STRUCTURING A FINANCIAL DEPARTMENT

THE LONG VIEW OF PRICING, PAYMENTS AND PROFIT

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Now that you and your partners have built up a respectable client base, a reputation for professionalism in a particular niche or two, and you have started to realize the financial rewards for all of that effort, the time has come to ask yourselves the question you've been avoiding: 'can we really continue to handle the financial aspects of firm growth all on our own?' If your firm is like most firms that are on a solid growth trajectory, the answer will be that the time has come to create a financial department. It doesn't have to start off as a big department, and it might not need the staffing and sophistication of a Big Law firm. But it will need to be structured in such a way as to facilitate your firm's scalability and growth.

In-house? Or Outsourced?

In an era where many specialized tasks and processes for a law firm are outsourced rather than being built from scratch in-house (think IT, marketing, SEO), many firms look to utilizing a full-service accounting or business financial planning consultant on an ongoing basis rather than just at tax time or for the quarterly report and payroll preparation. But being an outside service doesn't mean that it can't serve as your firm's full-time financial department. In many cases—especially while your firm is still small—the need for a financial department can be met even if your current budget does not allow for investing in the added staff, training, and technical infrastructure that an in-house financial department would require. When the size or cash flow of a firm is not yet sufficient to warrant a permanent, in-house position, consider an outside financial department as a viable option.

Regardless of whether your financial department is inside or outside, certain planning basics are a must in order to ensure that firm financial management is properly addressed.

Short-term Budget, Long-term Goals

As with any business' financial planning, your firm will need to develop a profitability financial model that reconciles short-term budget realities with long-term goals. Despite the fact that few law schools instruct in the business side of the practice of law, mastering those skills will be crucial to building and maintaining your practice, even if you rely on outside experts to advise you. Financial management involves planning and organizing the financial operations of your law firm—especially tracking revenue as related to expenses— and setting a plan for revenue growth.

The first step in any financial planning model is to establish a realistic, workable budget built around your existing cash flow. Unfortunately, not all billings result in current cash flow, and outstanding receivables are just one of the budget categories that must be accounted for.

Analyzing the Metrics

The financial analysis begins with reviewing just what sources of cash are available. Apart from the initial capitalization for start-up

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— Brooke Lively, CFA, and CEO of Cathedral Capital, profitability strategists.

funding, a build-up of cash reserves set aside from revenue should be a part of the firm discipline that is established from the beginning. But what if revenue shortfalls disrupt the planned monthly reserve accumulation? If cash on hand is insufficient to cover anticipated expenses, then it may be necessary to dip into available lines of credit. A word of caution must be inserted here that for the small- to mid-sized firm, relying on institutional (or private) debt should be an option reserved for when an otherwise healthy cash flow has an unexpected interruption, such as the spread of a pandemic, temporary illness of a partner, or a similar brief upset to a generally sound financial profile.

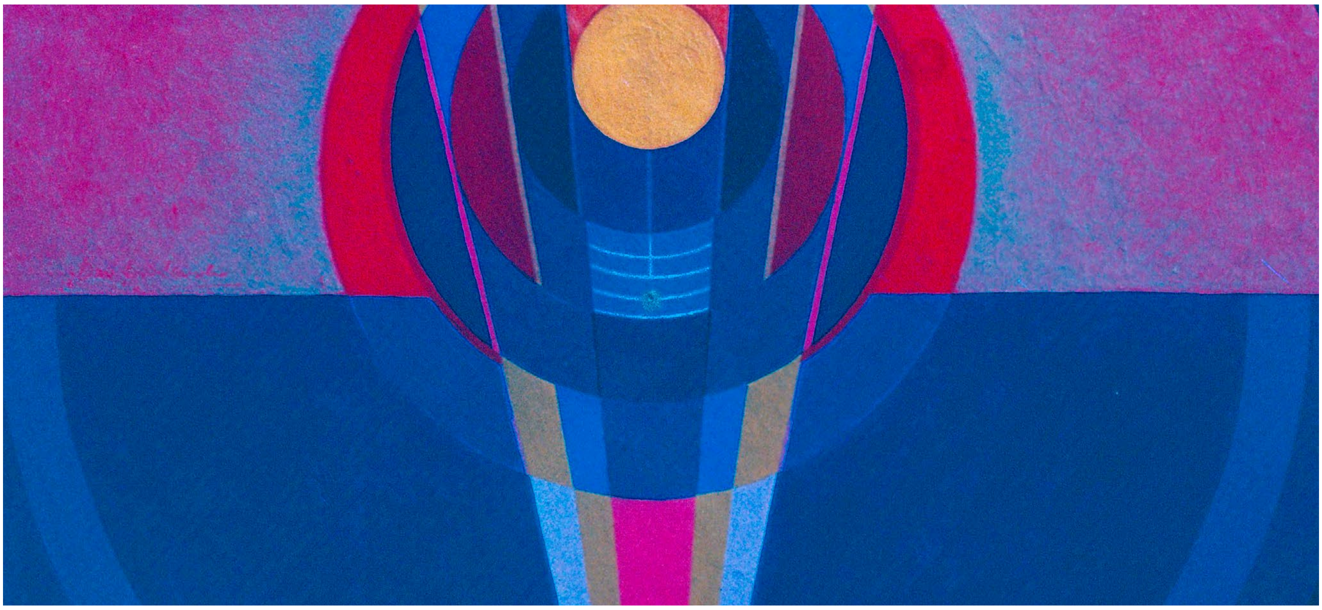
Opinions vary as to how much of a reserve should be maintained, but many financial managers put the figure at somewhere between three to six months of operating expenses.

Boosting the Cash Flow

What happens in a situation where the client base is solid and client representation is ongoing, yet the cash flow has too many ebbs and flows rather than a steady stream? The financial management department should be tracking such patterns in order to identify whether too much of the practice is focused on contingent fee arrangements or, perhaps, not enough upfront retainer sums are collected. Unpaid client billings must also be closely monitored in order to make sure that receivables do not get out of hand. When a practice spends—or, more correctly, wastes— too much of its time on its own collections, that is a sure sign that something is amiss in the financial management department; receivables should rarely reach the point that they turn into collections. Accelerating receivables invoicing is, therefore, an important part of a firm's financial administration.

Staying on Top of Financials

Even larger firms with established, well-run financial departments need stakeholder oversight. Leaving financial operations to a professional financial department is one thing—leaving financial matters and decision-making alone is quite another. A well-structured financial department, regardless of whether in-house or outsourced, will still need regular reporting to and input from the firm's principals. It is the role of the financial department to supply the data and revenue/expense figures needed by the partners in order for them to make the critical decisions as to practice and marketing strategies and growth acceleration, or, perhaps, reining it in.



Records and Compliance

Beyond tending to the financial administration of the firm, the financial department will also be charged with accurate and up-to-date record-keeping. This is important not only for such matters as tax issues but also with regard to compliance issues, particularly as to the firm's IOLTA or lawyer's trust account requirements as mandated by the state's rules of professional responsibility.

At some point, usually, once your firm can afford to fund a full-time, in-house financial department, the financial staff's familiarity with the firm's overall operations, risk tolerance, and expectations for growth will enable them to provide more independent guidance with less need to run as many modeling alternatives by the partners. At the end of the day, when it comes to your firm's scalability and profitability, the most 'senior partner' might just be the firm's entire financial department.

Executive Summary

1. The Issue

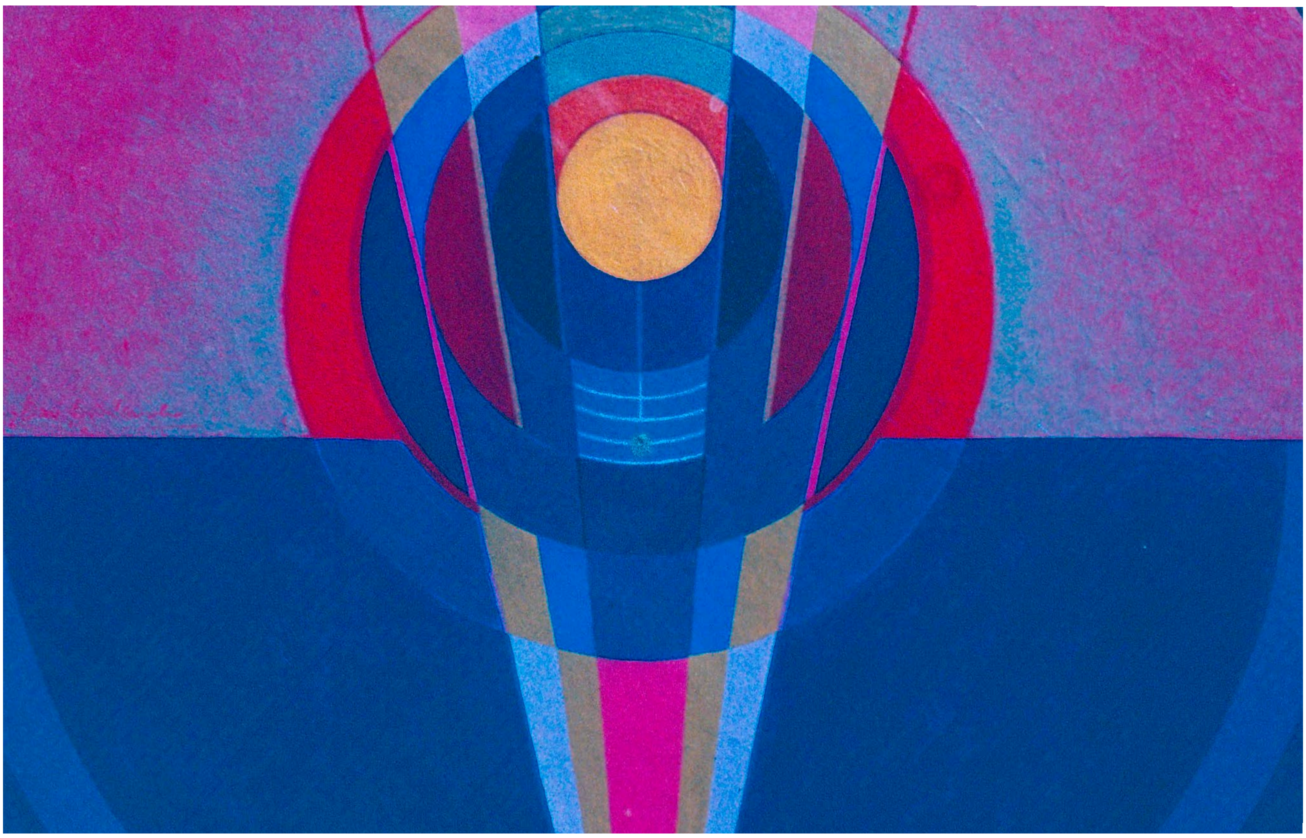
When is it necessary to create a financial department, and how should it be structured?

2. The Gravamen

All firms need input from a financial manager, whether it be in-house, or outsourced, part-time, or full-time.

3. The Path Forward

Outsourcing of a firm's financial department—especially while the firm is small—should be considered in the same light as outsourcing IT, marketing, and other specialized yet necessary support services.



Action Items:

1 Start with a Budget:

A realistic assessment of start-up costs, where cash flow will come from, operating expenses, and how much of a reserve your firm should keep on deposit are all metrics that need to be carefully analyzed together with your financial managers.

2 Plans for Growth:

Aside from current operational needs, your financial managers should be key players in your plans for upscaling and growth.

3 Maintain Oversight:

Even the most professional of financial managers should not be given free rein to 'go solo' entirely; rather, their role should be that of adviser and supplier of data necessary for the partners to ultimately make key financial decisions.

4 Receivables Gatekeeper:

The financial department, whether in-house or outsourced, must be tasked with keeping a close eye on receivables lest they get out of control to the financial detriment of your firm.

Further Readings

1. https://centerbase.com/blog/the-complete-guide-to-your-law-firms-finances/
2. https://www.natlawreview.com/article/guide-to-law-firm-finance-management
3. https://www.lexisnexis.com/uk/lexispsl/practicecompliance/document/393850/5GFX-CG01-F18F-Y55P-00000-00/Financial_management_law_firms_overview
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6. https://www.lawkpis.com/law-firm-financial-management/

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After receiving his Juris Doctor degree from The John Marshall Law School in Chicago, Mr. Brochin served as an Administrative Law Judge with the Illinois Department of Labor for six years where he presided over cases dealing with job separation issues and matters pertaining to contested Unemployment Insurance claims. He also co-wrote the agency's administrative rules, and periodically served as a 'ghost writer' for Board of Review decisions. Following that position, he was Director of Development for a Chicago-area non-profit college where he was responsible for High Net Worth donations to the institution. For the next eighteen years he practiced as a solo practitioner attorney with an emphasis in the fields of Real Estate law and Commercial Contracts transactions, and was an agent for several national title insurance agencies.

In 2003 he was recruited to head up a U.S. title insurance research office in Israel, a position he held for four years, and between 2007-2017 he participated in litigation support for several high-profile cases. He has taught Business Law as a faculty member of the Jerusalem College of Technology, and has authored a wide variety of legal White Papers and timely legal articles as a professional legal content writer for GPL clients. Separate from his legal writing, he has co-authored academic articles on Middle East security topics that have been published in peer-reviewed publications.

William H. Anderson, Esq.

MANAGING DIRECTOR AND HEAD OF
FINANCIAL PRODUCTS AND SERVICES

William Anderson is Managing Director and Head of Law & Compliance. He leads the GreenPoint practice in providing regulatory, legal, and technology solutions to law firms, legal publishers, and in-house law departments around the world, overseeing our team of experienced US attorneys and data and technology experts. Will has over 25 years' experience working with corporations to improve the management of their legal and corporate compliance functions. Will began his legal career as a litigator with a predecessor firm to Drinker, Biddle LLP. He then served as in-house counsel to Andersen Consulting LLP, managing risk and working with outside counsel on active litigation involving the firm.

Will has leveraged his legal experience interpreting regulations and appearing before federal (DOJ, SEC, FTC) and state agencies (NYAG) to oversee research and other areas at Bear Stearns. In this capacity, he counseled analysts on regulatory risk and evolving compliance requirements. Will also consulted on the development of a proprietary tool to ensure effective documentation of compliance clearance of research reports. Will then went on to work in product development and content creation for a global online compliance development firm pioneering the dynamic updating of regulated firms' policies and procedures from online updates and resources. Will holds a Juris Doctorate with High Honors from the Washington University School of Law in Saint Louis and is admitted to state and federal bars. He lives in Pawling, NY, with his wife and daughter.

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About GreenPoint Global

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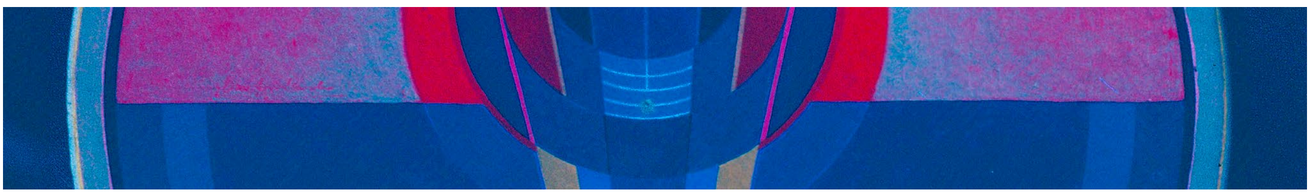

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