

Managing Matters

The matter has always been at the heart of a law firm, forming the basis of everyone's work. Until recently, the amount of financial management required on any given matter has been relatively simple. Just make sure the work is recorded, and remember to bill the client from time to time, or at the very least at the end of the job. Admittedly, time recording has become more complex, with clients frequently demanding a full narrative with every bill, and expecting bills more frequently.

Pressure is now coming from clients to change this situation. Fees may be fixed or capped, and conditional or contingent fee arrangements are now more common than before. Even where traditional time based billing is still in place, or rather especially where this is the case, clients are requesting access to information about levels of work in progress (WIP) so that they can control their costs. In all cases, the estimated fee quoted has taken on a much more important role, and it would be a brave or foolhardy partner who billed above estimate without having his justification to hand for why the facts the estimate was based on have changed.

While their pressure on one side to quote or estimate high enough to cover the fees, there is also a pressure to keep quotes and estimates low in order to get the work for the firm. Clients are much more likely now to obtain competitive estimates from several firms, or even go through a full tender process. Finance directors are therefore leading the way in encouraging partners to improve their accuracy.

Behind all this though there is a problem. Accuracy in estimating the cost of working on a matter comes from experience. While experience of working in similar matters is important, in order for this to be useful the partner must have experience of dealing with the detail of the costs involved in these other matters. In other words, partners will not be able to improve their ability to estimate the final bill until they have closely monitored the build up of WIP on a number of similar cases. They also need to go through the exercise of comparing estimates with the actual final WIP and bills raised, and working out the cause of any differences.

Measuring profit

Firms tend not to measure profit for each matter, and focus rather on the calculation of recoverability. It is as important for partners to have a good idea about the profitability of each matter as it is for it to watch the overall profitability of the firm, as it is only at matter level that it can be monitored and controlled, and hopefully improved.

A good understanding of underlying costs and hence profit margins is becoming more important with the current changes to the charging model. Many firms undertake work for valued clients that they know is not profitable. In these cases it is clear that knowledge of

when such work ceases to cover even the basic cost of doing it will be of benefit. It is also important to have an understanding of the overall profitability of the client – a few high profile matters may mask the fact that overall the client does not contribute much in the way of profit, even if it does provide a large contribution in terms of fees.

Another key area where more needs to be known about the costs of working on a matter are fee arrangements where the fee is based on the successful outcome of the matter. A level of fee is usually agreed that is paid regardless of the outcome, with further fees for the successful outcome.

As explained earlier, only experience of working with the financial figures on matter will give a partner experience when negotiating a new one. For this reason, all matters should be looked at with profit levels in mind, and this should not just be considered the first time a client requests special fee arrangements, when it is too late to get the experience.

The problem with measuring profit is working out the base cost, and in particular the allocation of overheads to each matter. As this is for monitoring purposes, the exact method is probably not too important so long as it is not open to abuse by partners trying to improve their statistics. What is important is that there is a consistent model applied across the board, and that the total allocation of overhead costs is correct, so that the sum of the profit per matter totals the profit for the firm. Obviously as the figures are needed as the work is done, and not after the close of the year end, there will be an element of estimation in both the fixed cost and the profit calculations.

The simplest model for getting a base cost for work is to take the overall running costs of the firm including salaries, and divide by the total chargeable hours targets (or realistic estimates if the firm sets unattainable targets). This should probably be modified in proportion to the chargeout rate of each fee earner. With the overheads defined as a simple hourly rate, monitoring of base costs for each matter as it goes along becomes a very simple exercise.

More complex models can be developed that allocate fixed and variable costs in different ways. Whole books can and have been written on the subject, but for most firms a simple model is best, adapting it as they gain experience.

Estimating – divide and conquer

The difficulty of estimating the fees a matter is likely to incur will increase with the overall size and complexity of the matter. Except for the smallest matter which will be worked on, for the most part, by one fee earner, the matter will need to be broken down in order to arrive at a reliable estimate. In addition to the level of fee earner, where the different chargeout rates mean time has to be tracked separately, there are two simple ways to split the work. Most matters will lend themselves to one or the other method, but the largest matters will almost certainly need to be divided both ways in order to get enough detail.

The first split is by the role of the fee earner, normally their area of expertise. An estimate can then be made that the matter will take so much partner time for general corporate work, and so much time for a tax partner, and so on. The same process applies to other levels. When using this type of split, it is important to note that the aim is to have only one task for each person.

The second way of dividing up a matter is by the tasks or stages involved. This works very well for matters that require the same technical skills throughout, but where the work goes through a distinct series of phases. This is not the same as commodity work that can be automated – these stages may well be labelled initiation, design, documentation and completion, which could apply to a large number of different types of work. Having split the work up this way, each stage can be estimated by looking at how much time will be required for each level of staff.

Combining the two methods gives a simple way of breaking down a very large matter into small pieces that can be estimated with some degree of certainty. In essence, this creates a grid with the projects stages along one side and practice areas or specialisms along the other. A major advantage of this method on large matters is that the task of creating the estimate can also be divided, with a partner in each area calculating the amount of input required at each stage from their team only. The estimates for each stage can then be summarised to create the overall predicted cost for the matter in question.

Monitoring

Creating a good estimate is only part of the story for effective matter management. When everyone is highly skilled, the final bill should come out on target, and the client will be happy. As we have seen though, it is necessary to monitor a matter in order to gain experience in judging costs and effort. In reality, the changing nature of the business and the number of variations for any one type of work mean that the scenario of being able to confidently predict fees every time will never happen. What can be achieved though is a much higher degree of accuracy that can be maintained so long as financial monitoring of matters is also maintained.

Once systems are in place to present the ongoing information, and the discipline of estimating the size of all matters in advance is in place, monitoring is a fairly simple exercise. There are a few figures that need to be reviewed as the matter progresses.

The first important point is that the way the matter is split up for estimating at the start should also be the way it is tracked going forward. This does mean that time should be recorded against the same blocks of work. Where the split was by area of law, this may simple be a case of monitoring work by practice group or department, which may already be maintained in the practice management system (PMS). Where the matter has been split into phases, it is likely that this will need to be entered as it is worked on to the time recording system. Some PMS's allow the creation of different phases, or sub-matters. If not, all time recoding systems

make some allowance for coding entries for analysis, and some method will need to be agreed for this to be done.

The second thing to look at is the figures that should be checked. For each section of estimate (and for each level of fee earner) there are two figures for hours to be compared – the predicted time and the actual time worked. When looking at costs, these hours should be converted to monetary values in three ways. The theoretical cost at standard chargeout rate, the cost to the client at any agreed rates for this matter, and the overhead cost to the firm of providing this resource.

With these figures being checked as the matter progresses, it will be simple for the partner in charge to see where any errors in estimates are occurring. For example, it may be that for some types of work, the completion phase always goes over budget, or it may be that estimates from one practice area are always too large. Whatever the results, it can be seen that by monitoring closely, differences between the estimated and the actual bill can be identified as they happen, removing the need for a post mortem.

As an additional benefit, by paying attention to the build up time during the matter, the client can be kept better informed. Not only does this keep them happier, but there is a greatly increased chance that any overrun on cost can be explained and agreed as you go along, leading to a higher recovery at the end of the day.

Write-offs and lost time

No one expects to be able to bill all the time recorded on all matters, although that is obviously the target. Time is written off for a variety of reasons, especially where junior staff are learning on the job. However one of the common reasons is that the WIP has exceeded the estimate given to the client, and there is no expectation that the additional fees would be paid. Gaining experience in estimating by monitoring all matters will help reduce the problem.

There is a hidden problem in this area though, with time that is effectively written off before it is recorded. This occurs where the fee earner, often under pressure from the partner on the matter, does work but does not record the time spent, or notes a lower figure instead. This is particularly common on matters that have been won in a competitive situation with a very low bid, or where a matter starts to look as if it will exceed an estimated or agreed fee already given to the client.

Apart from causing the fee earner concerned problems with attaining their chargeable hours targets, unfairly if this is done due to partner pressure, lost time is a major problem with improving job costing. When the matter is reviewed to see how much effort was required compared to the estimate, the figures will show a much better match than was really the case. This in turn will lead to future matter being underestimated, and a cycle of poor matter management and pressure on the fee earners working on these matters is created.

The best way of ensuring that people in the firm learn from previous matters is to ensure that there is a culture of accurate time recording. Time written off when the bill is created needs to be looked at and understood, which can only happen if it is an accurate figure. The same applies to any fees written off after the bill is sent, where discounts are given and the cash actually collected is less than that billed.

Conclusions

If this all sounds a bit daunting, and seems to be suggesting overloading partners with financial information, then it is worth bearing in mind a few points:

- While partners may not be used to looking at this level of financial information, your clients are. Unless partners get better at this, they will remain at a disadvantage when negotiating fees.
- Firms almost certainly already track all the required information. It is just a matter of presenting the right calculations based on this to the partners.
- The firm must create a culture of accurately recording time, and of partners and other fee earners monitoring the costs against expectation as the matter progresses.
- No special technology is required to provide this information, although systems do exist to make it all much simpler. This information is required at least daily however, and it is not practical to do this on paper, so careful consideration will need to be given to the delivery.

Much of this use of financial information and close management of day to day work is fairly new to many firms. Business advice companies like Firstcourt can help make the information they have accessible to partners and other members of the firm who need it. Most firms are now at the stage where information gathering is no longer the problem, but analysis, presentation and delivery need to be improved to make the maximum use of it, which in turn will lead to increased revenue and more importantly increased profitability.

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