Law Firm
MANAGEMENT

Payroll management
3 critical issues require your attention

Should your firm consider a two-tier partnership system?

Emergency!
Don't let a disaster put your firm out of business

How to combat competitive pressure and grow your firm

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3 critical issues require your attention

The economy has finally regained strength, and many law firms are expanding and hiring new employees. While this is generally positive news, hiring support staff, associates and partners can make payroll management — already a challenge for many firms — more difficult. If your firm is adding people to the payroll or even outsourcing more work to independent contractors, make sure the following three critical issues receive close attention.

1. Payroll taxes

Every employer must withhold Social Security, Medicare and income taxes from its employees' pay. Withheld Social Security and Medicare taxes, along with the employer's Social Security tax contribution, generally are known as payroll (or FICA, for Federal Insurance Contributions Act) taxes.

For 2016, the Social Security tax rate is 6.2% each for the employee and employer, up to a wage base limit of $118,500. The Medicare tax rate is 1.45% each, with no wage base limit. Your firm also must withhold an additional 0.9% Medicare tax from employees whose wages are in excess of $200,000 per calendar year. Withholding of this additional tax must begin in the pay period in which you pay wages exceeding $200,000 — and you must continue to withhold it until the end of the year. Only employees are subject to the additional Medicare tax, not employers.

Under recently proposed legislation, workers would automatically qualify for overtime based only on their salary.

However, the Federal Unemployment Tax Act (FUTA) is your firm's responsibility. Employers must pay 6% of an employee's wages — up to the wage base limit of $7,000 — with a maximum credit of 5.4% for payments to state unemployment funds.

Employers also must deposit any withheld taxes with the government. Failure to do so on a timely basis can cause the IRS to hold your firm and other "responsible persons" personally liable for all outstanding amounts plus penalties and accrued interest. Moreover, you must report FICA wages and withheld FICA and income taxes quarterly (using Form 941) and FUTA

What about PEOs?

Some law firms avoid payroll hassles by shifting payroll management to a professional employer organization (PEO). Among other advantages, PEOs enable firms to outsource payroll responsibilities — as well as human resources, employee benefits and workers' compensation — so they can focus on their core competencies. And because PEOs represent multiple employers, firms enjoy greater financial leverage when negotiating services and benefits.

Employers don't give up control of their employees, though. PEOs generally agree to function as co-employers, but your firm would retain control and daily supervision of its staff.

Congress recently created a new entity called a "certified professional employer organization" (CPEO). CPEOs will be solely liable for payroll taxes and penalties — an attractive feature for all employers. The IRS will begin accepting applications for certification on July 1, 2016.

wages and taxes annually (using Form 940). State withholding and reporting obligations vary.

2. Employee misclassification

Employee misclassification is a hot topic right now. In July 2015, the U.S. Department of Labor (DOL) issued guidance on the appropriate standard for determining whether an employee is misclassified as an independent contractor under the federal Fair Labor Standards Act (FLSA). In recent years, the DOL has entered agreements with many state agencies to cooperate in pursuing enforcement against misclassification of employees as contractors.

But, contractor misclassification isn't the only type of misclassification on the enforcement radar. This past summer, the DOL published proposed regulations that would dramatically change the determination of whether employees qualify for the "white-collar" exemptions from the FLSA's minimum wage and overtime requirements.

If approved, the regulations would make it much more difficult to classify your employees as exempt. Specifically, workers would automatically qualify for overtime based only on their salary (for 2016, less than $50,400 per year or $122,148 for certain highly compensated employees) regardless of their duties. Employers also must be aware of state tests, which may be more stringent.

3. Recordkeeping

The DOL requires every employer covered by the FLSA to keep records for each nonexempt worker (again, state requirements may vary). The law doesn't specify the form of records, but they must include certain identifying information about the employee and data about the hours worked and wages earned. The law also requires this information to be accurate.

Payroll records should be retained for at least three years. Records that are used for wage computations should be retained for two years. The latter includes:

- Time cards,
- Wage rate tables,
- Work and time schedules, and
- Records of additions to or deductions from wages.

You may keep the records in your firm's office or a central records office.

Ongoing challenges

Laws and regulations affecting payroll taxes and other employee compensation issues are often in flux. So never assume you can put payroll management on autopilot. Your financial advisor can help ensure your firm complies with all of the relevant requirements. ▣

Should your firm consider a two-tier partnership system?

If your firm hires and retains only partnership-track associates, it could be turning away profitable legal talent. Offering a two-tier structure, with equity and nonequity partners, might make your firm more attractive to recent law school graduates while also helping you hold on to more experienced attorneys who need some flexibility.

Capital contributions

Under a two-tier system, a firm has two different types of partners, with different responsibilities, roles and levels of financial commitment. Equity partners generally make a capital contribution and participate directly in the firm's profits. They're personally liable for the firm's debts and have ultimate control over its policies and strategic direction.

Nonequity partners — also known as contract, fixed-dollar, salary, income or nonshare partners — make no capital contributions and share in profits only indirectly through salaries and performance bonuses. They may be indemnified by equity partners and, while they might participate in partner strategy meetings, generally have only limited voting rights.

The two-tier system represents a clear contrast with the old "up or out" model. Traditionally, firms have had only equity partners and equity partners-in-waiting in the form of associates who hope to make partner. The problem with such a structure is clear: Skilled attorneys who lack business development skills or would rather devote their time to legal work can get pushed out.

Off the beaten path

The primary benefit of a two-tier system is that it enables firms to keep talented attorneys in the fold. But it's not only nonrainmaking attorneys who might find a nonequity partnership appealing.

As Millennials gradually come to dominate the American workforce, a greater percentage of employees are demanding a better work-life balance. This social trend is catching many employers, including law firms, off guard. Younger attorneys may be profitable and productive and yet not want the office-bound lifestyle associated with a traditional partnership track. Some, however, may want to keep that option open farther down the road after, for example, they've raised a family.

Nonequity partnerships can also help attract senior attorneys with desirable niche experience. Letting partners off the hook for business development can help your firm land coveted specialists who indirectly bring in new clients that require specific legal expertise. Finally, nonequity partnerships are likely to appeal to attorneys who need to take time off from the firm, for lateral hires and for retiring partners.

Keeping compensation fair

The two tiers of partners naturally are compensated differently. Nonequity partners should be well paid — earning significantly more than senior associates — based on their skills, hours worked and factors such as client satisfaction. But their compensation should be less than that of equity partners who have made bigger financial and professional commitments to the firm.

If your firm adopts a two-tier system, try to be consistent in how you compensate nonequity partners. This can be a challenge when the nonequity track includes, for example, rising associates, lateral hires with big books of business and former equity partners nearing retirement. The amount and quality of such individuals' work can vary dramatically.

Advantages outweigh drawbacks

Two-tier partnership tracks aren't without potential drawbacks. In some firms, the nonequity tier could be seen as a refuge for second-class or underperforming attorneys. However, the advantages of the system generally outweigh such risks — especially if you solicit plenty of feedback from your attorneys and consult a financial advisor experienced in partner compensation issues. ▣

A part-time option

A flexible firm doesn't only offer two partnership tracks — it also provides partners with the time flexibility they need to stick with your firm and produce their best client work. If you don't already, consider allowing part-time partnerships.

To ensure a part-time option works for everyone, clearly define the terms and responsibilities of such partnerships. Your firm's policy should spell out a partner's minimum work hours and schedule. If you're unsure about how the arrangement will work out, include a probationary period that allows either the partner or your firm to terminate the arrangement.

It's critical that part-time partners set goals around the hours they need to bill each year and the time they need to devote to firm duties. Your firm should compensate these partners based on how well they achieved these goals, along with other criteria.

Emergency!

Don't let a disaster put your firm out of business

Whether it's a vicious winter storm that knocks out electricity and transportation for days, a deadly terrorist incident like the recent one in Paris or a cyber attack that compromises critical records, your firm faces myriad threats to its continuing operations and the safety of its attorneys and staff. Don't think, "it can't happen to us," because it certainly can. The key to surviving a disaster — and minimizing the damage — is to plan for it.

Brainstorm the worst

The first step is to brainstorm likely disasters or emergencies that could disrupt your firm's operations. Although one individual may be responsible for managing the disaster plan project, everyone with management and supervisory responsibilities should provide feedback. Include every major and minor event that could interrupt operations, from natural disasters to power outages to employee fraud.

> *If your firm's building is uninhabitable due to an earthquake or flood, where can you set up shop? How would you notify clients, employees and vendors?*

Big events, such as fires and terrorist attacks, may be the first things that come to mind when you think "disaster." But keep in mind that it's usually the smaller, personal events, such as the unexpected death of a key partner, that affects a firm's productivity and even its ability to survive.

Make an action plan

Once you have a list, it's time to decide on courses of action for each disaster. Determine who needs to do what and when they need to do it. For example, if the managing partner becomes disabled and is unable to work again or the whole executive committee is wiped out in a plane crash, who takes over? Who has access to client files? Who else can sign checks? What happens to the line of credit at the bank?

On a larger scale, if your firm's building is uninhabitable due to an earthquake or flood, where can you set up shop? How would you notify clients, employees and vendors? Who will have the necessary information to make this happen?

Don't forget to plan for technology disasters — which can occur even if you take every precaution. Back up data offsite in the event your server and onsite hardware become physically damaged or temporarily inaccessible. And in case a hacker steals client financial information or personnel records, be ready with a damage control plan.

Minimize threats

While having plans in place to deal with emergency situations is crucial, there's much you can do ahead of time to neutralize potential crises. Start with your insurance policies, determining what's really covered and, more important, what's not. For example, if your firm is located on a floodplain, you may need a separate flood insurance policy.

Next, develop a coordinated approach for contacting clients to let them know you're still in business and attending to their needs. You'll also need a plan for communicating with employees — if for no other reason than to confirm that they're safe. If it's possible to work, employees should have a number they can call to find out where to report and how to contact colleagues. Other options are to post a notice on a secure area of your firm's website or even use an old-fashioned phone chain.

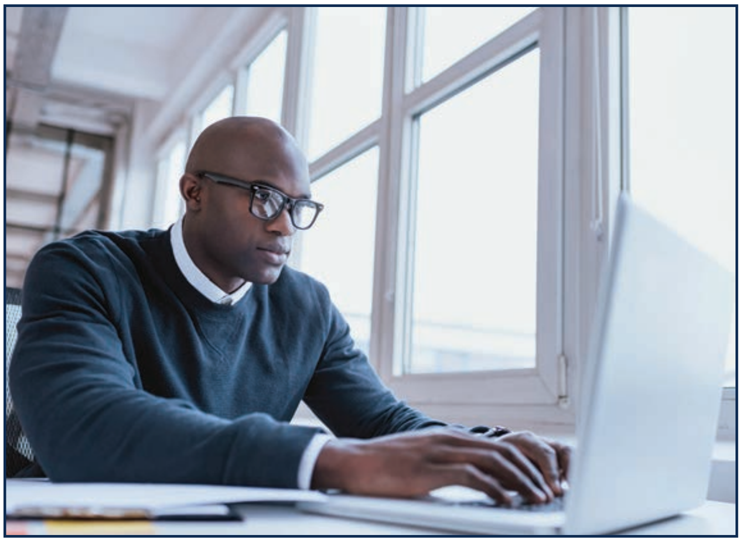
In spite of disasters, your vendors and employees will expect to be paid for past work and services. So create a plan to allow emergency payroll and accounts payable processing.

How to cope

Disaster plans aren't just for big firms with hundreds of clients and several floors of office space. Small firms may have even more to lose. Whatever your size, set aside some time to think about how you'll cope should the worst occur.

How to combat competitive pressure and grow your firm

A recent LexisNexis study found that a majority of law firm marketing and business development professionals are optimistic about their firms' growth prospects — a shift from only a few years ago, when most took a gloomier position. However, 52% continue to see competition as a major threat.



If your firm is concerned about the competition, take heart. New tools may be able to give you an edge.

Enlist data as an ally

Competitive intelligence (CI) is a process designed to help businesses maintain and improve their market position. It involves gathering and analyzing information on competitors, clients, potential clients and the relevant market environments. With the Internet making data so readily available, there's little excuse not to pursue CI on at least an informal basis.

Your firm's library, marketing efforts, business development, strategy, and planning staff can — and should — play CI roles. Their efforts ideally will result in data and conclusions that help lawyers and business developers identify prospective clients, pitch new business and evaluate your firm's strategic initiatives.

Leave sales to the professionals

A recent Legal Marketing Association (LMA) survey found that 42% of law firms had hired staff with primarily market-facing responsibilities. As the LMA noted, the data is impressive considering that lawyers are famous for regarding their client relationships as personal and proprietary. In some firms, delegating even a slice of the sales function to others can be a threat to a lawyer's standing. Indeed, the survey's respondents identified as barriers to the introduction of sales professionals both partner objections and a lack of understanding of the sales process and role of sales staff.

Sales professionals are especially desirable where attorneys aren't particularly adept at initiating pitch meetings or performing necessary follow-up. Although most lawyers are experts in their own legal niche, they may not be conversant in their firm's overall capabilities, which can undermine cross-selling opportunities. In such circumstances, sales professionals may be better equipped to manage the business development process — helping prepare for pitch meetings, facilitating postmeeting communications and providing support for lawyers closing a deal.

Be agile and receptive

The legal industry has undergone tremendous changes in recent years, with competition perhaps fiercer than ever. Firms that continue to thrive will be those who are receptive to new growth strategies and are agile enough to embrace them, rather than simply relying on referrals and other traditional business development methods.

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