



Looking ahead: Is your succession planning up to speed?

What's your firm worth?

4 financial threats to your firm's long-term survival

How paralegals affect your bottom line

LAW FIRM MANAGEMENT

SPRING 2017



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Looking ahead: Is your succession planning up to speed?

Millennials' emergence as a prominent demographic has highlighted the need for many workplaces to prepare for a generational shift. Law firms are no exception, particularly those founded by dynamic Baby Boomer rainmakers. If firms are going to survive and thrive, they must think about how to transfer management and primary client relationship responsibilities from senior partners to their younger colleagues. In other words, law firms need to engage in comprehensive and formal succession planning.

ADVANTAGES OF SUCCESSION PLANNING

Despite the growing wave of Baby Boomers nearing retirement, it's not unusual for succession planning to fall through the cracks at many businesses, including law firms. Some firms are too consumed with drumming up and servicing clients to spare the time or effort. At others, partners may resist such planning, fearing it signals instability to clients and staff or believing it will happen organically as younger attorneys climb the ladder and join the partner ranks.

These reluctant partners might feel differently once they see a breakdown of firm revenues. When they realize the amount of revenues tied to certain clients who are serviced only by senior attorneys, they may be more open to the need for succession planning. The risk of losing clients due to the departure of "their" attorneys jeopardizes the remaining partners' bottom lines.

Those bottom lines are also threatened when talented midlevel or young attorneys leave the firm. A succession plan may boost retention of these individuals — in the absence of clear planning, these attorneys may have doubts about the future of the firm, including their futures with it.

One other reason to succession plan? If you don't, your clients might do it for you. If clients

don't see younger attorneys pitching in, they may grow concerned. If, for example, a business client has been sending an aging senior partner 20 matters every year, it could reduce that load to three or four, sending the rest to another firm seen as more vital and cutting edge.

TIPS FOR AN EFFECTIVE SUCCESSION PLAN

So what should you do if your firm is without a succession plan for your senior partners? Here's how to begin:

Start now. An effective succession plan should already be in place *before* succession is needed. Don't wait until the long-time partner's departure is imminent.



REPLACING A MANAGING PARTNER

The retirement of a managing partner generally is more significant than other departures. As with the replacement of other partners, though, the transition from one managing partner to another should be progressive, where possible. Over time, the departing attorney can shift decision making and other power to the successor, until they naturally reside there when the departure finally occurs.

It's usually best to look inside for a successor to the managing partner. Successors brought in from outside the firm may be eminently qualified but still have a hard time breaking through. This is especially true in firms with strong cultures, where they can have a hard time shaking the "outsider" label.

That said, don't select internal successors solely on the basis of rainmaking ability. Rainmaking and management are very different skills, and success in one area doesn't necessarily translate to success in the other. "Management material" for a law firm means possessing demonstrated legal, leadership, management and client relations skills.

Include provisions for emergencies.

Unfortunately, law firms don't always have lead time — partners can die or become disabled unexpectedly. Account for these possibilities in your plan.

Secure buy-in from partners. It's no surprise that powerful partners can find it uncomfortable (or offensive) to think about life after they leave the firm they've devoted much of their lives to for years. They might resist transferring power, or, worse, undermine their successors. They may need convincing that succession planning is the best way to preserve their legacies. One way to start is by involving them in the selection of their successors. Offer them different status (for example, emeritus, of counsel or semiretirement) that allows them to stick around without the hassles that can come with full partnership.

Prolong the transition. Experts advise firms to allow five years for smooth handoffs of client business and wind-downs to retirement.

ALTERNATIVES TO SUCCESSION PLANNING

It may sound counterintuitive, but not every law firm needs a succession plan. For example, a law firm losing multiple partners or its founding partner could be better off merging with another

firm. Or, a law firm may sell its practice, or areas of its practice — including goodwill — if the firm satisfies certain conditions under the American Bar Association's Model Rules of Professional Conduct Rule 1.17 (and similar state bar rules). Finally, as unthinkable as it might seem, some firms might consider simply closing shop.

A law firm contemplating the loss of significant leadership needs to take a realistic look at its place in the market. Does it have a lucrative niche in which to compete? Do the remaining partners like each other and work well together? Or is the firm ill prepared to deal with the changing legal landscape, with some partners already phoning it in and long-brewing resentments beginning to boil over? When such questions are answered honestly, it could turn out that the firm has no good reason to stay afloat.

START PLANNING NOW

With advance planning, law firms can dramatically increase the odds of successful transitions as senior partners head out the door. Note, though, that succession planning is an ongoing process, with adjustments made as necessary when the firm, its clients and their respective industries undergo change. •

What's your firm worth?

Law firms generally don't pay as much attention to their value as, say, technology companies or public corporations, but a variety of circumstances can trigger the need for a firm valuation. Although attorneys may often deal with business valuations in the course of their work for clients, they might be surprised to learn how law firm valuations can differ.

WHEN DO YOU NEED A VALUATION?

A firm valuation may be in order for:

- A partner buyout,
- Tax purposes,
- Partnership disputes,
- Divorces involving partners,
- Life insurance purposes,



- Buy-sell agreements,
- Financial reporting, or
- Bankruptcy proceedings.

One of the most common scenarios for a law firm valuation is the sale of the firm — even when the sale isn't imminent. For solo practitioners or partners in smaller firms, for example, the sales price, as based on a valuation, could be an important part of retirement planning.

WHAT FACTORS AFFECT VALUE?

Your firm's value will likely be based on its historical gross receipts (used to project future income) and its assets. The valuation will consider both tangible assets, such as real estate, furniture and equipment, and intangible assets.

A law firm's most significant intangible asset is typically its goodwill, the value of which could even exceed the value of its tangible assets. Goodwill represents factors such as the practice's location, name, reputation, client base, staff, policies and procedures, and other characteristics that are separate from the attributes of the firm's individual attorneys. This "practice goodwill" assumes clients would stay at the firm even if individual partners were to leave.

WHICH VALUATION METHOD APPLIES?

Businesses are usually valued using one of three methods:

- 1. Market value.** The market-based approach is less useful for law firms, as it can be difficult to find comparable guideline transactions.
- 2. Asset value.** The asset approach computes the fair market value of a business based on its balance sheet assets and liabilities. Because law firms often use cash basis financial reporting, goodwill probably won't appear on the balance sheet, meaning the asset approach won't give

any value to a firm's goodwill without additional calculations.

3. Income value. The income approach may prove most suitable for law firms. The valuator estimates the firm's future earnings and applies a risk-based multiplier (generally, between 0.5 and 3.0). Calculation of the multiplier considers factors like the current book of business, geographic

location, number of clients, practice areas and potential for repeat business.

EXPERTISE MATTERS

Turn to qualified valutors for accurate and reliable valuations. Training, experience and familiarity with the industry, as well as the applicable standards and methods, are critical. •

4 financial threats to your firm's long-term survival

Even with the economy on the upswing, many in the legal industry face precarious times, and they may not realize it. Several threats in particular could jeopardize your firm's financial future.

1. LONG-TERM DEBT

Overborrowing is perhaps the most significant risk for some law firms. It's not unusual for firms to splurge on large office space with high-end furniture, cutting edge technology and other trimmings that usually come with high fixed costs in the form of financing. Such debt can undermine a firm's bottom line, making it challenging to generate enough revenues to cover their expenses.

If your long-term debt exceeds the value of your assets and cash on hand, you're essentially borrowing against future partner earnings.

Further, if your long-term debt exceeds the value of your assets and cash on hand, you're essentially borrowing against future partner earnings. This could cause long-term financial issues and even prompt valued partners to jump ship.



2. UNFUNDED OBLIGATIONS TO RETIRED PARTNERS

Many established firms are plagued by unfunded retirement obligations. Like long-term debt, payments to retired partners under partnership agreements dating back years or even decades — to a time of shorter expected lifespans — divert profits from current partners.

If more than 1% or 2% of your revenues are going to what are basically annuities for inactive partners, you're in danger when it comes to both cash flow and partner retention. (A related potential problem is a lack of succession planning. See "Looking ahead: Is your succession planning up to speed?" on page 2 for more information on this issue.)

3. OVERCOMPENSATION OF CURRENT ATTORNEYS

Compensating active attorneys also can be risky for a firm's finances. The urge to expand (more

on this below) causes many firms to offer large guaranteed salaries to lateral hires, especially those regarded as rainmakers. But what if those laterals don't produce the expected revenues? After all, guarantees effectively remove profit-based incentives to bring their clients over and develop new business.

High, unwarranted salaries can obviously reduce firm profitability, not to mention the resentment they can cause among colleagues. They might even push your incumbent attorneys to test the waters elsewhere in hope of landing similar deals.

4. ILL-ADVISED EXPANSION

As noted above, guaranteed salaries often stem from the desire to expand. Law firms operate in an environment where growth is frequently seen as the ultimate hallmark of success. In fact, some firms are continually expanding, seemingly

just for growth's sake. However, not all growth is good growth — and that can have negative financial repercussions.

Opening new offices that aren't necessary and don't pay for themselves or promoting attorneys to partner status for reasons other than merit can backfire. You may well increase your firm's liabilities without generating the revenues needed to offset the debt, let alone increase profitability. Worse, you could leave your firm without the financial flexibility and agility to react to changes in the market or jump on unexpected opportunities.

FOREWARNED IS FOREARMED

Being aware of these threats is half the battle. Your financial advisors can help you prevail in the other half by making the necessary adjustments to overcome or avoid financial threats that might hold back your firm, now or down the road. •

How paralegals affect your bottom line

Just about every law firm employs paralegal staff. But are you using them too much or too little? Are they overpaid administrative staff or underpaid legal staff? By finding the right balance, both you and your paralegals will benefit.

DEFINING THE JOB

The National Association of Legal Assistants states that paralegals “have knowledge and expertise regarding the legal system and substantive and procedural law which qualify them to do work of a legal nature under the supervision of an attorney.” According to the American Bar Association, approximately 85% of paralegals spend some time performing clerical work on a weekly basis, and almost all of them (95%) regularly communicate directly with clients via email and written letters. And while drafting basic court filings and contracts is a traditional paralegal duty, paralegals

increasingly manage their firms' technology applications and engage in marketing and business development activities.

Setting paralegals' billing rates based on experience often means that senior paralegals offer the best profit margins.

Although the roles and responsibilities of paralegals (or legal assistants) can differ widely by firm, these employees ideally should spend minimal time performing clerical or other work suited to legal secretaries and administrative staff. By the



same token, paralegals shouldn't do work that's best handled by lawyers.

As a reminder: Although paralegals can perform many substantive legal tasks, they must be careful not to overstep their bounds. Only attorneys can provide legal advice to clients, represent them in court, plan legal strategies, take depositions, set fees or accept engagements.

How your firm uses paralegals may depend on the type of individuals you hire. Although some firms require paralegals to have formal legal assistant education or certification, others hire college graduates with little or no previous experience and train them on the job. Some of these recent graduates are considering law school themselves.

COMPARING REVENUE AND COSTS

Consider performing a profitability analysis that allocates expenses (such as salary and benefits) to partners, associates and paralegals. Then, calculate revenues for each of these groups. When you compare revenues with costs (incorporating

such factors as utilization and realization), you may be surprised to find that paralegals are your firm's profit center. Setting paralegals' billing rates based on experience often means that senior paralegals offer the best profit margins.

Although paralegals can be profitable if your firm charges hourly rates, the greatest financial potential of paralegal work typically comes in fixed and contingency cases. By enlarging paralegals' roles in such engagements, you reduce your firm's investment in them and free up associates to work on other matters.

RETAINING THE BEST

Because senior paralegals often are the most profitable staff members, look for ways to retain them. Ways to do this include:

- Providing career path and professional development opportunities, such as continuing education and management roles,
- Treating paralegals as knowledgeable team members by allowing them to contribute to practice group decisions and participate in client meetings, and
- Providing a mechanism for paralegals to provide feedback or voice concerns about the attorneys with whom they work and how cases are managed.

Consider designating a paralegal coordinator, such as a senior paralegal or partner who understands the value that paralegals bring to the firm and its clients. The coordinator can be responsible for hiring and training and for optimizing paralegal resources, by, for example, making sure that individuals are assigned to matters that make the best use of their experience and skills.

IMPROVING PROFITABILITY

Appropriate assignments make for improved workflows and fulfilled staff. And your bottom line improves when attorneys aren't doing work that your paralegals can handle. It may be time to review your paralegal assignments to improve your profitability. •



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