

LAWYERS JOURNAL

L A W P R A C T I C E M A N A G E M E N T

Do you conduct an annual financial checkup for your law firm?

By Keith Cameron

The Benefits of an Annual Checkup

At some point in our lives, most of us recognize and commit to the need for an annual physical examination. There are so many compelling reasons to do this: to detect health-threatening issues which can be managed if detected early, to check the status of key metrics we aren't able to see more frequently (like indicators from a blood test), to compare our year-over-year changes, to uncover the otherwise invisible threats to our health as we age, and to recommit to habit changes to improve our health.

There are parallels between the reasons for annual physical exams and the reasons to conduct annual financial checkups for your firm. Oftentimes, there are problems you don't notice, like increasing amounts of time worked but never billed, expenses and overhead increasing disproportionately to your revenue; and so on. With an annual review, there are opportunities to resolve your trending problems, such as too much indebtedness, substandard collection realization, and exorbitant banking fees. An annual review of your financial performance and operations can identify evolving problems and opportunities that often go unnoticed when watching only your daily and monthly financial performance, and it can identify opportunities to improve your operational efficiency, keep your firm financially safer, and ultimately increase net income.

If your law firm is like most, someone on your Finance or Executive Committee regularly manages and reviews your firm's financial performance during the year in conjunction with your accounting manager or controller. So, your budget review, income statement, cash flow, balance sheet, etc. get at least monthly attention. You may have excellent procedures in place and feel confident about your financial operations, but do you also regularly review the less visible indicators of your financial system's health? You could easily monitor these far less noticeable indicators, and in turn, obtain crucial information and impactful results. In this article, I



Keith Cameron

will describe these infrequently reviewed financial health indicators and recommend a method for completing an annual financial checkup.

The Areas to Cover in an Annual Financial Checkup

So, what are some of these less visible financial areas to review once a year? First, you should begin by discussing these matters with your outside accounting firm and your principal internal accounting professional.

Accounting firms have several levels of review, which accomplish different objectives, such as Compilation, Review and Audit. The type of review I'm suggesting may already be included in work the accounting firm is doing for your firm or could be performed if you request it. Keep in mind: Your accounting firm also works with other law firms and often knows relevant efficiencies and procedures that could benefit your firm. However, if you decide to do your own review annually and conduct a more thorough review less frequently, listed below are examples of the areas for which you would want to collect data. These are simply examples of what other firms have found helpful to review annually; you may have different areas to add to the list, and some may not apply to your firm.

- Are your expenses increasing at a greater rate than your revenue?
- Is the revenue per partner ratio declining?
- Is overhead per attorney increasing at a greater rate than the cost of living?
- Realization: a) Is your billing realization (billed amount divided by the initial amount to be billed) less than 95 percent? b) Is your collection realization (collection divided by amount billed) less than 92 percent?
- Inventory: a) Is your unbilled time over 180 days greater than 15 percent of the total unbilled time; b) Are your accounts receivable over 180 days greater than 25 percent of your total accounts receivable; and c) are your combined unbilled time and accounts receivable more than 3½ months' billing for your firm.

- If contingent fee work is only a small portion of your firm's work, are contingent fee hours more than 10 percent of total client hours?

- Create some metrics to help you keep your firm's debt below a threshold, such as: is your debt greater than the value of your fixed assets? Is the debt greater than the partner contributed capital?

- Meet with your bank representative to explore ways to lower your bank fees and ways to increase your firm's efficiency with services you are not using like lockbox and remote check deposit. New services are developed and their usefulness for your firm changes over time. An annual review is a perfect opportunity to explore these.

- Even if you don't have a more formal review done by your accounting firm, they may have recommendations for you on improvements in your operational, security and other areas. Such improvements could include tighter checks and balances, changes to prevent fraud, ways to capture and bill your attorneys' time entries more efficiently, and fee collection procedures.

As I'm sure you noticed, few of these areas are covered in your current daily and monthly review of your financial operations.

A Simple Method for Conducting an Annual Financial Checkup

Conduct your checkup at a time of the year when other financial activity is slower, such as February. It may simplify your work to create a form, or spreadsheet, listing the key areas, any benchmark data you are trying to achieve, and then add the related data each year. Collect the data, input it on the form and review the results to identify any areas to analyze in depth to decide if you want to take action to change the current situation. All the data for the examples above should be readily available, so the data-gathering phase of the checkup could be completed in a few hours.

In addition to using the benchmarks incorporated into the areas listed above (e.g., billing realization at 95 percent), you can also identify areas of concern by reviewing your data in at least the following two ways:

- Compare your results to representative data from other law firms in your economic region and your size range. This type of comparison can be very revealing, but such data is often hard to obtain.

- Compare your data year over year. So, the first year will set a base for future years' comparisons. This approach will let you know how your firm is trending, and you can decide if you want to improve that trend.

Conclusion

At a minimum, a financial checkup would confirm how well the listed areas of your financial system are operating. It may even motivate you to improve on areas you haven't been focusing on. For many firms, the early years of conducting a checkup lead to significant improvements, then it becomes a method for identifying areas for continuous fine tuning. If you decide on improvement projects for your firm, remember that execution can be difficult. Start with no more than two projects at a time to better ensure success. An annual financial checkup can be a fairly easy way to add a lot of value. ■