240	$ 180	
Billing at Standard Rates	$ 595,000	$ 490,000	$ 432,000	$ 456,000	$ 351,000	$ 2,324,000
Realization Percentage	95%	98%	98%	98%	98%	
Average Fees	$ 565,250	$ 480,200	$ 423,360	$ 446,880	$ 343,980	$ 2,259,670
Headcount	6	8	4	4	2	24
	$ 3,391,500	$ 3,841,600	$ 1,693,440	$ 1,787,520	$ 687,960	$11,402,020
Expense Factors						
Average Compensation		$ 300,000	$ 200,000	$ 160,000	$ 90,000	
Expense Cost per Lawyer						
Direct	44,000	44,000	44,000	44,000	44,000	
Indirect	92,383	92,383	92,383	92,383	92,383	
Average Expenses Paid	136,383	436,383	336,383	296,383	226,383	$ 1,431,915
Average Profit/Lawyer	$ 428,867	$ 43,817	$ 86,977	$ 150,497	$ 117,597	
Number of Lawyers	6	8	4	4	2	
Total Profit	$ 2,573,202	$ 350,536	$ 347,908	$ 601,988	$ 235,194	$ 4,108,828
Divided by Number of Equity Partners	6	6	6	6	6	6
Average Income per Equity Partner	$ 428,867	$ 58,423	$ 57,985	$ 100,331	$ 39,199	$ 684,805



Law Firm Economics

Summary of Equity Partners' Compensation

	Aggregate	*Partner*	*Percentage*
Income Generated by Equity Partners	$ 2,573,202	$ 428,867	63%
Income Generated by Leverage of Lawyers	$ 1,535,626	$ 255,938	37%
	$ 4,108,828	$ 684,805	100%

Learning to manage all of these moving parts takes time and experience; however, paying close attention to these factors and making adjustments as possible within the parameters of the firm and the competitive marketplace can result in substantial fiscal and economic benefits to all members of the firm.

Continual focus on the actual data within a firm versus budgeted information is critical to taking appropriate steps on a timely basis to facilitate changes and improve performance. Moreover, keeping all professionals apprised of these matters enhances the opportunity for firm-wide acceptance of the changes.

Law Firm Economics

III. Management Reporting and Budgeting

Reports prepared for the equity partners or management group of law firms are critical in providing key information to be used in conjunction with strategic planning, budgeting and, quite simply, making sound business decisions. The form and content of these reports will vary from firm to firm since objectives vary by firm. Further, the frequency of preparing management reports can differ from monthly to quarterly to annually. Obviously, monthly reports are optimal; however, reports should be prepared, at the very least, on a quarterly basis. The current environment in the legal community is dynamic and extremely competitive; therefore, management should be informed regarding financial and operational performance on a timely basis. Law firms do not succeed by simply practicing law.

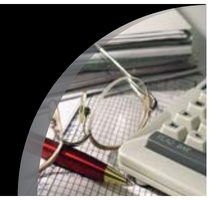
Good times are associated with making decisions on a course of action that allow the firm to continue prospering and achieve even more profits for the equity partners. Difficult times force management to determine whether to stay the course or develop plans to improve and seek out other opportunities to grow and prosper. Often, these opportunities are missed and signs of distress may be ignored or brought to the attention of management too late. It is critical for management to keep a finger on the pulse of the firm to be in the position to recognize when it is time to make the difficult decisions.

As you will get a sense from this chapter, financial management of a law practice is much more than an accounting exercise or a necessary means to prepare the firm's tax return. Rather, management from a financial perspective starts with a well thought out plan or budget; then continues with a practice of reviewing, analyzing and interpreting results; and, finally, concludes with consideration and incorporation of historical results into a long-range strategic plan.

Review of Actual Versus Budgeted Results

Preparation of a budget is not a meaningful exercise unless it is monitored and compared to actual results of the firm. Performing a comparison to the budget established at the beginning of the year is an important way to measure the firm's performance. Financial results should be viewed on a monthly as well as a year-to-date basis and compared to prior-year month and year-to-date information. The results should be broken down by partner, by client, by practice area or by location for firms with multiple offices. This additional breakdown provides for more effective management of the firm overall, as well as each practice group.

To obtain a truer economic picture, internal financial results should be presented on an accrual basis. It is important for management to have a record reflecting results as they occur (i.e., as clients are billed and expenses are incurred). This will provide a more accurate assessment of income that can be distributed to equity partners.



Law Firm Economics

A review of the income statement will focus on professional fees billed to date as well as the major expense categories, including attorney and administrative compensation, occupancy costs, office expenses, and professional activities. Comparing these line items to the budget will identify areas that may require the focus and attention of management. Presenting all items of income and expense as a percentage of total revenue helps isolate trends and problem areas.

The important aspects of the balance sheet should be the level of fees receivable, unbilled fees, working capital (defined as current assets less current liabilities) and debt. Depending on the level and turnover of receivables, the ratio of current assets to current liabilities will be higher than 1:1. Management must ensure that the firm can satisfy its short-term obligations at any point in time, and timing of the receipt of fees receivable plays a significant role. Like the items of income and expense, all assets and liabilities should be compared to the budget. Any variances should be investigated by management to determine whether a variance is caused by an isolated (nonrecurring) event or is the start of a trend (either positive or negative). This will allow management to make informed decisions relative to practice strategy, client retention and partner compensation. Also, presenting all assets and liabilities as a percentage of the total assets or (common-size analysis) is helpful on many fronts.

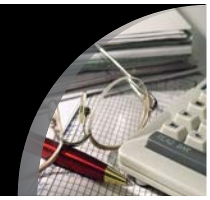
Reducing total assets of the firm by total liabilities provides the book value of firm equity (or net assets). This net figure will seldom have a direct correlation to economic value, as there are likely assets (primarily intangible assets, including client lists/relationships, firm name/reputation and workforce) that are not recorded.

Analysis of Operating Statistics

Properly-calculated statistics and ratios can provide management with the key information to operate the firm. Reports containing billing realization, attorney utilization (analysis of chargeable time), an analysis of leverage (including the use of paraprofessionals), expense analysis, and billings and collections are prepared internally to assist management in analyzing and interpreting financial statements and measuring performance not only on a firm level, but also by practice area or individual attorney.

Billing Realization

As Chapter II noted, profitability is directly tied to increases and decreases in realization. Lower realization occurs when the billing attorney decides to discount the standard rates of the attorneys working on a specific project. Conversely, higher realization is achieved when clients are billed at a premium for certain services or projects. Information gained from monitoring billing realization can be used in developing attorney compensation as well as determining client retention. Increases in attorney billing rates and chargeable hours may not translate to increased revenue unless these amounts can be billed to a client.



Law Firm Economics

Utilization

Utilization of the professional staff should be tracked in the firm's time-reporting system. Non-chargeable time reflects a lost opportunity for the firm and, therefore, a breakdown of each professional's total time may indicate areas of inefficiency and need for improvement. Any improvement in chargeable time that can be billed to a client should benefit the firm from a financial prospective. In the past, we saw more of a variance between the chargeable time of a partner versus an associate; however, partner chargeable time has increased over the years as clients have demanded more of their involvement on certain cases or projects. Obviously, this circumstance limits the partner's or firm's ability to leverage work. Please refer to the detailed discussion regarding utilization on page 19 of this material.

Leverage

A firm's ability to leverage work to lower-costing attorneys or paraprofessionals typically leads to increased income for the equity partners. Larger firms will have the ability to leverage as opposed to smaller firms, in which partners tend to undertake most of the work. Management of the firm should compare leverage to historical trends as well as industry statistics. The 2015 Altman Weil study noted that 55.7% of the law firms polled believe that reduced leverage will be a permanent trend.

Expense Analysis

Analysis of trends in a firm's expenses will identify areas of focus for cost containment. The single largest expense of a firm is compensation costs. Total compensation costs should be analyzed in conjunction with head-count and median or average compensation per employee class or category. Since partners are assuming more work, a reduction in attorney headcount and utilization of non-attorney professionals may be a lasting trend.

Operating expenses will be broken down and analyzed on a cost-per-attorney basis, as these expenses will increase or decrease depending on headcount. This information can be compared to historical trends as well as industry statistics. According the 2014 Survey of Law Firm Economics, average total expenses per attorney in the Mid-Atlantic region were $175,915, representing 38.4% of average gross receipts per attorney.

Billings and Collections

Since receivables are the most significant asset of a law firm, a report of professional fees receivable, as well as unbilled fees (or work in progress), should be prepared on a monthly basis. Equity partners/management must be aware of the aggregate amount and age of the fees yet to be collected, as it affects the near-term cash flow of the firm. As fees age, there will need to be a determination of the collectability and assessment of bills that need to be written-off. Aged receivables should be tracked by the responsible billing partner. Receivables

Law Firm Economics

should be segregated by time outstanding (e.g., current, over 30 days, over 60 days, over 90 days and greater than 120 days) and analyzed for trends.

In addition to calculating billing realization, law firms should monitor the "turnover factor," which is the average number of months that it takes from the date on which time is charged to a client account to the date on which cash is received. The table below illustrates the calculation of the turnover factor:

Billing Partner	*Fees Receivable*	*Unbilled Time*	*Total*	*Monthly Average Time Charges*	*Speed of Billings*
A	$ 1,200,000	$ 200,000	$ 1,400,000	$ 320,000	4.4
B	950,000	150,000	1,100,000	375,000	2.9
C	875,000	175,000	1,050,000	290,000	3.6
D	750,000	125,000	875,000	260,000	3.4
Total	$ 3,775,000	$ 650,000	$ 4,425,000	$ 1,245,000	3.6

As can be gleaned from above, Partner B collects her receivables and work in progress in under three months, while the firm averages 3.6 months. According to the 2014 Survey of Law Firm Economics, in the mid-Atlantic region the average value of unbilled time at year end per equity partner was $494,461, while the value of fees receivable was $269,258 per equity partner.

The following points regarding billing and collections are fairly obvious; however, when those with billing responsibilities are consumed with performing the services, these simple practices can take a backseat:

- Ensure that time is properly and accurately charged to each client.
- Between billing cycles, check on unbilled time or work in progress to prevent surprises when it is time to prepare the invoice, which includes ensuring that all work that is charged is consistent with the scope of the work expected by the client and any out-of-scope work is authorized and can ultimately be billed.
- Prepare client invoices promptly at the end of a time-reporting cycle; minimize unbilled charges.
- Educate clients on payment expectations, and follow up to reinforce policies.
- Implement and adhere to a collection policy relative to outstanding invoices.
  - Some firms have a policy of automatically writing-off outstanding fees billed after a certain period. This may not be a best practice, as there may be instances in which clients did not receive or misplaced the invoice, or may need additional time to remit payment. Having a responsible party (or parties) managing receivables will translate to a quicker conversion to cash.

Law Firm Economics

- In some cases, the billing partner may need to discount his or her fees in order to collect. Having an understanding of when and what level of discount to offer is crucial.

Cash will not become available to be distributed to equity partners until bills are rendered and cash is collected. Having to borrow funds or equity infusions from partners to finance uncollectible and unbilled fees in not an ideal situation and can lead to undue financial stress.

The reports and analysis prepared for the partners and management of law firms can be voluminous. In addition to the above-noted reports and analyses, charts and graphs can be prepared to illustrate trends in firm revenue, expenses, leverage and revenue per attorney. All of this information is critical in managing day-to-day operations as well as undertaking strategic planning and budgeting.

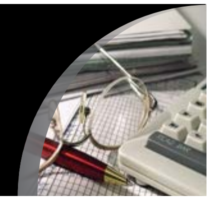
Budgeting

Budgeting is an integral component of managing a successful law practice. As in many service businesses, there exists the belief that the key to success is simply working harder; however, that is not the only ingredient to success. Lacking business and management knowledge or advice can cause any business to fail. Law firms operate in an ever-changing environment, and taking the time to look forward, plan and establish internal controls and a system to review financial performance on a periodic basis will be an investment that yields significant dividends into the future.

Budgeting should be an annual practice and used as a means to set firm and practice-area goals and measure attainment of the goals. Plans made a few years ago may now be irrelevant in the current environment. Ideally, the budgeting process should be undertaken at the practice-group level, as practice-group leaders will have an understanding of both the internal and external factors that influence their particular areas. Once all budgets are prepared at the practice-group level, they can be aggregated to provide an overall firm budget.

Revenue – Fees

Projecting revenue will pose the greatest challenge when preparing a budget. It is not as simple as taking last year's revenue and applying a growth rate. Partners need to dig down into the details to estimate all work for existing clients (inclusive of recurring work as well as special projects) and also assess the level of work attributed to new clients. Projecting work associated with new clients is always difficult, and the hours estimated in connection with this work are seldom precise. Estimating new client work will take into consideration such factors as historical patterns of new work; the amount of practice development undertaken by the partners and marketing professionals; strategic plans for expansion including the addition of practice areas or groups; contraction of work or practice areas; and competitive pressures.



Law Firm Economics

Projected billable hours should be estimated for each practice group. Projecting billable hours will also serve as a guide to determine the necessary complement of staff to accomplish the anticipated workload. Firms will be reluctant to add additional personnel for special projects, especially when attorneys are under-utilized. Billing rates will be applied to each level of professional for each client, and expected realization rates relative to each client should be estimated. It should be noted that the most-recent Survey of Law Firm Economics reported that firms of all sizes expected to increase billing rates by 5% or less.

Other items that need to be considered when preparing the revenue side of the budget include collections, alternative fee structures and discounts given to recurring clients and new clients in connection with securing the work. Another important item to consider, in the event that additional professionals may be needed to handle increased workload, is the time for the attorney to become acclimated and up to speed. This figure will vary depending on the level of the professional hired. During this time, costs will be incurred; however, the attorney may not be contributing to top-line revenue.

The following illustrates the budgeted fees for the estates and trusts group of the JD Law Firm. As noted herein, there are many considerations and assumptions that form the basis of the revenue side of the budget.

JD Law Firm – Estates and Trusts Practice Group

Existing Client	*Actual Hours*	*Average Billing Rate*	*Actual Fees*	*Budgeted Hours*	*Budgeted Billing Rate*	*Budgeted Fees*	
A	1,200	$ 350	$ 420,000	1,400	$ 375	$ 525,000	
B	2,000	425	850,000	1,800	430	774,000	
C	5,000	325	1,625,000	6,000	350	2,100,000	
D	600	450	270,000	900	500	450,000	
E	800	400	320,000	–	–	–	
Total	9,600		$ 3,485,000	10,100		$ 3,849,000	
Realization –							
Existing Clients		94%	$ 3,275,900		95%	$ 3,656,550	a
New Clients				3,500	$ 425	$ 1,487,500	
Realization –							
New Clients					92%	$ 1,368,500	b
Total Budgeted Fees (a + b)						$ 5,025,050	

Law Firm Economics

Referencing the example above, it can be observed that rates per hour are expected to increase; however, the work for Client B will decrease, and Client E is not expected to be a source of recurring revenue. Realization is expected to improve from 94% to 95% relative to existing clients, while new client realization is expected to be at 92%. Lower realization for new clients can be attributed to discounted billings or time incurred in connection with a project that cannot be billed. Overall, fees attributed to existing clients represent 73% and fees from new clients account for 27% of JD Law Firm's total revenue.

The 2014 Survey of Law Firm Economics notes that law firms of all sizes see litigation as the fastest-growing practice area, followed by corporate. The survey further noted that the average per attorney gross receipts of firms located in the mid-Atlantic region was $458,623, with commercial litigation averaging $470,258 per attorney.

Expenses

Budgeting for expenses is a somewhat-easier process than for revenue, as expenses will follow revenue. As noted throughout these materials, compensation and occupancy are the most significant expenses of law firms. In the event that a firm expects significant growth by adding a practice group or location, payroll, benefits and occupancy costs should be projected to increase.

Compensation for all positions under equity partners should be commensurate with experience, and bonuses should be tied to meeting performance goals. The total cost of an employee goes beyond his or her salary, and all benefits (such as health insurance, life insurance, disability insurance and retirement plan contributions) should be considered. It is a good practice to monitor staffing levels on a regular basis. Surveys can be consulted to provide benchmark compensation for attorneys. A detailed discussion of compensation is beyond the scope of these materials.

Occupancy costs are typically the second-largest expense of law firms. These costs include rent, maintenance and expenses of the space that are not capitalized and depreciated. Rent costs can be controlled somewhat through negotiation; however, when a firm is rapidly expanding and is in need of additional space, there may be less room to negotiate.

Other important expenses (such as business development/marketing, technology, and professional expenses including dues, training, continuing legal education and other functions) should be considered and included in the firm's budget. Other personnel in the firm, including marketing, IT and human resources, can be included in the budget process.

Law Firm Economics

Occupancy and other expenses can be allocated to practice groups based upon revenue or headcount. The cost allocation will allow management to prepare a budget of the net profits for each practice area as well as per equity partner. If projected revenue or profits fall short of the budget, management will need to assess what transpired that led to the deficit Adjustments may need to be made going forward depending on the nature and ultimate cause of the shortfall.

In addition to items of profit and loss, the firm should have a budget for capital expenditures. These expenditures can include leasehold improvements, computers, furniture and fixtures, and software. These expenses should be projected annually, based on the expected needs of the firm for a given year. Management should be on top of any requirements and necessary timing to upgrade software or hardware. Capital expenditures can either be funded either through cash flow from operations or debt (i.e., using the firm's line of credit).

Final Thoughts

Budgeting establishes expectations for partner compensation and also assists management of the firm in properly making decisions regarding financing and investment needs. In addition, undertaking, implementing and monitoring budgets increases accountability, improves productivity and, ultimately, increases profitability.

The use of non-attorney executives to assist in managing the firm can add the financial sophistication and focus that equity partners may lack. As noted in a recent article in the *Pittsburgh Post Gazette,*[3] "S. David Fineman, president of Fineman Krekstein & Harris, said that, from time to time, his firm uses nonlawyer business professionals to help with aspects of business management. And that is likely to increase across the small and midsize market."

[3] Small, Midsize Law Firms Adapt to Increased Scrutiny from Clients, Max Mitchell/The Legal Intelligencer, *Pittsburgh Post Gazette*, May 26, 2015

Law Firm Economics

IV. Law Firm Analytics and Trends

There is no question that every law firm possesses unique attributes that are integral to the group's success. In an environment in which competition can arise at every turn, understanding specific financial-performance attributes and how they compare to others in the industry can lead to management decision-making that is more pointed and, as a result, lead the firm more quickly in the direction of further enhancing current success.

In addition, paying close attention to current trends facing the legal profession and the practice of law can lead management teams to be more forward-thinking and allow for the adaptation to change at a faster pace than what otherwise would be possible. Make no mistake – all service professions are changing, and law is no exception. Technology, marketing, recruitment and even the manner in which legal services are (and will be) provided are changing at a breathtaking pace. Failure to recognize and adapt to these changes will likely lead to lesser fiscal and economic success.

The amount of industry data available for use in developing an understanding of how any particular firm stacks up against other firms is staggering. Annual surveys and studies are generated regularly and can serve as useful proxies in establishing baseline data. There is no shortage of useful information available.

The most common resource for this baseline information is *The National Law Journal's* Survey of Law Firm Economics. The 2014 edition (the latest available) is based on 2013 data and, per the Introduction, is one of the most complete, accurate and up-to-date sets of economic statistics and financial data available about the legal profession. The survey is co-produced annually with *ALM Legal Intelligence*. The 2014 survey was released on July 23, 2014, and the 2015 study is expected to be released at approximately the same time this year.

Another common resource that can prove very helpful in the management of a law firm is the annual Law Firms in Transition Survey, as previously referenced throughout these materials. This survey can provide a great deal of insight into challenges faced by law firms and also what many in the profession expect in the future. The 2015 study is the seventh edition produced by Altman Weil, Inc.

A substantial amount of information is available and can be used to better any legal practice; however, it is important to fully understand the mechanics of the survey results and the geographic region from which the results are drawn. Notably, the separation of statistics by geographic region within the country can lead to significantly greater usefulness for law firm management teams. Moreover, stratifying data by number of attorneys within any region can lead to increased usefulness and greater reliability in comparative results. All major resources available for consideration by the management team stratify data in these ways.

Law Firm Economics

Keep in mind that there are two ways to view industry information and operating trend analysis. The first is to compare select items within the firm's operations and the firm's financial statements and, then, compare these items to others in the legal profession that most closely resemble the characteristics of the subject firm. Differences in the subject firm versus median industry data can lead to the identification of both strengths and weaknesses in the fiscal and economic well-being of the subject firm.

The second way to determine fiscal and economic well-being is to analyze trends in the firm's operating history. Using side-by-side comparisons of one year's financial information to the next allows the firm's management team to quickly identify changes in year-over-year performance by item within the subject firm's financial statements. These trends can then be used as a foundational tool for strategic planning and operational management.

In consideration of selecting the comparative measures that are the most useful, the nuances of a legal practice must be distinguished from any other operating practice. Going back to the fiscal and economic basics in Chapters II and III, the fundamental profit model of a law firm must be reiterated.

A commonly-used financial model, first introduced by Mr. David Maister as an algebraic mathematical equation, sets forth the following:

NIPP = (1+L) x (BR) x (U) x (R) x (M)

Where,

NIPP	=	Average income per partner
L	=	Leverage (total number of associates to partner)
BR	=	Blended standard hourly billing rate
U	=	Utilization (total chargeable hours to total hours recorded)
R	=	Realization (chargeable hours x standard rates x amounts billable/collectible)
M	=	Margin (partner profits divided by revenue)

Assuming some sample variables, the above formula might look like the following:

L	=	2 (two associates for every partner)
BR	=	$180 per hour
U	=	utilization is set at 91% (1,875 chargeable hours)
R	=	realization is set at 91%
M	=	margin is set at $325,000 (35% of revenues)

Law Firm Economics

Applying these variables into the formula:

NIPP	=	(1+L) x (BR) x (U) x (R) x (M)
NIPP	=	(1+2) x $180 x 1,875 x .91 x .35
NIPP	=	(3) x $180 x 1.875 x .91 x .35
NIPP	=	$540 x 1,875 x .91 x .35
NIPP	=	$1,012,500 x .91 x .35
NIPP	=	$921,375 x .35
NIPP	=	$322,481

Shown another way:

Number of Fee Earners	36
Average Total Chargeable Hours	1,875
Total Chargeable Hours	67,500
Blended Standard Rate per Hour	$180
Total Standard Fees in WIP	$ 12,150,000
Realizable Portion of Standard Fees	91%
Total Realizable Billings/Collections	$ 11,056,500
Margin	35%
Total Margin	$ 3,869,775
Number of Partners	12
Net Income per Partner	$ 322,481

As has been discussed throughout the course of today's program, each item within the standard model can work to improve fiscal and economic performance in a legal practice. As such, setting aggressive goals for these items is critical to optimizing any subject firm's performance. As was illustrated earlier, slight improvements in utilization and realization can add meaningful dollars to partners' income. Thus, it is important to monitor these items on a consistent basis and incorporate the results of these analyses into the decision-making processes within the firm.

Law Firm Economics

Leverage is also a critical element of partner profitability and a concept that is somewhat foreign to many attorney management teams. Law is one of the last bastions of direct personal service, as many law firms observed by the authors have not embraced the concept of more heavily leveraging client work and projects.

It is not unusual in the markets that we have observed, including the tri-state region centered in Western Pennsylvania, that associate to partner ratios are 2:1, or lower. Many explanations have been provided to explain this low level of associate staffing, including client demands that the partner do the work, competitive pressures from other firms that will assign partners to the work and, finally, project deliverable quality that will falter without direct partner intervention in all aspects of the work.

In truth, based on observances of trends within the Altman Weil surveys, public law practices will have to more firmly incorporate the concept of greater leverage into their operations to maintain growth in profitability per equity partner. With increases in standard hourly rates growing at much lower percentages than in prior years, new ways of rendering quality services will be needed to more efficiently render client services.

While comparing law firm leverage to the accounting profession may be somewhat unrealistic, especially at the current time, looking at medical service providers and the fact that doctors are generally leveraged at 2:1 or 3:1 by physician assistants, as well as nurses and medical aids, demonstrates how other professions are focusing on extending professional capabilities through leverage.

While benchmarking variables against industry data can be an exceedingly worthwhile effort, care should be taken to fully understand what management seeks to accomplish by this process. Once management's motivations are identified and understood, specific performance indicators can then be focused upon.

A relevant article in *Law Practice Magazine*[4] noted the need for law firms to utilize a financial dashboard to better control where the firm is heading. In conjunction with that process, the article recommends that the subject firm's management adopt key performance indicators that are deemed critical to the success of the firm.

The authors of today's program concur strongly with that need. The items that the authors feel are most appropriately observed in the context of managing the productivity and financial performance of a law firm may include the following:

- *Professional Utilization Percentages* – All full-time equivalent timekeepers (including paralegals) must be subject to pre-set goals and objectives, and management must focus regularly on progress against goals.

[4] Your Financial Dashboard, Stephen Mabey and Colin Cameron, *ABA Law Practice Magazine,* September/October 2013 - The Finance Issue

Law Firm Economics

- *Professional Realization Percentages* – All personnel responsible for billing time accumulated on clients must be subject to pre-set goals and objectives, and management must focus regularly on progress against goals.
- *Open Matters/Backlog* – This indicator can serve as a measure of workload and allow for more astute planning so that projects are delivered more efficiently without overworking firm personnel.
- *Net Income Ratio* – This indicator is often used as a proxy for firm profitability and reasonableness of partner compensation.
- *Average Net Overhead* – This indicator serves as a primary tool for demonstrating the amount of overhead that each partner must cover before profits are generated. It is the "nut" that must be fully met before there is any profit produced.
- *Work In Progress-Unbilled* – This indicator reflects the time at standard rates that has been entered into the time and billing system accumulated for any specific project.
- *Days Receivable-Uncollected* – This indicator tracks the number of days that it takes for the practice to collect the cash on its billings. The collection of accounts receivable is critical to the overall cash flow of the practice.
- *Uncollected Receivables-Bad Debts* – This indicator tracks how much of the firm's billings are going uncollected. This is also a key element of cash flow management.

With respect to recent trends in the practice of law, the 2015 Altman Weil survey provides an extensive look at how firms are coping with a number of critical trends in meeting client needs and expectations while allowing for continuing growth in profitability.

Pursuant to the survey, gross revenue, revenue per lawyer and profits per equity partner were all up in 69% of the firms responding. While this phenomenon is a positive indicator of the strength of the profession, it is noteworthy that the numbers are down from 2011, when firms experiencing similar growth comprised nearly 73% of the firms responding.

It is also noteworthy that in the firms responding with positive growth, nearly 40% experienced growth of just 1% to 4% – and, keep in mind that inflation is approximately 2.5%. Finally, it is important to understand that the remaining 31% of respondents either remained flat (about 10%) or fell in all categories.

Related to the 2014 increase in revenue per partner, the survey inquired as to the factor(s) that drove the performance gains. In 77% of the respondents experiencing an increase in revenue per lawyer, rate changes

Law Firm Economics

were noted as the most significant factor. Interestingly, controlling realization was a key factor for only 57% of the firms responding, and utilization was a factor for 65% of the respondents.

Corresponding with the revenue increases, firms also saw overhead grow in 2014, as 15% saw increases of 4% and more, and another 36% saw increases at 1% to 4%. For 2015, 74% of law firm leadership expects firm revenues to grow; however, of this amount, two-thirds of the respondents expect growth to be 4% or less.

The expectation of low growth is not surprising, as the survey notes that both equity and non-equity partners are not sufficiently busy in a majority of the law firms responding. The issue of overcapacity in many firms, particularly the larger firms, continues to burden equity partners and firm profits in these practices.

The primary threats to the responding law firms (and in particular, the larger and medium-size firms) are corporate law departments in-sourcing projects; advances in technology that allow clients to reduce the need for lawyers and paralegals; and non-law-firm providers of legal and quasi-legal services.

Over 80% of the respondents expect legal work to continue to be more commoditized and anticipate stiffer competition from non-traditional providers. In both cases, the respondents respect the trends to be permanent.

The final survey trends that we will discuss in today's program deal with pricing services in a legal setting. According to the survey's respondents, 94% of all firm leaders expect more price competition to be a permanent trend. Of this total, nearly 31% are taking steps in their strategic planning to address this issue.

The 2015 survey compared the change in gross revenue, revenue per lawyer and profits per equity partner from 2013 to 2014, as reported by firms that said that they are pursuing a strategic change in pricing services versus firms that said that they are not. In all three cases, the firms that are addressing this issue saw 5% to 8% differentials in growth.

The following initiatives were being undertaken by these firms to support pricing strategies:

- Developing data on cost of services sold – 64.6%
- Training attorneys to talk with clients about pricing – 46.0%
- Setting margin goals in firm and practice-group plans – 31.9%
- Identifying each client's unique pricing preferences – 29.5%
- Incorporating pricing into all planning efforts – 27.7%
- Adding a pricing director/assigning pricing responsibilities – 26.0%
- None of the above – 17.9%

Law Firm Economics

Final Thoughts

While there are numerous unique ways in which market pressures on law firm revenue can be addressed (and over time, relieved to some extent), it is clear that doing nothing is not an option. Certainly, firms that select that option will be left behind in the future. The survey shows that for medium-sized and smaller firms, 20% to 30% of the firm's total revenues come from discounted rates. The hit is even greater for the largest firms.

Pricing strategies that are based on some alternative billing mechanism beyond hourly rates are now used by over 93% of all firms surveyed. However, only 10% of total firm revenues are generated by these "non-hourly-rate" service projects, an increase over the prior-year survey. Additionally, 68% of the respondents using alternative billing arrangements do so on a reactive (versus a proactive) basis.

In the next decade, firms will see a number of challenges on the fiscal and economic fronts that attack not only the profitability of the firm, but also the bedrock of traditional management strategies. The leaders of tomorrow can simply sit back and let the chips fall where they may, or they can latch onto new ideas and creative ways to redefine law firm management so that their firms might flourish in spite of the anticipated changes.

Financial analytics and trend analysis are two critical elements of meeting these challenges head on and, used properly, will allow for a transition into an ever-changing marketplace with a capacity to excel and significantly enhance profitability.

Law Firm Economics

Conclusion and Practical Considerations

While the preponderance of professionals in the field of law have not had extensive training in fiscal and economic matters relating to the management of an operating business, an understanding of concepts such as those discussed in this program is critical to the financial well-being of any firm and its stakeholders. Remembering from the outset of today's program that the legal services component of any law firm's operations is simply the "product," it is necessary that members of the firm's leadership team approach the "business" of law as any other businessperson might do in similar circumstances.

The approach required is, first and foremost, to ensure that strategies are adopted and steps are taken to ensure that product quality is at the highest possible level. There are many quality law firms across the country, and a good number of them are located right here. As a result of the sheer volume of attorneys practicing in this region, quality of service is a must to stay competitive. While distinguishing quality services that one firm provides from those provided by another quality competitor firm is difficult, it is not nearly as difficult to distinguish a low-quality service from a high-quality service.

Maintaining a high level of quality in all services offered is a defensive, more than an offensive, strategy. By failing to recognize that there are other quality providers that can serve as an alternative to any specific firm, and that clients always have a choice, low-quality providers will eventually fall to the wayside. However, even though quality service is critical to overall firm success, it is seldom sufficient on a stand-alone basis for firm differentiation and growing practice revenues.

To accomplish the task of moving the firm forward with respect to financial success, the overriding initiatives will focus on revenue growth and the efficiency of producing the legal services requested. Revenue growth is predicated upon the creation and implementation of strategic objectives for practice development, including firm-wide and individual marketing goals. Setting the goals, by and of themselves, is not always conducive to marketing success, however. Holding expected producers accountable through a continuous process of monitoring performance and assessing results is a necessary part of the overall attainment of firm goals in this area.

Efficiency breeds profitability (so long as quality is maintained). Improving on the delivery of legal services can take many forms. In the 2015 Altman Weil survey, the seven key trends listed below were identified as being critical to improving delivery processes:

- Use technology in innovative and unique ways to reduce the effort required from human resources
- Shift the firm's focus more closely to "knowledge" management

Law Firm Economics

- Shift a greater amount of work to contract/temporary lawyers
- Shift work from firm lawyers to paraprofessionals
- Re-engineer project-delivery processes and procedures and confirm the firm's commitment to these processes and procedures by providing ongoing and continuous training
- Reward efficiency and profitability in compensation decisions
- Adopt a strategy of using non-law-firm vendors

The authors of today's materials would add that an important part of enhancing project-delivery efficiency is to create an environment among all personnel that welcomes an ongoing and constant critique of the firm's operating practices. Such an environment will allow for fresh observations from all members of the firm's team and enable the parties that are functioning in different roles to take ownership of the processes and procedures. Management should never wander far from the idea that innovation, and not tradition and history, will guide all professions into the future.

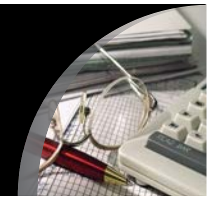
Please note that those items listed above are presented in the order of significance assigned by the respondents to the Altman Weil survey. For example, of the firms responding to the question of technology's growing importance, the number-one item being considered is enhancing technology capabilities within their firm.

The one item that seems to permeate most of the responses is the gradual shift away from lawyers being the only service providers. This is a sea change from historical and traditional practices where headcount has always been the measure of firm growth. Illustrating this trend is a recent article appearing in the *Pittsburgh Post Gazette,* titled, "Do Law Firms in Pennsylvania Need to Thin Their Ranks?"[5]

The article notes the Altman Weil survey, but it also includes information from a separate Citi Private Bank survey. The Citi survey shows that headcount at Pennsylvania firms grew more than in all but one region of the country in the first quarter of 2015, increasing by 1.9% in Pennsylvania for the quarter versus 0.6% throughout the balance of the United States.

These surveys show that while firms are growing, at least in terms of revenue, they struggle with the issue of excess professional capacity. While this may seem, at first, counter-intuitive, it goes back to the addition of more efficient processes and the efficiency with which projects are being completed. Much of this phenomenon is attributable to lateral hires with "books of business" and the expansion of technology and alternative providers in their firms.

[5] Do Law Firms in Pennsylvania Need to Thin Their Ranks?, Gina Passarella/The Legal Intelligencer, *Pittsburgh Post Gazette,* May 26, 2015



Law Firm Economics

The general business model, while simple in concept, can be exceedingly complex and difficult to manage. In addition to the many concepts the authors have addressed in this program, there are still many areas of challenge. A partial listing (not to be considered all-inclusive) might include the following;

Recruitment

Law schools have not been reducing tuition and costs, so the decision to pursue a career in law requires not only a substantial commitment of out-of-pocket funding and personal time, but also the forbearance of earning a living during the period that the students are in law school. While overstaffing is a current problem, it is still imperative that a steady stream of new attorneys be available as the profession evolves. The individuals filling these "slots" will be the very best, as the near- to mid-term trend reflects a need for fewer associates. As law school enrollments decrease, competition for these individuals will be keen and will force costs up. Thus, management teams MUST focus on near-, mid- and long-term staffing needs and plan accordingly.

There is also a need to focus on exactly which characteristics and traits the firms are looking for in a law school graduate. Does the firm need every hire to be an "A" candidate, or will a solid "B" candidate suffice? Is every hire brought in to take a shot at becoming an equity partner, or should some be hired as individuals who fill critical needs for a certain time period?

Additionally, lateral hires and other types of providers must enter into the mix, including a potential shift of greater responsibilities to paralegals.

Attorney Training

Training has many traditional meanings, but the firm of tomorrow is likely to focus just as closely on project management, fiscal management, practice development, critical thinking, leadership and business operations as they do on technical client matters. The downside of an approach like this is that there must be an ongoing commitment to staff development. Such an approach requires both a direct monetary commitment as well as forgone revenue, in that significant time is committed to training. However, these costs should, at some point, come back around as the experienced team members will be better able to adapt and lead the firm into the future.

Compensation

No word strikes more of an emotional chord than compensation. Very often, the best that firms can accomplish is to try to avoid discontent after the process is complete. The factors rolled into compensation are many and can include the geographic market; experience; technical expertise; financial and profitability perfor-

Law Firm Economics

mance; current client project and new client project origination; authorship; size of the firm; type of services offered by the firm; leadership and administrative role; and hours worked and charged to clients, among others.

The compensation criteria will differ by role of the individual in the firm, and the determination process can take on many different facets of consideration. While any compensation program should be comprehensive, caution should be taken to not make the program too complex, or understanding will be impossible, which will lead to overall dissatisfaction.

Automation/Technology

Broader consideration of technology will be more relevant than ever and require longer-range considerations than have historically been incorporated into the firm's planning. The addition of new technology on an almost-daily basis makes it imperative that the legal profession do everything within its power to embrace the addition of such tools as Skype, GoToMeeting and other lower-cost avenues to accomplish the firm's overall mission and to meet client objectives and expectations, while ensuring that the firm's pricing structures are commensurate with the marketplace.

Long-range Planning

While mentioned throughout these materials, long-range planning will help guide firm leadership teams through all of the matters previously discussed, plus, perhaps the most important element of firm growth, which is the addition/retirement of equity partners. In addition, long-term growth financing, be it equity or debt, is better handled when incorporated into the firm's long-term growth planning initiatives.

Data Security

The authors view client confidentiality as one of the most significant elements of the practice of law, especially as technology continues to evolve within the profession. There is no easy way to safeguard client information without a true commitment and focus on developing strategies intended to combat the exposure and risk associated with electronic file storage and recordkeeping. As technology changes at a rapid pace, data security must be at the forefront of all technology discussions within the firm.

Risk Management

No one should need to advise attorneys on the merits of maintaining a risk management function within their firms. Besides more simple concerns such as office security and protection of physical assets, conflict issues, client acceptance issues, project delivery issues and professional conduct issues all require a focus by firm leadership. Most often, this function has been led by a committed Risk Management Group or partner.

Equity Partner Retirement Succession

The issue of retiring equity partners who may go on to receive equity payouts beyond their working periods continues to be an area of contention and difficulty for law firms. Not only do these decisions require comprehensive analysis and assessment by both parties, the fact that the process, by definition, pits partner against partner makes the overall planning sensitive, if not troublesome.

Final Thoughts

This program is not intended to be totally inclusive of all issues and challenges facing law firms today, but does set out many of the decisions that are required of firm leadership on a day-to-day basis, as well as in the course of longer-term planning. The commitment to such planning, in terms of costs and forgone revenues in the near term, can be dear. However, the authors of today's program feel that the cost of not moving forward with this type of focus is likely to lead the firm on a path that will yield fiscal and economic results far below the actual potential of the firm's attorneys and staff.

Grossman Yanak & Ford LLP has a great deal of experience in assisting legal firms with better understanding their financial performance and operating results. In addition, we have the capability to provide assistance with the use of financial statements and interpreting debt/equity structures, vertical and horizontal expense integration analysis, operational improvement opportunities, and overall strategic and technology recommendations. A sample of these services can be found on our website: http://gyf.com/industries/professional-service-firms/law-firms/

Should you have a follow-up question regarding today's program, or if you would like to meet to discuss any element of your practice (even if you are not on the current leadership team), please contact Bob Grossman, John Yanak or Melissa Bizyak – their contact information is included at the front of these materials.

It has been our pleasure to provide today's program. We hope that you have found the information helpful and that it will prove beneficial as you move forward in your practices.

Thank you for keeping Grossman Yanak & Ford LLP in mind for referrals for audit and accounting, tax, technology, litigation support and business valuation services.

We again sincerely thank you for attending today's presentation!