



FINANCIAL REPORTING ESSENTIALS

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Is one of the following a familiar scene at your firm?

Scene One: Each month-end the books are “closed”. Then reports are run and distributed. You receive a rather large stack of reports. The reports contain important information. Yet, aside from pulling out the work-in-process (WIP) for billing, the reports are barely touched. Generally, the bulk of the reports sit on the credenza or desk corner or floor until the next month, when the old stack is replaced by the new.

Scene Two: Month end does not really have meaning except for payroll tax liabilities, and expenses due on the first of the month, like rent. Your firm is small, and therefore your “needs” for financial information are limited largely to what you need to get a bill out the door, and how much cash is in the bank.

If either of these scenes creates a strong sense of *deja vu*, your financial reporting could use an overhaul.

When it comes to financial reporting, most firms err by operating at either extreme noted above — too much or too little. It does not help you make good decisions to weigh you down with mountains of paper which you will never find time to wade through. Nor can you make good business decisions in the absence of data.

I suggest you prepare a one page synopsis which identifies and summarizes each of the key statistics which should be monitored regularly in a law firm. It should show totals for the current month, year-to-date, and the prior year-to-date, too. All on one page. (The numbers are readily available off today’s Time & Billing software packages.) And because the key statistics report is so simple to understand and become comfortable with, it is guaranteed to become your most used financial tool —in some cases the *only* tool used. Following are the nine key statistics you should review monthly:

BILLABLE HOURS: For firms which still worship at the altar of the billable hour, it is imperative to monitor hours regularly. Firms which work exclusively on alternate billing arrangements, like contingency, flat fee and such, need not monitor hours, and in fact may not even keep a record of hours.

FEES BILLED: One must be careful to note whether any adjustments in the current month might throw off the total.

BILLING REALIZATION: This area can dramatically impact profitability. Billing realization is computed as fees billed divided by the actual value of the time which was billed. For example, if \$1,000 worth of time (10 hours @\$100/hr) is billed out for \$900, the billing realization is 90%, meaning the firm has billed out at ninety cents on the dollar. Benchmark realization numbers can be obtained from the Altman Weil Pensa *Survey of Law Firm Economics*. If the firm is not attaining or surpassing the benchmark numbers for realization, efforts should be focused in this area. Improvement of even one percent overall can have a dramatic impact on the bottom line. Of course, realization can only be computed when time is accurately recorded.

FEES RECEIVED: This number will normally get the most scrutiny, aside from billable hours. In firms where compensation is directly tied to receipts (e.g. “Eat What You Kill”), receipts will be looked at from several perspectives, usually by originating and responsible attorney. But it is not necessary to take such a detailed look at receipts every month. Generally, just tracking the overall volume on a month to month basis is sufficient.

WORK IN PROCESS (WIP): At some firms this report is called pre-bills or bill drafts. It accounts for all unbilled time and costs incurred for clients. It gives an instant view of the firm’s active inventory. Old unbillable time and costs should routinely be written off, so the WIP is an accurate predictor of billings to come over the next 30 – 60 days for non-contingent matters.

ACCOUNTS RECEIVABLE (A/R): If your receivables keep increasing while your billable hours and fees billed remain the same, it means that you are not achieving the revenues you have worked hard to attain. Even though you review the aggregate total, you should still monitor individually any past due or unusually large receivables.

COST WRITE-OFF: This number represents the costs which are written off or down or “adjusted” at time of billing. Well managed firms have thresholds established for write-offs, beyond which the proposed write-off must be reviewed by another partner. The details of write-offs must be dutifully reviewed each and every month. Keep an eye out for noteworthy-sized write-offs, even if the aggregate total is unremarkable. These should be footnoted on the Key Statistics Report.



ACCOUNTS RECEIVABLE WRITE-OFF: If there is a problem with the bill, at least from the client's perspective, there will likely be some accommodation made by the firm. No matter how happy the clients are or how well the firm follows up on outstanding invoices, there will always be a certain percentage of write-offs. The IRS is concerned that invoices not be written off until a reasonable effort is made to collect. In law firms I've always found that the opposite problem exists. That is to say that attorneys, for some reason, just can't bring themselves to write off receivables. The firm is better off being more aggressive in writing off items which are highly unlikely to ever be paid. Then the A/R will more accurately reflect the cash revenue potential of the firm.

CASH ON HAND: This is the final number to monitor regularly. You'd be a rare attorney indeed if you weren't already asking for this number daily or weekly. If the overall numbers don't make "sense", this is one of the first places it will be evident.

The idea of looking at a one page synopsis of all the key statistics is to get a quick glimpse at the overall health of the firm, and to develop a clear sense of the work-to-revenue cycle of your firm. If any of the numbers requires further exploration, and if you have time to do so, you can always look at a more detailed report. But why spend the manpower processing and printing reports you will never get to? On the other hand, if you're one of those who has not been receiving reports, reviewing a one page report will not be too time consuming or difficult.

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