INCREASING LAW FIRM PROFITABILITY

More Than Raising Rates

Deborah J Schaefer | CPA
AGENDA

Understanding Firm Profitability

Understanding the Income Statement (P&L)

Increasing Profit by Increasing Income

Increasing Profit by Decreasing Expenses

Matter Profitability

Managing Timekeeper Productivity
WHERE DOES PROFIT COME FROM?

- **Income** (Money Received)
- **Cost of the Case**
  - Lawyers Time
  - Client Cost Paid

\[
\text{Income} - \text{Cost of the Case} = \text{Gross Profit}
\]

\[
\text{Gross Profit} - \text{Overhead} = \text{Net Profit/Income}
\]
R.U.L.E.S. of Law Firm Profitability

**Realization of billing rates**
- How much is ultimately collected” versus the “effort expended

**Utilization of attorneys**
- How timekeepers use time on billable vs. non-billable activities

**Leverage of lawyers**
- Ratio of associates or non-equity partners to equity partners in the firm

**Expense control**
- A planning process or budget that supports a firm’s goals

**Speed of billings and collections**
- Gap between time charges incurred and date payment is received
IMPORTANT NOTES ABOUT FIRM PROFITABILITY

• *Remember:* The Income Statement shows the financial profitability of the entire firm, not individual attorneys, matters, etc.

• Recording profit at the end of a fiscal year does not mean that every matter was profitable

• Analyzing profits on a matter by matter basis can help refine and manage the net profit of a firm

• Timekeeper productivity should be evaluated
USEFUL FINANCIAL STATEMENTS

• While all financial statements provide information about the operations of your firm, there are some that will easily help you track income and expenses

• Income Statement
  • Budgeted vs. Actual Income Statements
  • Previous Fiscal Years to Current Fiscal Year

• Balance Sheet
  • Own, Owe, Investment

• Detailed General Ledger
  • Master set of accounts detailing all financial transactions within a firm
INCOME (PROFIT AND LOSS) STATEMENT

• The Income (P&L) Statement is a financial report that summarizes revenues, costs, and expenses incurred during a specific period
  • Income (revenue) received less expenses
  • Based on one year (fiscal vs. calendar)
  • Compare years
  • Budget
# Example Income Statement

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Income</strong></td>
<td>$214,077.22</td>
</tr>
<tr>
<td>Payroll Expenses</td>
<td>$91,489.87</td>
</tr>
<tr>
<td>Employee Benefits Expenses</td>
<td>$28,730.46</td>
</tr>
<tr>
<td><strong>Total Payroll &amp; Benefits Expenses</strong></td>
<td>$120,220.33</td>
</tr>
<tr>
<td><strong>Total Firm Overhead Expenses</strong></td>
<td>$31,447.95</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>$151,668.28</td>
</tr>
<tr>
<td><strong>Total Net Income</strong></td>
<td>$62,408.94</td>
</tr>
</tbody>
</table>

_Fiscal Year Ending 12/31/18_
What is included in the Income Statement?

- Income (Fees)
  - Payments received from clients
  - All payments must be received before matter profitability can be determined
    - Interim profitability can be identified but cannot be used as a gauge for final outcome
- Retainers
  - Are retainers considered income?
  - Defined in client engagement letter
  - Where is the retainer deposited?
HOW TO INCREASE PROFIT

1) Increase Income

2) Reduce Expenses
INCREASING PROFIT BY INCREASING INCOME

• Evaluate Rates
• Evaluate Billing Process
  • Timeliness
  • Efficiency
  • Capturing Time
  • Client Cost Reimbursement
MANAGING INCOME

• Lawyer Productivity
  • Hours Worked vs. Billed
  • Billed vs. Collected
  • Write Offs, Courtesy Discounts
    • Electronic Billing Adjustments
    • Reason for Write offs/Adjustments
  • Non-Billable Work
MANAGING INCOME

Increase Billable Hours
- Increase timekeeper efficiency
- Analyze fixed fee cases
  - Record time for these matters
  - Compare time spent to fixed fee amounts
  - Adjust fixed fees
- Record Time in an accurate and timely manner
  - If time is entered each day more will be recovered
  - Create Budgets
MANAGING INCOME

• Difficult to obtain information about billing from Manual System
• Time and Billing software should be able to produce required reports
INCREASING PROFIT BY REDUCING EXPENSES

• Payroll is firm’s largest expense
  • How productive are your time keepers?
  • How much money do they earn for the firm?
  • Are you giving them the tools they need to be more productive?

• Overhead is a firm’s second largest expense
  • Rent
  • Do you have the best contracts for all services (Phone, IT, Internet, etc.)?
ANALYZING OVERHEAD EXPENSES

• Control Spending (Overhead)
  • Analyze overhead expenditures on a regular and timely basis

  • Fixed Overhead:  
    (Costs that do not vary as a result of changes in activity)
    • Rent
    • Equipment Leases

  VS

  • Variable Overhead:
    (Costs that vary as a result of changes in activity)
    • Trips
    • Conferences
    • Meals
OTHER WAYS TO REDUCE EXPENSES

• Control Spending Details
  • Ensure proper accounting classifications
  • Chart of Accounts
  • By Partner
  • By Practice Area
  • By Spending Classification

• Compare Monthly Expenses
  • Waiting until FYE – Too Late
OTHER WAYS TO REDUCE EXPENSES

• Budgeting
  • Compare Budget to Actual Monthly

• Recording Payroll Expenses
  • Include all related costs
  • Health Insurance
  • Payroll Taxes, FUI, SUI, Medicare, Social Security
  • Matching 401k, Pension
OTHER WAYS TO REDUCE EXPENSES

• Use Financial statements to Identify Spending Trends
• Compare past years to Current
• Analyze Expenses Against Income
Firm Profits

Income statement shows the financial results of a law firm as a whole.

A profit does not mean that every matter was profitable.

Analyzing profits on a matter basis can help refine and manage the net profit of the firm.
What is matter profitability?

The amount of money earned on a specific matter

How is that determined?

Impact of timekeeper productivity
HOW TO MEASURE MATTER PROFITABILITY

• Attorney productivity
• Analyze the types of law or the type of client
• Can expenses be better managed?
• How fast are your invoices being paid each month?
• Are you taking advantage of the data within your financial management system to evaluate what needs to be improved to increase your profitability?
• “RULES of law firm profitability”
Determining the Cost of a Case

• Time Tracking
  • All lawyers must enter all time in order to accurately determine profitability
  • Even non-billable or no charge time entries
  • Time must be entered even for fixed fee matters

• Time Worked
  • All time worked on file must be entered
  • Time reductions must be accounted for
  • Non-billable time is as important as billable time
TIME TRACKING

- Time Worked
- Time Billed
- Nonbillable Time on File
- Nonbillable Firm Time
- Nonbillable Personal Time
- Consider Time Entry Process
  - Time Required Enter Billable time
  - Mobility
CLIENT DISBURSEMENTS

- **Hard Costs** - Actual money paid on behalf of client
  - Checks Paid
  - Charges on credit cards
  - Accounts payable (paid or unpaid)

- **Soft Costs** - Recoverable overhead costs
  - Postage
  - Long distance
  - Delivery
  - Photocopies
BILLING THE FILE

• Types of Billing Arrangements:
  • Hourly
  • Flat Fee Matters
  • Percentage of Settlement, Appraisal, etc.
  • Flat Fee with Limits then Hourly
  • Fixed Amount each month
  • Payment Schedule
  • Variable Hourly Rates
  • Rate Exceptions
BILLING PROCESS

- Objectively Evaluate Billing Process
  - Timeliness of Sending bills
  - Cycle from Prebill to out the door
  - Delivery Method
  - Approvals
  - Edits
  - Presentation
  - Payment Options
BILLING

• Changes to Fees at time of billing
  • Categorized
  • Allocation method

• Changes to billed fees and client costs
  • Write down
  • Allocation Method

• Both will impact matter profitability.
CALCULATING MATTER PROFITABILITY

Receipts (Payments Received)  
- Time Worked (Billable & Nonbillable)  
- __________ Costs incurred, but not collected

= Matter Profitability
PROFITABILITY REPORTING

- Billing Realization
  - Compare worked against billed
- Profit realized per time keeper
- Effective Rate per timekeeper
- Detail Adjustments or Write-Offs
- Useful for Flat Fee Matters

This Photo by Unknown Author is licensed under CC BY-SA
EVALUATE & MANAGE

• Establish Routine
  • The more frequent information is analyzed the better to control
  • Monthly is best or completion of case
  • Minimum is Quarterly
Manage Income

- Budget Income
  - By Timekeeper
  - By Case
  - By Type of Law

- Forecast Income
  - Analyze past performance
    - Collection rates and timeliness
  - Analyze current open cases
  - Economic Indicators and forecasts
EVALUATE STAFFING & MANAGING TIMEKEEPERS

- Evaluate Staffing
  - Assign Timekeepers to work based on productivity
  - Reassign to avoid overload
  - Identify staff strengths and weaknesses
EVALUATE STAFFING & MANAGING TIMEKEEPERS

- Managing Timekeepers
  - Lawyer Productivity
  - Hours Worked vs. Billed
  - Billed vs. Collected
  - Write Offs, Courtesy Discounts
    - Electronic Billing Adjustments
    - Reason for Write offs/Adjustments
  - Non-Billable Work
PROFITABILITY REPORTING

• Cost of the timekeeper

• Fees Earned vs. Timekeeper Compensation

• Compare to industry standards
EVALUATING AND MANAGING PROFITABILITY

• Compare Actual to Budgets/Projections
• Identify Trends
• Consider Industry Trends or Statistics
• Economic Climate
• Make Changes
• Communication
• Marketing Changes
PRODUCTIVITY & PROFITABILITY

• Productivity does have an impact on profitability
  • How efficient are your timekeepers
  • Tools to increase productivity
  • How is time entered?
    • Ease
    • Timeliness
  • Document Storage and Retrieval
  • Scheduling
  • Communication
INCREASING TIMEKEEPER EFFICIENCY

• Tools:
  • Document Management
  • Calendaring
  • Case notes
  • Communications
  • Contacts
  • Remote Time Entry
  • Research
LEGAL OFFICE SOLUTIONS

Available Solutions
Cloud vs. On-Premise Solutions
All in One
Practice Management vs. Billing Accounting
Trust Accounting
Type of law specific