Are your client trust account practices up to snuff?

How portfolio pricing can increase your profitability

Cybersecurity requires an incident response plan

State of the legal market
New industry model is emerging

LAW FIRM MANAGEMENT

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Are your client trust account practices up to snuff?

Ethics rules require most attorneys to maintain trust funds that segregate client funds from firm funds. Violations, whether the product of intentional devious acts or mere negligence, can have dire consequences. While the specific rules vary by state, some common pitfalls crop up across jurisdictions. Therefore, it's wise to regularly review your client trust account (CTA) practices to ensure you're not at risk of tripping up.

PREMATURE PAYMENTS

You sometimes may be tempted to help clients out by disbursing settlement funds before the funds have cleared, especially if your firm has a single account that holds all client funds instead of individual CTAs. After all, you know the account has sufficient funds to cover the disbursement and will be reimbursed. But you'll likely violate the rules because you're paying one client with another client's money.

You also can risk making premature payments to the firm, particularly when you take fees paid in advance. These funds generally are a liability that you owe until you earn them, at which point you can transfer them to your operating account.

Don't make the mistake of relying on the bank to keep the requisite records and provide copies when needed.

Some states allow flat or other fees paid in advance to be deposited in a firm's operating account in certain circumstances. When in doubt, place them in the CTA until you obtain some clarification of the applicable rules. In addition, make sure credit card payments of advances aren't directed to your operating account if they aren't permitted.

NEGATIVE BALANCES

Many people have at some point written a check against funds they haven't deposited or that haven't yet cleared their consumer banking account, resulting in what's known as a negative balance. Odds are, they reason, the funds will clear before the check recipient deposits it.

THE FINANCIAL INSTITUTION MATTERS

When it comes to client trust accounts (CTAs), financial institutions aren't fungible. For example, some states require attorneys to open the accounts only at approved banks or banks that satisfy certain criteria.

When opening a CTA, consider whether your client already has an account with an institution because it could affect FDIC insurance coverage. For example, if the client has an account with $150,000 at Bank A, and you hold another $150,000 of that client's funds in Bank A, only $250,000 of the client's money might be covered under the FDIC per-depositor limit.

In addition, review the bank's procedures and timing affecting the availability of funds. How long does it take for deposits to clear? What are the daily deadlines for crediting deposits and paying checks? Learn about any fees and penalties and how they're triggered and pay them from your firm's operating account, not the CTA.

CTAs generally can't have negative balances without violating the rules. A CTA can either have a positive balance (meaning it's holding client funds) or a zero balance (because all client funds have been paid out). A negative balance signals, at best, negligence and, at worst, misappropriation.

This is a problem, even if the account has automatic draft protection. Depending on whether the arrangement covers only the exact overdraft amount or automatically deposits a flat amount, firm funds could commingle with client funds. "Instant credit" arrangements, where the bank agrees to immediately credit accounts for deposits while it waits to collect the funds from another financial institution, carry a similar risk because the credit essentially is a loan to the firm.

INADEQUATE RECORDKEEPING

CTA rules generally require you to hold on to bank statements and canceled checks. It's advisable to also keep deposit receipts, checkbook stubs and copies of client checks for a complete audit trail. (Check your local rules for the required retention period.) Don't make the mistake of relying on your bank to keep the requisite records and provide copies when needed. This negligence alone could constitute a violation. Plus, banks fail, merge or undergo other changes that could jeopardize the availability of years-old checks and other documentation.

Most states also expect attorneys to keep their own records explaining transactions depicted in the bank's documents. Maintain a detailed ledger that records the transactions for each client with the:

- Date, amount and purpose of each deposit, and
- Date, amount, payee, purpose and client name for each disbursement.

Keep an account journal that tracks each transaction through each CTA. Record every deposit and disbursement to the client ledger and account journal within 24 hours so nothing falls through the cracks.

COMPLIANCE IS CRITICAL

Small missteps that undermine your CTA compliance could lead to disciplinary action. The requirements can seem onerous, but following the rules is less of a burden than sanctions or potential disbarment. •

How portfolio pricing can increase your profitability

While hourly billing has been the mainstay of legal billing, it's not the only option. Clients are looking for cost-effective alternatives from all their business providers, including legal services. One alternative is portfolio pricing. What is it and why should your firm consider it?

WHAT IS PORTFOLIO PRICING?

Portfolio pricing generally involves charging a fixed fee for a series of matters. In a portfolio pricing arrangement, work is bundled and priced as a single unit. A "portfolio" might encompass all of a client's work in a specific practice area for a set period of time. Or it could include all of the work involved in a specific transaction.

Portfolio pricing arrangements might also base compensation on the outcomes, volume of work or duration of the engagement. Riskier matters may incorporate penalties or bonuses in addition to the fixed fee.

For clients, the advantage of portfolio pricing is obvious: the predictability of fees.

The downside of such fee arrangements is that your firm shoulders some of the risk. If an engagement requires more hours than originally estimated, you may lose money. Good project management, therefore, is essential. You also need a thorough engagement letter that covers all the services that will be included — and excluded.

WHAT ARE THE BENEFITS?

For clients, the advantage of portfolio pricing is obvious: Fees are predictable. But portfolio pricing offers several benefits to firms, too. For example, handling a large portfolio of transactions or

product liability claims can produce economies of scale not available with individual matters.

Portfolio pricing also facilitates leaner, more efficient staffing — an important goal for any law firm. By establishing dedicated teams to deal with particular portfolios, your firm will likely improve efficiencies. And team members will gain in-depth knowledge of the client and its people and build enduring relationships. This can lead to greater client satisfaction as well as more business and client referrals.

HOW DO YOU CREATE IT?

As with any alternative fee arrangement, you'll need to keep a close eye on a variety of metrics that will contribute to, or undercut, your firm's profitability on portfolio pricing arrangements. At least initially, consider working with a financial advisor to set portfolio prices. Your advisor can help you identify the fundamental assumptions on which the price is based, as well as determine the scope of the portfolio. In addition, the advisor will help to set budgets that reflect required profit margins, and ensure that the price covers all of the relevant components. These include attorneys' fees, administrative costs, overhead, anticipated risk and partner compensation.

During the portfolio arrangement's lifespan, your advisor can monitor profitability and flag potential areas of concern, such as transactions that aren't

completed according to schedule. Your advisor can also alert you if the original assumptions for a portfolio aren't bearing out so you can address them with the client and, possibly, negotiate a revised price.

IS IT FOR ALL CLIENTS?

Portfolio pricing isn't appropriate for every client. Do some research before pursuing portfolio pricing opportunities and take into consideration such factors as a client's industry and regulatory environment.

Your relationship with the client is another important factor. Be sure to consider a client's legal work, including volume, types of matters, and past and pending litigation, as well as your profit margins for the work. Competition from other firms for a client's business might also motivate you to offer an alternative fee arrangement such as portfolio pricing.

WHAT ARE YOU WAITING FOR?

As the country makes its way through the coronavirus (COVID-19) pandemic, billing and fee structures of many law firms may need to be adjusted. Portfolio pricing can be one of the best ways to attract and keep expense-conscious clients. It can also help your firm achieve greater profitability and more predictable cash flow by lowering overhead costs and increasing productivity. In the end, your firm will be better able to attract a diverse blend of clients. •

Cybersecurity requires an incident response plan

Law firms have continued to increase their focus on cybersecurity, but according to the American Bar Association's (ABA) latest *Legal Technology Survey Report*, only about one-third of respondents have an incident response plan. As the ABA notes, all attorneys need tailored cybersecurity programs, and incident response is a critical part of such programs. Your firm's response to a data breach will go a long way toward mitigating — or exacerbating — your financial and reputational costs.

WHY YOU NEED A PLAN

Law firms are vulnerable to both internal and external incidents. Whether it's an attorney misplacing a device with confidential information, an administrator falling prey to a phishing or ransomware attack, or a hacker targeting the firm, the consequences can be devastating.

That's why you need to establish formal plans and procedures to stop the breach and restore affected systems. A structured response will prove much more effective than an ad hoc, heat-of-the-moment response. Imagine the time and expense to be saved by, for example, having on hand the contact information for the qualified (and insurer-approved) vendors you need to effectively respond.

WHERE TO START

The first step is to assemble an incident response team (IRT). According to the Ponemon Institute's 2019 *Cost of a Data Breach Report*, formation of an IRT reduces the total cost of a data breach by an average $360,000, from the mean cost of $3.92 million. The team must, of course, be equipped with the authority and tools it needs to achieve such savings.

Ideally, an IRT is cross disciplinary, with representatives from areas including management, IT, human resources, finance/accounting, marketing and client relations. Assign each area specific roles and responsibilities in the event of a crisis. It's best to have two representatives from each

area to increase the odds that someone will be available when an incident occurs.

WHAT TO INCLUDE

Law firms don't have to start from scratch. You can base your plan on reputable standards such as the National Institute of Standards and Technology framework, taking into account your state's relevant laws, regulations and ethics rules.

> *Establishing formal plans and procedures to stop the breach and restore affected systems will prove much more effective than an ad hoc response.*

Regardless of the model you follow, your incident plan must cover a range of issues, including:

Incident reporting and confirmation. Establish a mechanism for attorneys and staff to report suspected incidents. Give the IRT the flexibility to promptly respond to reports to determine their validity.

Investigation/mitigation of loss and business disruption. Forensic consultants can help your firm find the source of a breach and respond appropriately (for example, by quarantining affected devices, systems and servers). While loss mitigation and the return to normal operations are paramount, evidence preservation for prosecution purposes and the protection of attorney-client privilege also are essential considerations.

Recovery. Mandate testing and validation of all systems before they're restored to use. Putting this requirement in writing will make it easier to resist the pressure to restore systems prematurely.

Notification. Failing to comply with the strict statutory notification requirements (while also adhering to ethics rules) can lead to stiff penalties and other repercussions. Notify the relevant insurers as soon as possible, too, to avoid forfeiting coverage.

Training/drills. Ponemon reports that the formation of an IRT combined with testing of the plan (for example, in tabletop exercises) reduces data breach costs more than any single security process.

Review/lessons learned. Have the IRT conduct a post-mortem after any incident to determine what went right and wrong, and revise the plan going forward.

AN ONGOING PROCESS

With many employees working remotely due to the coronavirus (COVID-19) crisis, cybersecurity is more important than ever. Remember, drafting an incident response plan isn't a one-off task. Cyber threats evolve and firm operations and personnel change, making it important to update your plan regularly. •

New industry model is emerging

After several decades of operating on an essentially law firm-centric model, a new model appears to be emerging for the legal services industry. While noting incremental improvements in 2019 financial performance, the *2020 Report on the State of the Legal Market* from the Legal Executive Institute (LEI) serves as a warning that firms should adjust for the new model if they wish to survive.

PERFORMANCE UPTICKS

According to the report, most firms in the U.S. legal market saw "fairly steady overall financial performance" in 2019. Demand, worked rates, fees worked and headcount all grew in 2019. Productivity, however, slipped into negative growth.

Direct and indirect expenses continued to rise in 2019, especially for recruiting and professional services. The collected rate realization (compared with worked rates) held steady around 89%. And average revenue growth increased 5.4%.

3 CHANGES

Despite the relative stability in financial indicators, the report claims that mounting changes are likely to undermine the future performance of firms that don't prepare for them.

The report identifies three major changes:

1. The strengthening hand of clients. Since the Great Recession, clients have taken control of the legal market, no longer deferring to law firms. They're exercising their new power in multiple ways, such as relying on competitive procurement processes when hiring outside counsel, requiring strict budgeting and billing processes, and imposing outside counsel guidelines for billing, expenses, staffing and other matters.

2. The growth of non-law firm competition. An LEI survey from January 2019 found that corporate use of alternative legal service providers (ALSPs) had expanded significantly. Moreover, the Big Four accounting and auditing firms also are expanding in the legal market. They're delivering services in a wide range of areas, including finance, mergers and acquisitions, compliance, and employment law.

3. Law firm innovation. Some law firms already are responding to the changes with their own innovations. They're increasing their reliance on their own professionals and specialists (for example, HR, IT and finance) by including them in client-facing teams. They're also improving their internal systems to boost efficiency and make better use of profitability data. Some are outsourcing more (including to ALSPs), while others are creating their own subsidiaries for legal-related services.

PLAN AHEAD

The LEI report acknowledges that the new model hasn't yet become the norm, but concludes that the market is clearly moving in that direction. Law firms, the report says, should expect clients to continue to drive service providers toward multidisciplinary practice-type services. The upheaval in the wake of the coronavirus (COVID-19) pandemic will undoubtedly result in changes to the legal services industry. •

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