

Interactive Budgets That Talk Back

by Norm Mullock of Redwood Analytics



The heightened competitiveness of today's legal market has driven law firms to re-evaluate many of their internal processes. As the industry embraces advanced analytic tools such as data warehouses, business intelligence platforms and dashboards, there is one significant area that risks being overlooked: budgeting.

Firm managers require detailed data about the precise areas in which the firm is not performing as expected and explanations as to what's causing the discrepancy. The aforementioned tools provide the details needed to understand actual performance multi-dimensionally. But for this information to have its greatest impact, firms should develop budgets with the same level of detail — and do so efficiently.

For example, recognition that staff expenses are rising beyond expectations is only the first step toward effectively controlling these administrative costs; a firm also must know the factors driving that increase: which offices, which practices and even which timekeepers are responsible?

While this information typically can be determined, eventually, by running multiple spreadsheet reports, so many variables affect law firm budgets that waiting for a bundle of reports to examine every performance glitch can paralyze those charged with financial planning.

In the above example, a firm would have to run one spreadsheet tracking staff cost by title by office, another by

practice group and, if secretarial expenses appeared to be a problem, a third that tracked such costs against timekeepers by experience level. That's not taking into account associated linkages such as ratio of timekeepers to secretary, staff sharing across timekeepers, subpractices and any number of other variables. Once an analysis is developed to explain actual performance, the next step is to develop a model that allows for the ability to track these expenses with changes to other budgeted items such as growth in timekeepers.

Multitasked Budgeting

Fortunately, some law firms are beginning to wean themselves from the traditional budget process structured primarily to estimate how much the partners stand to earn in the coming year, while increasingly, they're taking steps to create budgets that do more than forecast the bottom line — they can be used as financial planning tools to explain performance at every level of firm operations.

To use a budget as a true financial planning tool, it needs to be interactive; planners must be able to plug in a range of variables and instantly calculate how those variables will affect performance. Because we live in a multidimensional world in which performance is affected by many variables at once, deriving such results through two-dimensional spreadsheets is time-consuming and difficult. Hence, some financial planners are turning to budgeting applications that allow them to create multidimensional modeling engines customized to their firm's strategic needs. Once these tools have been incorporated, those charged with developing and managing the budget can plug in an array of variables to see instantly how financial decisions will ripple through to firm performance across office, practice and timekeeper.

Going back to the example regarding staff cost overruns, a law firm with a customized accounting module instantly can project next year's growth in timekeepers, including lateral additions. Using output reports highlighting various operational ratios, financial managers can detect whether the firm's projected secretarial expenses are in line with maintaining existing staff/timekeeper ratios as the firm grows. Alternatively, if targeting improvement in these ratios is the goal, a firm can work backwards to derive the number of recommended new secretarial hires. Two clicks to see how these costs stack up two different ways.

The data driving these performance modules are fed automatically from the firm's accounting systems — billing

and compensation. There's no need to spend time inputting information to obtain such results.

With the ability to cross-analyze data through a single click, time and effort spent churning data and running reports can be better used to plot and adjust the strategic course of the firm. That's the power of integrating the budgeting process with planning and performance measurement.

The Value of Budgeting

The static nature of most law firm budgets stems from the traditional purpose of the budget — to inform partners of the profits they can expect in the coming year. Once the sometimes excruciating process of arriving at those numbers is complete, the budget process at many firms is dropped for the remainder of the year, except for persistent reminders to make the numbers.

But to thrive in today's business world, law firms must measure and adjust their performance continuously. As firms grow, it becomes increasingly important to spot performance discrepancies early, to keep small variations from becoming major revenue shortfalls and expense overruns. Firm financial planners have to be able to use the budget to explain in real time why the firm isn't performing as predicted. They have to be able to understand and model the drivers of the business.

Are collections off? A firm has to know, as soon as possible, whether it's because of the timing of the billing cycle or whether production is low. To get at this kind of information quickly, a firm needs a budgeting platform that automatically takes financial data from the firm's time and billing systems, and processes that information using modeling engines. Such tools allow planners to stress test the assumptions of the budget by running multiple scenarios.

Increasingly, firms are searching for these types of sophisticated solutions to replace their existing budget processes.

A typical example is a law firm that sought a more dynamic revenue model to replace its work value budget. Its chief financial officer wanted a model that could project, by office and practice group, cash flow and its timing for beginning inventory and each month's production. Principally, he wanted a model that would allow him to distinguish timing variances arising from changes in firm performance.

Drawing on an automated feed of actual information, a model was created that used the firm's historic patterns to capture monthly cyclicity. Because the model was dynamic, the CFO was able to stress test his revenue projections by adjusting assumptions. It allowed for rolling forecasts to generate projections on a monthly basis.

By creating a budget that speaks back — that answers fundamental questions concerning law firm performance — finance staff and management can use the budget as a tactical, strategic tool in planning efforts.

Key Budget Tools

Once firm management recognizes the impetus to increase the power of its budgeting process, the next step is to examine whether the firm's existing budgeting platform can address planning needs.

Most firms currently rely on multiple files of disconnected spreadsheets to produce their financial data. But better tools exist to predict performance and assist with the implementation of strategic planning efforts. This new generation of budgeting tools offers law firms several advantages. They automate the budgeting process and allow for the increased need to solicit input and buy-in from a larger group of budget contributors. In addition, these applications are better equipped to accommodate the increased complexities caused by the many variables affecting today's budgets.

The first characteristic of an effective budgeting platform is the ability to automate the process. Budget templates should be fed by the firm's billing and compensation systems so the numbers are current and the finance staff can spend more time analyzing data and less crunching numbers.

For some firms, it is simply the ability to automate that is a driver to revamp the budget process.

The director of finance at one law firm sought to change its budget platform because too much time was being spent each year maintaining its existing model. The desired solution would automate the current process without changing it. With several smooth budget cycles following automation, the finance director is looking to automate the firm's monthly reporting system as a next step.

A second component to improving the budget process is moving from e-mail to an online platform for the dissemination of budget templates and solicitation of feedback from contributors. As firms grow and increasingly manage their budgets by practice group and office, the number of people involved in the budget process increases. Budgeting is an opportunity to create buy-in from practice group leaders and managers throughout the firm, and such buy-in leads to greater accountability.

Web-based applications allow multiple budget contributors to plug in their information directly into single combined

templates, replacing the need to create one worksheet per contributor. Users only access the templates relevant to the components of the budget for which they have responsibility. However, financial planners can view all information as soon as it is entered, literally watching the budget as it is being built.

The chief financial officer of one law firm noted that although his firm's traditional budget process generally worked well, the dissemination and compilation of information was so time-consuming and inefficient that it had become onerous. The firm switched to a Web backbone to distribute its budget information, and the CFO was pleased with how this change alone improved the budget process.

The first two components of better budgeting concern process — installing automation and moving to Web-based workspaces. The third key is to improve actual performance of the budget itself. This is accomplished by employing multidimensional technology reflecting the reality that multiple variables affect outcomes at every level of budgeting. Budget platforms that organize data into three-dimensional modeling engines, or “cubes,” can process data at multiple data intersections. One such cube often can do what it takes more than a dozen spreadsheets to accomplish.

Modeling engines can be employed effectively on both the revenue and expense side of the budget. Through modeling, financial planners can analyze the economics of change across multiple dimensions quickly. For example, potential rate increases of three percent, five percent and seven percent, and realizations of 92 percent, 95 percent and 98 percent, can be run through the entire revenue process, producing nine different numbers at the push of a single button, without having to create and save nine separate workbooks.

In an effort to develop optimal staffing mixes, one law firm had a modeling tool created that allowed for analysis by skill sets, availability and billing rates. The firm's CFO was especially pleased with the ability to account for capacity (productivity of each timekeeper as measured against overall firm workload), an often-overlooked component in profitability analysis.

This type of modeling helps to identify more accurately the types of billable work that is interchangeable and can be completed by multiple timekeepers in the same class, versus work that is more specialized and only can be completed by select timekeepers.

The capability to analyze staffing arrangements and corresponding profitability has helped this firm respond more accurately to client requests for alternative billing

arrangements. It uses modeling to analyze pricing and staffing scenarios to assure profitability before agreeing to a particular rate. When a client requests a blended rate, the staffing can be adjusted or the firm can counter with a more appropriate rate. The ability to price matters more precisely helps the firm keep its rates competitive.

Additionally, the same firm uses modeling to evaluate collections, analyzing current data against historical payment patterns. This analysis helped the firm meet its collections budget from the first quarter the firm switched budget platforms.

On the expense side, a typical module is the income statement cube, which summarizes expenses by office, department, month or time of year and year-to-year comparison.

Considering the endless variables that figure into budgetary adjustments, the power to instantly change assumptions is indispensable.

Best Practices Budgeting

Not surprisingly in today's electronic world, enhancing the budget process is a project that requires both finance and IT expertise. To do it effectively also requires a broad knowledge of industry budgetary best practices.

Many law firms repeat the same budget process for years — even as they grow, diversify geographically and by practice area, and as the timeframe required to respond to business realities shortens. Often, this creates a mismatch between the existing process and the data needed. Firms are forced to oversimplify their budgets, producing imprecise results.

For example, in the ongoing struggle to forecast realized income, law firms have developed homegrown approximations based on realization rates, growth and the cash that came in the door the previous year.

This approach has several shortcomings. The first problem is that such estimations begin to fall apart at the practice group level. The law of large numbers — which protects approximations made at the firmwide level — does not protect such estimates made at the practice level, because variations by practice don't have the opportunity to cancel each other out. As practice group management has taken hold in firm financial planning, a better way is needed to forecast income.

Another inherent weakness with law firm cash estimations is the tendency to over-budget revenue in a growing firm or practice, because the traditional approach fails to account for the lag time between growth in work value and the realization of collected cash. Firms have used a historic haircut to right this wrong, reducing annual budgeted collections by the firm's

current growth rate. But in today's consolidating and competitive environment, the assumption of steady, predictable growth often does not hold true.

Most importantly, this approach to predicting cash fails to deliver one of the most fundamental values of budgeting: to provide a benchmark against which to measure actual performance, as well as a means to understand and analyze monthly variances. Under the typical approach, if a firm collects less in one month than budgeted, determining the cause is difficult. It's hard to judge whether the variance is driven by lower than expected production, billing and/or collection realization, or it's only a factor of timing and will be made up. The cause is difficult to identify, even at a firmwide level, because the relationships between these factors have been assumed rather than proven.

There is a more reliable way to conduct revenue modeling. By using historic billing and collection information, in terms of how work value actually translates into cash, firms can create more accurate forecasts — and at a multidimensional level (*e.g.*, by timekeeper, practice group and office).

But building such models can be complex. It requires analyzing historic billing and collections information to identify seasonality patterns, and applying such patterns to develop monthly billing projections. The more precise modeling engine a firm seeks, the more sense it may make to seek outside assistance from those with budgetary design experience across several firms.

Beyond Budgeting

To compete for business and improve performance on a daily basis, today's law firm budget must go beyond earnings forecasts to give law firm managers, financial planners and business developers real tools. And to be useful, a budget must be dynamic. Creating one that speaks intelligently when queried gives financial managers the ability to produce real-time answers when they need them most.

Increasingly, the failure to create an interactive budgeting process puts a firm at a major disadvantage. In the time it traditionally takes to identify and solve budget variances, the business realities often change. Firms that cannot react quickly to shifts in their business risk being left behind.

Zero Click Time Capture

by Ray Deck of of Element55

Step Two: Simplifying Reimbursements

In the fall of 2004, we replaced reimbursement checks to employees (but not partners) with ACH transfers to directly deposit the payment to their bank account. We did some customized programming with our accounts payable application, linked to the bank account information contained in our payroll system, created an output file that met the bank's electronic transfer requirement. And "viola" — we were in the business of electronically reimbursing employees once a week. A system-generated e-mail notifies the employee about the details of the reimbursement.

Step Three: Converting the Partners' Draws

It was now time to convert the partners, and in January 2005, we announced a voluntary program for this group, giving them the choice to be paid via ACH and reducing their personal banking activities or continue to be paid by check. Converting a partner's monthly draw payment is easy, as we have historically paid it through the payroll system. Direct deposit of the draw check was done at the same time we mandated it for all employees. However, expense reimbursement and supplemental draws have proved to be a bit more cumbersome. We've found that sometimes the partner wants the payment to go to different accounts depending on the type of payment. The system we established within our accounts payable application required that all amounts paid to an individual be either always paid by check or always ACH to a single account. By doing some one-on-one education about the features available today from most banks online and with the use of ATM machines, some partners are able to see a new way of approaching their personal banking. Within the first three weeks of the announcement, almost 50 percent of the partners had signed up. We anticipate that the majority will ultimately switch to ACH.

Total Success — Almost!

While the whole project turned out to be a bit more complex than we originally thought and though it took a lot longer than anyone imagined, we are quite happy with the end result. The accounting department's dream of 100 percent electronic payment to our employees is about to come true.

Note: Thompson Coburn LLP uses the following software:

Payroll system: UltiPro from Ultimate Software Group, Inc.

Accounts Payable: CMS.Net from ADERANT

Billable hours are the lifeblood of any major law firm, and capturing those hours accurately and in a timely manner is critical.

But recording billable activity to timesheets is often a pain for attorneys and enforcing timely recording a headache for many firm administrators — with the frequent result that legitimate billable time goes unrecorded and unbilled.

The law firm of Edwards & Angell found a pain remedy — and a way to reclaim additional billable hours with less effort. Last year, the 300-attorney firm replaced their outdated "electronic" time entry system with a fully-automated time capture system, allowing most time to be recorded at the time it is worked, even when the attorney does not keep contemporaneous notes. It's called zero click time capture.

A Timesaving Timesheet

The heart of the system is a timesheet that is automatically pre-populated with activities conducted over the course of the day, such that it is mostly filled out when the attorney first opens it. He sees, for example:

.10 hours on an e-mail message to a client in re the schedule for completing a deal this month

.80 hours on a phone conference with opposing counsel

1.4 hours revising the pleading for another case

According to Keith Kotler, Director of Accounting at Edwards & Angell, the system allows attorneys to find out exactly what they did during the day, and he says attorneys are amazed to learn all the little, yet billable, things they actually did. They have an idea, of course, based on what they wrote down on a notepad. But what a surprise when they open up the timesheet and see the actual frequency of their phone calls and quantity of their e-mail responses.

Integrating with Information Systems

The underlying power of zero-click time capture lies in its ability to communicate with the various applications and communication systems throughout the office to contribute to the automatic time entries without the attorney having to start or stop the clock or keep manual journals for most common activities. The system provides the following capabilities: