Learning Objectives

- Define the core concepts associated with accounting conventions and terminology
- Examine and articulate financial statement information
- Discuss rules related to client trust accounts
- Discuss the importance of budgeting
- Discuss the use of alternative (appropriate) fee arrangements, and how legal process improvements and legal project management are becoming more crucial
Core Concepts

- Cash/Modified Cash vs. Accrual
- General Ledger
- Basic Account Types

Cash vs. Accrual Recordkeeping

- CASH
  - MODIFIED CASH
- ACCRUAL
Modified Cash

How is modified cash different from cash at law firms?

- Fixed Assets on Balance Sheet
  - Advanced Client Costs
- Long Term Debt on Balance Sheet

General Ledger

- DEFINITION – A COMPLETE BOOK OF ACCOUNTS FOR A BUSINESS
- ONE HUGE DATABASE
  - CAN BE AS DETAILED AS YOU WOULD LIKE IT TO BE
  - INFORMATION CAN BE SORTED
Basic Account Types

- ASSETS
- LIABILITIES
- PARTNERS CAPITAL/OWNERS EQUITY
- REVENUES
- EXPENSES

Accounting Equation

ASSETS = LIABILITIES + PARTNERS CAPITAL/OWNERS EQUITY
Assets
BALANCE SHEET – NORMAL DEBIT BALANCE

• CURRENT OR LIQUID
• ADVANCED CLIENT COSTS
• FIXED
• CONTRA-ASSET

Liabilities
BALANCE SHEET – NORMAL CREDIT BALANCE

• CURRENT
• LONG-TERM
• TRUST LIABILITY
Partners’ Capital/Owners Equity

BALANCE SHEET – NORMAL CREDIT BALANCE

- COMMON STOCK
- PAID-IN CAPITAL
- RETAINED EARNINGS

Revenues

- FEE INCOME
- INTEREST INCOME
- MISCELLANEOUS INCOME
Expenses

- EMPLOYEE
- OPERATING
- PROFESSIONAL
- OCCUPANCY
- OTHER INCOME/EXPENSE

<table>
<thead>
<tr>
<th>BALANCE SHEET</th>
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<tbody>
<tr>
<td>Assets</td>
</tr>
<tr>
<td>--------------------------------------------------</td>
</tr>
<tr>
<td>Cash - Operating</td>
</tr>
<tr>
<td>Cash - Trust</td>
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<tr>
<td>Cash - Money Market</td>
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<tr>
<td>Current Assets</td>
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<tr>
<td>Furniture, Fixtures &amp; Equipment</td>
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<tr>
<td>Capitalized Software</td>
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<tr>
<td>Capitalized Tenant Finish</td>
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<tr>
<td>Accumulated Depreciation</td>
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<tr>
<td>Total Fixed Assets</td>
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<tr>
<td>Deposits - Rent</td>
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<tr>
<td>Deposits - Plants</td>
</tr>
<tr>
<td>Total Other Assets</td>
</tr>
<tr>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
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<tr>
<td>Total Assets</td>
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### REVENUE & EXPENSE STATEMENT

#### OPERATING EXPENSE

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<thead>
<tr>
<th>Description</th>
<th>Year to Date</th>
<th>BUSINESS INSURANCE</th>
<th>Year to Date</th>
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<tbody>
<tr>
<td>Fee Income</td>
<td>500,000</td>
<td>Insurance - Prof Liability</td>
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<tr>
<td>Revenue Income</td>
<td>20,000</td>
<td>Insurance - General &amp; Business</td>
<td>1,500</td>
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<td>Total Operating Income</td>
<td>520,000</td>
<td>Total Business Insurance</td>
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#### EMPLOYEES EXPENSE

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<tbody>
<tr>
<td>Salary - Non Partner</td>
<td>50,000</td>
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<td>180,000</td>
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<td>Total Employee Costs</td>
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<td>Non-Equity Partner Payments</td>
<td>300,000</td>
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<td>Payroll Processing Fees</td>
<td>800</td>
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<td>Non-Equity Payments</td>
<td>300</td>
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<tr>
<td>Total Payroll Processing Fees</td>
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<td>Total Employee Expenses</td>
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#### OCCUPANCY EXPENSES

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<td>Total Office Services</td>
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<td>Depreciation and Amortization</td>
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<td>Print Services</td>
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<td>Computer Software</td>
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<td>Total Information Technology</td>
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<td>Total Occupancy</td>
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#### ADMINISTRATION & FINANCE

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<tr>
<td>Bank &amp; Service Charges</td>
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<td>Interest Expense</td>
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<td>Total Administration &amp; Finance</td>
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<td>800</td>
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<td>NET INCOME</td>
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Trust Accounting

- Trust Accounting Rules
- Trust vs. Operating Accounts
- Three Part Reconciliation
- Multiple Client Funds in One Account
- Individual State Requirements
- ABA Model Rules

Trust Accounting Rules

- Basic Procedures
  - Separate Funds
  - Property of Client

- How do I find the rules for my state?
Trust vs. Operating Accounts

- Operating
- Trust

- Why should I have a separate bank for my trust account?

Three Part Reconciliation

Part 1

- The total cash receipts and cash disbursements should be added to the beginning cash balance to provide the ending cash balance. The ending cash balance is then compared to the bank statement.
Three Part Reconciliation

Part 2

• In order for the two records to match, adjustments must be made for items such as outstanding checks and deposits not credited to the account by the bank.

Three Part Reconciliation

Part 3

• Finally, and most importantly, total all the individual client or third party ledger balances and compare with the ledger balance for the trust account.
Setting Up A Separate Account For The Funds Of One Client

• If clients funds are going to be held for a longer period of time, which are expected to earn interest in excess of the cost of maintaining a separate account.
• Interest belongs to the client.

Individual State Requirements

• Financial institution designated from list
  • FDIC consideration
• Financial institution in a state where you practice
  • Unless client designates otherwise
• Expenses cannot be deducted for check fees/bank account charges, etc.
• Some states require attorneys to sign checks
  • Fidelity bonds
ABA Model Rules

• Rule 1.15
• (a) only a lawyer admitted to practice law in this jurisdiction or a person under the direct supervision of the lawyer shall be an authorized signatory or authorize transfers from a client trust account;
• (b) receipts shall be deposited intact and records of deposit should be sufficiently detailed to identify each item; and
• (c) withdrawals shall be made only by check payable to a named payee and not to cash, or by authorized electronic transfer.

ABA Model Rules

• Rule 1.15 continued
• (d) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person.
• (e) When in the course of representation a lawyer is in possession of property in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyers until the dispute is resolved. The lawyer shall promptly distribute all portions of the property as to which the interests are not in dispute.
### Internal Controls – Trust Requests

- Only certain individuals can authorize trust check requests.
- At least one person signing checks always reviews request for payment to determine:
  - Validity of request for payment
  - Reasonableness of the amount requested
  - If sufficient funds are available to pay the amount of the check
  - That an accounting to the client for receipt and disbursements is completed

### Internal Controls – Trust Requests

- **DO NOT** use your trust account for any purpose that is not directly related to the practice of law.
- Watch what your clients ask for such as using your trust account to run money through as an escrow agent or otherwise.
• Any questions?

• GAME TIME, PEOPLE!!!

Budgeting and Variance Analysis

• Definition and Reasoning
• Types of Budgeting
• Capital Budget
• Operational Expense Budget
• Revenue Budgeting with Realization
Definition of BUDGETING:

An estimate of costs, revenues, and resources over a specified period, reflecting a reading of future financial conditions and goals.

One of the most important administrative tools, a budget serves also as a:
- plan of action for achieving quantified objectives;
- standard for measuring performance; and
- device for coping with foreseeable adverse situations.

Why Prepare a Budget

- Assists with Controlling Expenses
- Creates a Historical Measure
- Important Part of Strategic Planning
- As a Communication Tool
Types of Budgets
What are they, and why should I use them?

- Expense
- Operating
- Capital
- Zero Based
- Top Down
- Bottom Up

Financial Reporting
Income and Expense Statement

- Income
  - Fees
  - Interest
  - Miscellaneous
Financial Reporting
Income and Expense Statement

• Expenses
  • Salary
  • Taxes
  • Benefits
  • Occupancy
  • Professional Services
  • Promotional
  • Other Operating

Financial Statements
Income and Expense Statement

• Actual vs. Budgeted
• Current vs. Prior Year
• Variance Analysis
Capital Budgeting

- Furniture, Fixtures and Equipment
- Tenant Improvements
- Advanced Client Costs

Operating Budget
RULES

• Realization of billing rates
• Utilization of attorneys
• Leverage of attorneys
• Expense control
• Speed of billings and collections

Budgeting Fee Revenue: Applying Realization Factors
Revenue Realization

• Two types of realization

  • Billing – amounts (or %s) of standard time charges that are eventually billed to clients

  • Collection – amounts (or %s) of billed fees that are eventually collected.

Target Billing Rate Graph

Overhead per fee earner - $19,800,000/132 = $150,000
Associate Heading
Cost Rate - $285,500/1,750 = $163 (Breakeven)
Required Internal Hourly Rate - $163/82% = $199 (Revenue Leaks)
Expected Profit Margin - $199/(100-22%) or 78% = $255 (To Be Profitable)

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<th>Firm-wide</th>
<th>Total</th>
<th>Equity</th>
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<th>Paralegals</th>
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<td>Less paralegal compensation</td>
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<th>Per individual group</th>
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<td>$125,000</td>
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<td>$6,000</td>
<td>$6,000</td>
<td>$6,000</td>
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<td>Total cost before any additional bonuses</td>
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<td>$264,000</td>
<td>$206,000</td>
<td>$117,000</td>
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<td>Expected billable hours</td>
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<td>1,550</td>
<td>1,750</td>
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<td>Cost rate</td>
<td>$382</td>
<td>$386</td>
<td>$143</td>
<td>$199</td>
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<td>Expected realization</td>
<td>88%</td>
<td>86%</td>
<td>82%</td>
<td>80%</td>
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<td>Required internal hourly rate</td>
<td>$434</td>
<td>$267</td>
<td>$116</td>
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<td>Expected profit</td>
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<td>Target billing rate</td>
<td>$485</td>
<td>$420</td>
<td>$265</td>
<td>$190</td>
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Budgeting Fee Revenue: Applying Realization Factors

1. Estimated Value of Annual Billable Time
2. Estimate Annual Billings: Apply Billing Realization
3. Estimated Annual Fee Revenue: Apply Cash Receipt Realization

• Let’s play a game!
Alternative Fee Arrangements

• Types of AFAs
• Hourly Fee – Seniority/Experience Based Pricing Levels

Why do we have alternative fee arrangements?

• Ethically, lawyers must act in the client’s best interest
• But hourly billing doesn’t necessarily incentivize lawyers to focus on the most efficient path to resolution or control costs
• Traditional hourly billing not affordable for some clients
Ultimate Goal of AFAs

• The ultimate goal for AFAs is a mutually beneficial arrangement – a win/win situation

And

• Mutual trust and a willingness to share risk typically leads to long-term relationships

Mutual Benefits of AFAs

• Predictability and Transparency
• Shared Risk
• Reduction of Administrative Resources
• Efficiencies
• Improved Communications
• Better Relationships
What clients want?

- Better value
- Lower rates
- Fixed rates
- Defined deliverables
- Better resources
- Better Project Management

AFAs – Starting the Conversation

Ask Questions:
- How do you start the conversation?
- What are the incentives for each party?
- What information is each side willing to share?
  - There is no problem asking a company what their legal spend was last year.
- Who participates in the conversation?
- How does each party define success?
Types of AFAs

• Full Contingency Fee
• Partial Contingency Fee/Performance Bonus
• Capped Fee
• Fixed/Flat Fee
• Risk Collar

Contingency Fees

• Full – depends entirely on success
  • No charge until resolution, and attorney receives % of recovery
• Partial – receives part of its normal hourly fees as a matter proceeds, and a lump sum or success fee at the end of the matter depending on the result
  • Reverse contingency fee where client is defendant: discounted hourly rate plus some % amount “saved” from agreed risk
Capped Fee

- Hourly rates are charged up to an agreed maximum amount for a particular matter.
  - Often with caps for several litigation stages
- Beyond that, if additional work is required to complete the matter, the law firm pays for it.

Flat Fee

Must be the right type of legal services best suited for a flat fee model which would be repetitive.

Why does it work?

Your attorneys know how long the work will take for specific tasks, stages of litigation.
Risk Collar

Hourly billing arrangement built around an estimated budget for a particular matter. The client pays a bonus if the work is completed under budget and/or gets a discount if the work goes over the budget.

Hourly based on agreed budget, but bonus for coming in under budget, and discounted rate if budget exceeded.

Blended Rates

- 100% hourly arrangement in which a single middle rate is charged for senior lawyers who normally charge more and junior lawyers who normally charge less. Whether the client or the firm benefits from this arrangement depends on the actual numbers in a particular situation.
ETHICS and AFAs

• ABA Model Rules 1.5
  • All fee arrangements must be “reasonable,” and a lawyer may not enter into an agreement for, charge, or collect an illegal or excessive fee
  • Specific requirements for contingent fees
  • For retainers
  • For flat fee

• Any questions?
• What AFAs have you seen?
• Did it work?
• Did you see something here you think may work well in your firm?
Two aspects of the law firm delivery service model

- Legal Project Management (case)
- Legal Process Management (administrative and business processes)

Essence of Lean
The essence of lean is to:

1. Add Value
2. Eliminate Waste
Adding value

• What is value?
  • Whatever your client thinks it is

• The Value Criteria
  • Does your work move the matter forward?
  • Is it something the client wants and is willing to pay for?
  • Is your work done right the first time?

• We need to cut down on spending too much time on things that don’t add value to our processes

Eliminating waste

• If we eliminate waste by becoming more efficient, we will:

  • Free up human, financial and technical resources for other valuable work
  • Be more proactive than reactive
  • Have more time to find new and creative ways to better serve our clients
Areas Of Waste

**DOWNTIME**

- **Defects** – mistakes, incomplete forms, data entry errors
- **Overproduction** – too many people, printing too many copies
- **Waiting** – late to meetings, interruptions
- **Non-utilized Talent** – skills not being utilized efficiently; billable work being done by fee earners
- **Transportation (of things)** – excessive paperwork handoffs, paper rather than electronic
- **Inventory** – documents waiting for signatures, files sitting on desk awaiting work
- **Motion (of people)** – looking for files, poor office layouts, too many trips to printer/copier
- **Extra processing** – too much research

DMAIC

- **Define** – What does your client want? Listen to the voice of the client
- **Measure** – How do you work now? Establish a baseline for improvement
- **Analyze** – Why do you work the way your work? Find the root cause
- **Improve** – How can you work better? Brainstorm and prioritize your ideas. Involve the subject matter experts.
- **Control** – Are you following your new process? Continuation is key, including continuing to review the process once improved.
Project Management
Driven by AFAs and Clients

• Client Level
• Matter Level Budgeting
  • How does this allow firms to see if they are profitable? By measuring their work product against their budget.
  • Will we be profitable moving forward? Need to evaluate findings to analyze what worked and what didn’t work.

Project Management

• How does legal project management work?
  • Set and adhere to budgets
  • Clarify what’s in or out of scope
  • Develop project plans
  • Share knowledge and information
  • Stay within fixed fee limits
  • Uncover optimal ways to work
  • Facilitate better communications with clients
  • Facilitate better communications among teams
Building a Client/Matter Level Budget

• How do we do it?
• How do we do it in an efficient manner?
• Are we doing enough work to make it valuable?

Project Management

• Your tools in the engagement process (You need your client’s input as they are primary stakeholders in the case)
  • Proposal language
  • Engagement letters
  • Matter timeline and schedule
  • Detailed scope of work
• Your tools in the planning process
  • Communications plans
  • Budgets
  • Staff and resource analysis
  • Project plan
Project Management

• What’s the main objective of the Legal Administrator/Management and where we can help?

TRAINING AND MORE TRAINING

Project Management

• Challenges?
  • Insufficient client feedback
  • Lack of knowledgeable team members
  • No budget or supportive technology
  • Unclear goals and roles
  • No top down support
  • Not enough training
• Any Questions?

• Let’s Build a Process!

Wrap It Up!

• Takeaways

• It’s hard to completely change the world!

• Baby Steps

• Leave Your Mark
Contact Information

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