

LAW FIRM SOLUTIONS: USE CLIENT INTERVIEWS TO CEMENT RELATIONS AND IMPROVE QUALITY SERVICE

JUNE 2011

RELY ON ACCRUAL ACCOUNTING TO EVALUATE FINANCIAL RESULTS

As law firms grapple with being better able to project their financial futures, CPAs and other advisors stress the importance of accrual accounting. This accounting method likely would have enabled many law firms operating on cash basis accounting to more quickly anticipate the changes that wreaked so much havoc in law firms. So, what's the difference? And, how does accrual accounting give you more of an early warning of financial changes?

Cash Basis Accounting Only Provides a Partial Picture of Financial Health

Cash basis accounting recognizes income only when it is received. Expenses are recognized only when they are paid. If a major client owes the firm \$100,000 in fees, those fees are not reflected in the firm's net worth. If the firm owes \$45,000 in accounts payable, those expenses are not reflected in the firm's net worth.

If cash has dried up, is it because clients are not paying their bills or because work-in-process dropped three months ago?

On a more complex situation, let's say you have a dispute with your landlord and do not pay rent for three months. On a cash basis, the law firm would look like it was making a lot of money. On an accrual basis, the unpaid rent would show as an accrued liability, and the net worth of the firm would be more accurately reflected.

Accrual Basis Accounting Offers a More Complete Picture

Accrual accounting offers all of the information obtained with the cash basis and much more. It provides a snapshot of a law firm's financial posture at a particular point in time – whether the end of the week, month, quarter or year. That \$100,000 fee owed the firm shows up as an account receivable, meaning the firm's assets are increased by that much. The \$45,000 in unpaid invoices shows up as accounts payable, increasing the firm's liabilities.

The net effect of including these two situations in the firm's financial statements is an increase of \$55,000 in the firm's net worth.

Similarly, using accrual accounting, if cash remains low but work-in-process (hours logged on behalf of clients but not billed) is climbing, then the firm knows that work is building and has a reasonable expectation of how much cash will follow.

Accrual Accounting as a Vital Management Tool

The cash method of financial accounting is little more than keeping books by means of a check register. Accrual accounting not only offers a more precise picture of a firm's financial posture, it also presents vital management data. Is that increase in cash available for a bump in partner distributions, or will those accrued taxes and accounts payable negate the possibility?

For projecting cash to be collected from work- in-process, most law firms determine from experience the percent of logged fees that normally get billed and collected – say 92 percent – and record that amount as an asset.

Accrual accounting also provides opportunities for establishing key ratios, such as debt to equity, which are used throughout the financial and general business community as indicators of financial performance. Please note, however, that for income tax purposes, you will remain on the cash basis.

If you would like more information on how to convert from cash to accrual accounting, give one of our law firm specialists a call.

USE CLIENT INTERVIEWS TO CEMENT RELATIONS AND IMPROVE QUALITY SERVICE

Asking clients what they think of your firm and providing a forum for discussion is an effective way to monitor quality of service, detect problems and fix them before it is too late. With more and more clients shopping around for legal service providers, this action is more important than ever.

We recommend a personal, face-to-face approach as an opportunity to demonstrate that you care about your clients and to cement bonds. Outlined below are common questions regarding client reviews and recommendations for implementing a review process at your firm.

How often should client reviews be conducted? We recommend formal discussions with significant clients once a year, though some firms do them more often. Decide how often to conduct individual client reviews based on perceived need, available lawyer time and firm philosophy.

Which clients should be interviewed? The more clients you can meet with, the better. Depending on the size of your firm, we recommend interviewing at least your top 25 to 50 clients. Be sure to select a broad range of every partner's clients, and be sure all specialties and service areas are represented.

Who should conduct the client review? Some firms require the partner responsible for the majority of a client's work to conduct the client review. Others delegate the responsibility to another partner or the marketing director, with the idea that clients might be more open about any problem areas with an "independent" reviewer. You also can use the client review as an opportunity to introduce partners the client does not know. This team approach fosters new relationships and introduces additional areas of expertise. Whatever the case, the person responsible should consult client files and appropriate partners for background on the client's situation and previous legal matters.

Where should we meet? The appropriate setting for client reviews depends on the tone you would like to set. Ideally, the reviewing partner will go to the client's office, which presents an excellent opportunity to gain first-hand knowledge of the client's business or industry. You also could ask the client to come to your office or conduct an informal review over lunch.

How should I "break the ice"? To lead into the discussion, summarize the extent of legal services performed on behalf of the client, as well as positive outcomes or benefits realized because of your firm's service. Explain that the goal of the client review process is to show the firm's appreciation and ensure continued quality service as defined by the client.

Follow-Up Is Essential

No matter how thorough, mutually beneficial, eye-opening or heartwarming the actual client review, relations will suffer if you do not follow up. Within one week of the interview, send a letter thanking the client for their input. Refer to specific suggestions they made during the interview. Communicate any changes

implemented or actions taken based on their comments.

Above all, apply what you learn during your client reviews. This kind of feedback deserves the attention of the managing partner or management committee.

Questions for Discussion in a Client Interview

1. What is the most important function we serve for you?
2. Are we performing this service to your satisfaction?
3. Are any legal services not being performed to your satisfaction?
4. Do we meet your expectations in terms of informing you of developments in your legal matter or case?
5. Do we meet your expectations in terms of informing you of changes in the law or areas requiring legal attention?
6. Suggest ways in which our services might be improved.
7. Are present billing arrangements satisfactory?
8. Do you understand the format of bills and matter designations? Do you have suggestions for improvement?
9. Do you consider our fees low, fair or excessive? Explain.
10. Are partners and staff:
 - a. Prompt in responding to your calls?
 - b. Readily available when needed?
 - c. Knowledgeable about your business?
 - d. Professional in appearance and manner?
11. How might current developments in your business or industry affect our relationship and your need for legal services?
12. Suggest additional services that you would like us to provide now or in the future.
13. Have you referred friends, family or business contacts to our firm? Why or why not?

UTILIZE A PARTNER SUMMIT TO ADDRESS POTENTIAL CHANGES TO THE STRUCTURE OF YOUR FIRM

Partner or firm retreats were one of the first things to feel the axe in the past couple of years as firms tightened their belts to weather the economic turmoil. With economic improvement stumbling into reality, now may be an excellent time to gather the partners again for a retreat summit. However, given the disruptions many firms have experienced, and the prognostications for continued structural changes within law firms, this summit should address bedrock issues relating to the future structure and practices of your law firm.

This summit should be more than the usual discussion of partner admissions, acquisitions, marketing, electing management positions, compensation changes or any of the other important but not critical issues facing law firms. Rather, this summit should provide a forum for open discussion of how your firm might restructure itself for prospering in this new world for law firms.

Hot Topics for Discussion

Many issues for restructuring law firms are floating around the profession. In-depth discussions of some of these can be found in a simple Internet search. You may consider creating a "required reading list" of articles that partners should complete prior to the summit meeting.

Of course, the first item to put on the table is whether the firm needs to make changes. Some law firm partners may resist any change to operating as in the past, but most partners are well aware of the need.

A presentation by management would be appropriate.

Below are just some of the approaches being considered or implemented by law firms.

- A revised leverage structure, that may include:
 - Fewer equity partners.
 - Fewer career track associates and more staff attorneys, including recruiting directly into the staff attorney level.
 - More contract lawyers.
 - More paralegals or virtual paralegals, coupled with stronger administrative support to relieve the need for more lawyers.
- Outsourcing of some legal services and back office tasks.
- More robust technology resources.
- Business training for all lawyers so that they can better understand their clients' and law firm's operations.
- Associate apprenticeships, similar to internships and residencies for doctors.
- Changes to recruiting, including improved screening and pre-testing to better identify talent and reduce attrition.
- Ending or revamping mandatory retirement.
- Implementing studies for ways to improve efficiencies in the law firm.
- Training all partners or in-charge attorneys on process and project management to add efficiencies in serving clients and reduce time associated with matters.
- Competency-based advancement models for associates.
- More vigorous adoption of alternative fees, beginning with studies to determine appropriate methods and levels of fees.

Lay Summit Groundwork Carefully

The discussion topics above represent significant issues for all law firms. They may generate angst among partners. To prepare the environment, create presentations or required reading lists to acquaint all partners with why these issues need to be discussed and the ramifications of adoption or rejection. Consider a half-day pre-summit gathering where the firm's current metrics are shared, along with an agenda for the coming summit.

Though all topics might be considered, only include on the agenda those that management considers vital to the firm's future prosperity. Or, at the pre-summit meeting, have partners rank the issues by priority, and only address the three to five that partners consider most critical.

Go Offsite for Best Results

A gathering of partners to discuss items of this nature demands full attention of partners, uninterrupted by cell phones, clients, or day-to-day affairs. An offsite location is best, and an out-of-town location is preferred if budget permits. This will underscore the importance of the meeting and better focus the attention of the partners.

Be sure the location's meeting room is roomy and comfortable, and that food is varied, appealing, and efficiently served.

Normally, partner retreats feature recreational activities to help build *esprit de corps*. Consider carefully whether this high-level, more intense summit gathering should include such activities.

Recreational activities are very beneficial, but don't let them steal too much time.

OUTSIDE OWNERSHIP OF LAW FIRMS IN U.K. AND AUSTRALIA

Beginning October 6, 2011, law firms in England and Wales will be able to raise external capital through Alternative Business Structures (ABS). Australia saw its first law firm IPO in 2007. Questions arise: What does this mean for firms in the United States? And, what is the likelihood that the U.S. might adopt such changes?

Legal profession observers offer mixed opinions as to the effect in the U.S. Most see no effect for smaller U.S. firms. However, most see the potential for greater competition for international firms as firms in the U.K. access outside capital, acquire smaller firms, offer more services, and compete in the global market – perhaps more efficiently than U.S. firms.

Could outside ownership happen here? Of course, every jurisdiction in the U.S. has the equivalent of American Bar Association Model Rule 5.4. Rule 5.4(a) says that a lawyer or law firm shall not share legal fees with a non-lawyer. Rule 5.4(d) says that a lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit if a non-lawyer owns any interest in it.

In 1981, the Kutak Commission proposed relaxing the prohibition of non-lawyer ownership. It was rejected by the ABA membership. However, the idea has been kicked around in back rooms ever since. Milton C. Regan, Jr. of Georgetown University provides a good discussion of outside ownership of law firms and the potential for making the case for such in the U.S. in his article, which can be found online at http://www.law.georgetown.edu/legalprofession/documents/outside_investment.pdf.

FOCUS ENERGIES ON BUILDING PARTNER COLLEGIALLY

The summit retreat outlined on page three does not afford much opportunity for building collegiality among partners. Yet, the very topics to be discussed suggest that collegiality will be more important than ever. Discussion of such bedrock issues may lead to anxiety and strongly voiced opinions. Further, the transformations of the past two years likely have damaged partner collegiality. Consider these suggestions for improving collegiality both before and after the summit.

Monthly Breakfasts – Institute monthly breakfasts hosted by the managing partner. If your firm is large, mix those invited to any one breakfast in terms of responsibility, professional stature, tenure, department, specialty, etc. Hold the breakfast at a nearby location and keep the gathering unstructured. The objective is to let people get to better know each other and the managing partner.

Weekly E-mails – Send weekly e-mails from the managing partner to all other partners. This is not a “get your bills out!” e-mail. Rather, this communication focuses on more personal items or professional accomplishments. Share the kind of information that will lead to partners better knowing each other as people.

SPOTLIGHT ON MP&S

MP&S PRACTICE LEADER COMMENTS ON THE GROWTH OF THE NONPROFIT SECTOR

The March 2011 issue of *Accounting Today* featured a special supplement that focused on the accounting industry. Mike McNee, Partner-in-Charge of the Nonprofit and Government Services Group and the Westchester Office of Marks Paneth & Shron LLP (MP&S), was asked to comment on the growth of the nonprofit sector as a specialized segment of the industry.

As the Big Four chose to reduce their focus on the nonprofit sector, this presented opportunities for mid-sized firms to expand the services they offer in this niche area. Mike noted that nonprofit clients now comprise nearly 10 percent of MP&S's entire practice. This increase has taken place over the last decade. Nonprofit and governmental entities are an important and valued service sector for MP&S.

The supplement also included *Accounting Today's* annual national ranking of the top 100 accounting firms. MP&S has risen to become the 30th largest accounting firm in the nation.

CASE STUDY: ASSESSING DAMAGES IN LOST WAGES CLAIM

When an employee is terminated, injured or for some other reason unable to work, what wages has he or she lost? What damages should be awarded? The question is central to thousands of personal injury claims each year. The answer is by no means straight forward.

Josefina Tranfa-Abboud, Director, Litigation and Corporate Financial Advisory Services, is often retained as a testifying economic expert in cases involving damages related to lost wages. At trial on a recent case, under direct examination she highlighted serious conceptual shortcomings in the plaintiff's economic expert's assumptions affecting the plaintiff's economic expert projections of lost wages. In a case study entitled "How Thoughtful Testimony from an Economic Expert Was Key in Multiple Million Dollar Lost Wages Suit," she discusses how the participation of an economic expert through economic damages analysis and testimony can make a decisive difference.

MP&S COMMENTARY AND PERSPECTIVES

Published Commentary and Perspectives from Marks Paneth & Shron Professionals contains selections of the firm's thought leadership output that were featured in leading journals, trade publications and/or our online library from the fourth quarter of 2009 through January 2011. The 20 articles in this compendium address such subjects as the new tax enforcement environment; valuation issues related to hedge fund dissolution; the boom in global start-ups and the importance of fresh-start reporting for companies emerging from bankruptcy. The collection is available in both print and electronically. Contact Marketing at marketing@markspaneth.com to request your copy.

FOR FURTHER INFORMATION

If you have any questions, please contact **Robert I. Feldman** at 212.710.1660 or rfeldman@markspaneth.com or **Howard K. Warshaw** at 212.710.1673 or hwarshaw@markspaneth.com, or one of the following Law Firm Services Partners:

Steven L. Berse: sberse@markspaneth.com

Thomas H. Engelhardt: tengelhardt@markspaneth.com

Michael J. Fosorile: mfosorile@markspaneth.com

Mark Levenfus: mlevenfus@markspaneth.com

Andrew H. Kubrick: akubrick@markspaneth.com

In addition, information on Marks Paneth & Shron's Law Firm Services can be found at www.markspaneth.com.

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