

Accounting for the Budget

Effective law firm budgeting requires year-round input. **By Joanne Sammer**

For most attorneys, creating and adhering to a firmwide budget is about as welcome as the prospect of root canal and probably about as enjoyable. However, even a root canal serves a purpose and so does a firm's budget.

A strong budget and budgeting process helps a firm set priorities, direct resources, guide business development and much more. Dallas-based Haynes and Boone uses an interactive process that "mixes accounting discipline with the reality of managing a law practice," says partner Terry Conner. "The accounting department focuses on projecting expenses and practice group leaders focus on projecting revenue with strong interplay between the two."

Throughout the year, Haynes and Boone creates profit and loss statements for both monthly and year-to-date performance. Its accounting department also generates reports for the firm's partners, board members, and finance staff that compare those numbers to the current budget and last year's figures for the comparable time period.

"This allows us to see trends from the previous year and to see where we are growing or contracting in certain line items so we can determine why that is happening," says Conner.

Keeping it current

An effective budget remains dynamic throughout the year and plays a large role in firm management. Chadbourne & Parke, based in New York City, also uses its budget to keep an eye on rev-

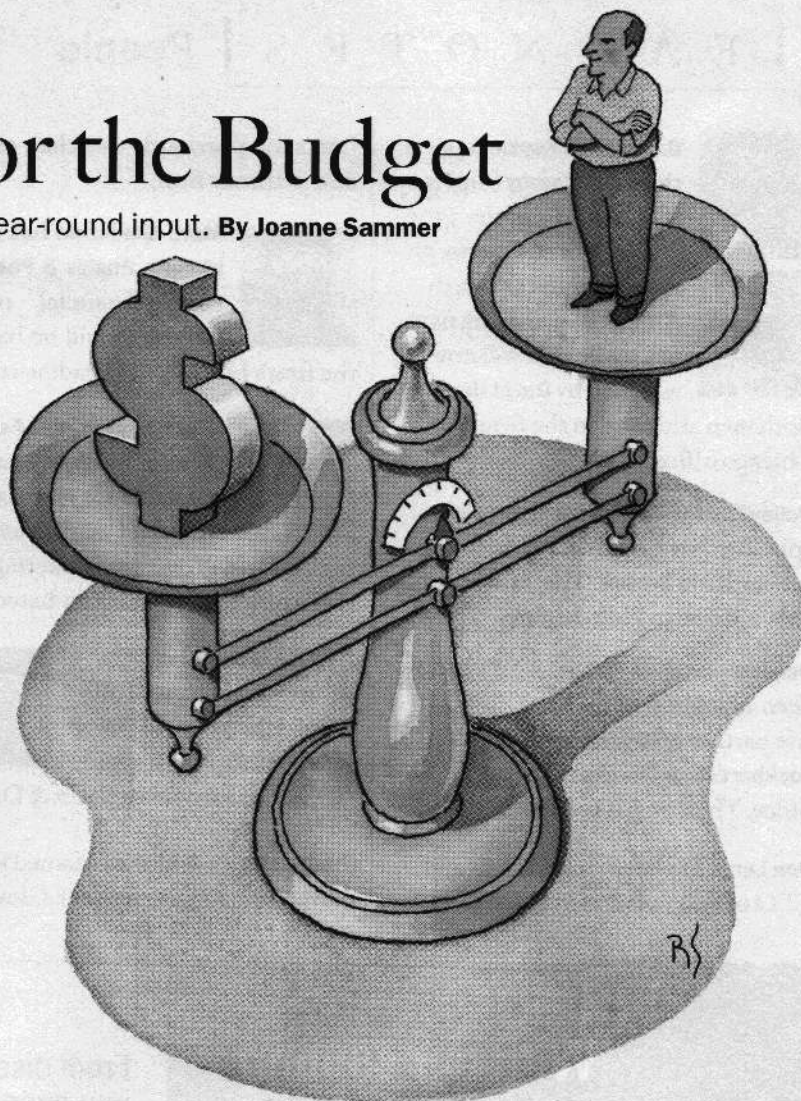
enue and expenses on a monthly basis. If something is happening that affects a department's ability to make its numbers, it is up to the department head to explain why things have changed and to get a new budget approved. "Budgets are based on assumptions that may not hold through the year," says Aniello Bianco, the firm's managing director.

Rather than making the budgeting process an annual event, firms should make changes to the budget, perhaps quarterly or as needed, to reflect unexpected additional hires and unexpected changes in revenue levels. For example, if the firm decides in the middle of the year to do something not planned for in the original budget — such as open a new office, acquire another firm, or take on major litigation that will require an increase in headcount — the resulting

financial changes must be incorporated into the overall firm budget. "Otherwise, the budget would be meaningless," says Debra Baltzell, executive director of Chamberlain, Hrdlicka, White, Williams & Martin in Houston. "A good budget alerts you to what might throw the numbers off so you can respond."

The budget as management tool

Effective and precise budgeting is quite important for Tampa-based Carlton Fields. It's critical because the firm uses a shareholder compensation system that sets pay levels at the beginning of the fiscal year based on the firm's revenue projections for the coming year. As a result, "budgeting is a critical process for us and we take it seriously," says Annie Hiotis, the firm's executive director of administration.



Carlton Fields' fiscal year begins on February 1 so the budgeting process begins in October. To come up with the expense side of the budget, each department forecasts its expenses for the year. Those figures are submitted in November and Hiotis then goes through those numbers line by line, challenging and adjusting figures as needed.

Forecasting the revenue side is harder. Projections are based on billing rates for the coming year and realization rates for the previous year. These numbers

should be, then drill down and find out why before that hits in the income statement in three or six months."

A key goal of budgeting is to help monitor expenses. Haynes and Boone uses the budget to keep operating expenses down. The firm relies heavily on its non-lawyer managers in the budgeting process and has increasingly given them more authority.

"We still review these managers' recommendations," says Conner. "Most of

firm also tends to have strong collections at calendar year-end in December and fiscal year-end in January as the firm stretches to reach its overall numbers for the year. "This is by design," in order to maximize collections at three points during the year, rather than just at calendar year end, says Hiotis.

Firms that take a more proactive approach to budgeting involve many people in the firm and conduct a thorough analysis of the numbers. Los Angeles-based Manatt, Phelps & Phillips involves the heads of all of its administrative departments and practices in the process. "Practice department heads need to buy into the budgeting process as a group, otherwise the budget won't work," says CFO Marc Goldstein. Eventually, he hopes to develop and implement a strategic planning process to guide his firm's long-term growth over three to five years. "We can use the budget to achieve our strategic plan," he says.

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are usually a couple of percentage points higher than the prior year's projections. "Revenue is the wild card so we tend to be conservative," says Hiotis.

Providing detailed line items to members of the firm can also help the attorneys prioritize their expenses. At Chamberlain Hrdlicka, Baltzell plans to expand the budget to provide more detailed information for marketing and business development at the practice level. "If someone spends \$2,000 a year on business development, that doesn't mean much," she says. "But if [the partners] see what that money was spent on, they can begin thinking about what value we got from that expenditure."

Baltzell also provides bimonthly reports on budget variances. This way, department heads and practice leaders can see if expenses or accounts receivable are higher than budgeted and increase collection activity or reduce spending. "We also look at other budget factors that impact income," such as billable hours that are outside the normal or expected level, says Baltzell. "If things are not on track, we can see where billings

the interchange with non-lawyer managers is over their budget assumptions and an analysis of their initiatives and projects." For example, if the IT manager wants to install or upgrade software or technology, that manager would have an active dialogue with the firm's management about the costs and benefits of the change. This has helped Haynes and Boone keep its expenses low. According to the firm's benchmarking efforts, its annual operating expenses are \$50,000 less than those of similar size law firms nationwide, says Conner.

Using the budget to maintain accountability is a common theme among firms. Carlton Fields reports to shareholders on budget-to-actual figures in an effort to hold the shareholders accountable for those numbers. Also, constant reporting of how the firm is performing against its budget projections spurs collections.

"Shareholders want to make sure the numbers are good for October 31 when the firm sets compensation levels for the next fiscal year," says Hiotis. The

Reflecting the culture

For better or worse, a budget is likely to reflect a firm's culture. If a firm is very hierarchical, the budget may be developed by a small group of partners with little or no input from others. Other firms simply take last year's budget and increase it by a certain percentage.

But firms can gain more value from their budgets and the overall budgeting process by taking an analytical, and inclusive approach to developing and managing the budget. By communicating with staff and partners about performance against the budget, Haynes and Boone has demystified the issues surrounding revenue, expenses, and income. Says partner Terry Conner: "In short, the partners know how the firm is doing and how their performance affects overall firm performance." LF

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