

managing the
**FINANCES OF
YOUR PRACTICE**





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practicePRO® is the Lawyers' Professional Indemnity Company's innovative risk management initiative. It is designed to help lawyers adapt to the changing practice climate and to the opportunities that change presents.

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practicePRO is a multi-faceted program of tools and resources to help you and your practice thrive.

managing the finances of your practice is just one of several booklets in the practicePRO managing series. Other practicePRO resources available to lawyers include: articles that highlight the professional's legal obligations and liabilities; practice aids that provide a "how to" approach to law practice; information on legal technology; education initiatives; and promotion of the concepts of wellness and balance.

For more information on how you can put practicePRO to work for your practice see the last page of the book or contact practicePRO at 416-596-4623.

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Disclaimer

This booklet includes techniques which are designed to minimize the likelihood of being sued for professional liability. The material presented does not establish, report, or create the standard of care for lawyers. The material is not a complete analysis of any of the topics covered, and readers should conduct their own appropriate legal research.

Taking an active role in managing the finances of your practice is key to building a successful law practice. Day-to-day pressures may make it difficult to find the time necessary to properly deal with practice-related financial issues. Nevertheless, foresight, active planning, appropriate internal controls, and an ongoing review of current finances are critical if your practice is to be successful and profitable. The need to proactively manage your practice's finances will become even more important as the profession becomes more competitive and the manner in which legal services are delivered changes.

This booklet provides a comprehensive review of various steps you can take to better manage the finances of your practice, both at the startup stage, and when your practice is well established. It also highlights some of the longer-term financial planning issues you should consider in preparation for the day you wind-up your practice.

Although some of the suggested steps may not be relevant to every lawyer, all practitioners will find helpful information in this booklet. Adapt the suggestions to fit your office and circumstances.

Many lawyers start out in practice with an office lease, a line of credit and the best of intentions. Initially, most do contemplate the financial needs of their practice. But too often, they don't give it all the attention it deserves – especially as things start to slide downhill. They honestly believe that things will “work out”. After all, the firms they came from were making it, weren't they? They are under the assumption that the road to success is paved by simply working harder.

However, working harder may not be the solution if you haven't kept your eye on the fundamentals of business success. As in many things, timing is everything. Rent, salaries and other bills all have to be paid on time or you risk losing both your access to credit facilities, and even your practice. When you combine overdue bills with clients who refuse to pay or delay in making payments on your accounts, you can easily be caught in a financial squeeze.

Planning is essential: Financial security and happiness are rarely an accident. Planning and building a successful practice should start with the preparation of a business plan and budget, and the implementation of appropriate internal controls. You should also be prepared for any unexpected interruptions that may affect the finances of your practice, and in particular, have appropriate insurance in place.

Lastly, regardless of whether you are joining a firm as a partner or associate, or simply sharing space with other lawyers, it is important to enter into an agreement that specifies your respective responsibilities and obligations.

prepare a business plan

A successful business should be planned on paper well before you open your doors. A business plan is your roadmap to the future – you can show it to banks, suppliers or others on whom you deal with to start up your practice. A business plan tells them that you have done the necessary homework to launch your practice.

What is a law practice business plan and what does it consist of? It is a concise and organized summary of how you intend to start and remain in

business. It is composed of four main areas: a general description of your business, your financial plan, your management plan, and your marketing plan. A more detailed description of what should be included in a business plan is available at www.practicepro.ca/financesbooklet.

Be precise, especially in the finances or budget part of the plan. Budgeting and managing your cash flows will be a big part of remaining in business. It is an old adage that what gets measured gets done: If you have set out straightforward goals and expectations to be met within a reasonable timeline, you will be able to judge for yourself if you are meeting, exceeding or falling behind your goals. On an ongoing and regular basis, review the goals you have set, and if you find yourself falling behind, take corrective action before it is too late. If you ignore the initial signs of trouble, you may find that you are quickly out of business, and possibly facing even greater debts than when you started.

prepare a budget

A budget will be an important part of your financial plan. When you are starting out, you need to sit down and prepare a detailed month-by-month budget for at least the initial 12 month period. To assist you, a sample budget spreadsheet is available at www.practicepro.ca/financesbooklet.

Your budget should include all expenses that you know of and/or can anticipate, and when they must be paid. Include an amount for unexpected expenses, since it is Murphy's Law that costs will always be greater than you expect, particularly as the volume of work increases. Build in marketing time and expenses. Most of all, build in your draw: If you don't look after yourself, no one else will. Compare the total expenses to your anticipated revenue. If you do not have an historical basis to forecast income, make an educated estimate based on your marketing plan.

implement appropriate internal controls

Ideally, your office should have clearly established internal controls for handling and documenting all types of financial transactions. These internal controls are really just policies and procedures that direct what steps should be taken when various financial transactions occur. Although a lack of internal controls does not necessarily constitute a breach of the Rules of Professional Conduct or By-laws, you may consider implementing internal controls to assist your efforts to comply.

The following are some suggested internal controls you may consider implementing at your office¹:

Cheque requisitions

When dealing with cheque requisitions for both your general and trust accounts, consider the following:

- all cheque requests are accompanied by a signed cheque requisition evidencing approval;
- only certain designated lawyers may authorize trust account payments;
- only certain designated individuals may authorize general account payments;
- firm personnel responsible for preparing cheques are instructed not to prepare cheques unless the requisition includes a signature of approval;
- supporting documentation (such as an original invoice, reporting letter, statement of receipts or disbursements) accompanies the cheque requisition, where possible;
- original copy of the invoice is stamped paid (to prevent an individual from using an invoice more than once to obtain funds); and
- photocopies of invoices are not generally accepted as support for cheque requisitions.

This section is based in part on the Financial Management Guideline prepared by the Law Society of Upper Canada (www.lsuc.on.ca/services/pmg_summary.jsp).

Cheque signing policies

When dealing with cheque requisitions for both your general and trust accounts, consider the following:

- cheques in excess of a threshold amount require the signatures of two partners;
- blank cheques are never to be signed;
- cheques made payable to financial institutions include details of the transaction;
- cheques are in numbered order and the sequence is checked; and
- at least one of the individuals signing the cheques always reviews the request for payment to determine if the request relates to trust funds and reviews the client file, to determine:
 - validity of the request for payment;
 - reasonableness of the amount requested;
 - if sufficient funds are available to pay the amount of the cheque; and
 - that an accounting to the client for receipts and disbursements is completed.

Trust records

Trust accounts are an essential part of the practice of law. When dealing with trust accounts and trust records consider the following suggestions:

- monthly reconciliations and adjustments are reviewed and signed by someone other than the individual who prepared the reconciliation,
- reviewer of the reconciliation ensures that:
 - reconciliations are prepared on time;
 - reconciled items are cleared promptly;

- all unusual items are questioned and an adequate explanation is given for the unusual nature of the item and noted in the firm records and client file; and
- a list of trust balances is periodically reviewed for closed or completed matters including trust balances that have not changed in the past twelve months; and
- Trust transfer requisitions are prepared to transfer funds from one client's trust ledger account to another trust ledger account, and:
 - written authorization from the client to transfer funds to another trust ledger is always obtained prior to the trust transfer;
 - the trust transfer requisition is signed by the responsible lawyer and an explanation is provided; and
 - the accounting department, or personnel responsible for accounting has been instructed to process trust transfer requisitions only if the criteria for signatures and explanations has been met;
- a senior partner or office manager periodically reviews the client's trust ledger accounts for unusual items; and
- blank trust cheques should be kept in a secure manner.

See page 10–16 for some further information on using trust accounts.

Clients' valuable property

Although it varies by area of practice, in many circumstances lawyers can find themselves taking custody of clients' valuable property. To ensure that this property is properly handled, consider taking the following steps:

- keep a proper inventory of valuable items held on behalf of the client(s); and
- make sure the physical existence of these items is periodically tested.

Staffing policies and procedures

Law firm staff are an essential part of getting all work done in a law office. The following are some suggested staffing policies that can operate as internal controls:

- the firm has a policy respecting an individual's need to take regular holidays;
- the firm conducts periodic reviews of lawyers' work;
- periodic reviews of client files are conducted by a senior partner or office manager to ensure:
 - the client receives an accounting for trust receipts and disbursements;
 - the details of the accounting to the client match with the trust ledger; and
 - the file is maintained in an orderly fashion; and
- lawyers are required to consider whether their outside interests may put them in a conflict of interest situation.

The firm should also be aware of indicators of potential problems which may result in inappropriate activities or conduct, including:

- a lawyer who is consistently too busy to take holidays;
- a lawyer who appears to be living beyond his or her means;
- sudden and significant increases in advances for entertainment expenditures;
- large increases in unbilled disbursements;
- a lawyer whose production has fallen off for no apparent reason;
- a lawyer who appears withdrawn or nervous; and
- a lawyer who continually makes last minute requests for funds.

Segregation of duties

Lawyers should segregate firm duties so that the same individual does not have complete control over the management of funds. Consider the following suggestions:

- the individual who opens the mail is different from the individual responsible for preparing a listing of all cash and cheques received;
- all cheques received are stamped “deposit only”;
- the firm issues receipts for all cash or cheques received to:
 - provide client with proof of payment; and
 - help prevent funds from being redirected to another client’s account; and
- the numerical sequence of receipts is checked to ensure that all funds receipted are also recorded in accounting records and deposited in the bank.

trust account don’ts

As a lawyer you are in a unique and special position of trust, and have been given the ability to use a very special tool, the client trust account. Mishandling client funds or misusing a trust account can have dire consequences – it is the most common reason for disbarment. For this reason alone, you should be diligent about the use of your trust accounts.

Lawyers are not bankers

No matter what demands or pressures are placed on you, DO NOT use your trust account for any purpose that is not directly related to the practice of law, and don’t simply run money through your account, as an escrow agent or otherwise. Doing so may raise a question as to whether or not you provided any legal services in connection with the monies that flowed in and out of the account. Activities that raise doubts about whether or not you provided legal services could result in a denial of coverage under your LAWPRO insurance policy, leaving you potentially personally exposed to the full costs of the claim being made.

Don't commit or be a victim of fraud

As a lawyer you are in a unique position of trust. Moreover, your access to a trust account and your ability to assist in the completion of transactions, make you an especially attractive alternative to traditional financial institutions for those who prefer not to leave a traditional paper trail. You could be duped into moving money around in inappropriate, and sometimes illegal, ways. During the transaction you could find yourself in the commission to or a victim of a fraud. Beware!

use of trust accounts

The use of trust accounts is governed by a complex set of requirements imposed by The Rules of Professional Conduct² and Law Society By-laws (see By-Laws 18 and 19³). You should make sure you are familiar with these requirements, and follow them without exception. These requirements are summarized⁴ as follows:

Money to be paid into trust accounts

A lawyer who receives money in trust for a client must immediately pay the money into a bank or other institution. Pursuant to By-Law 19, s. 2(2), a lawyer receives money in trust for a client if the lawyer receives the following from a person:

- money belonging in whole or in part to the client;
- money held on behalf of a client;
- money held on a client's direction or order;
- money advanced as a retainer for fees not yet rendered;

2 The Law Society of Upper Canada Rules of Professional Conduct are available at www.lsuc.on.ca/services/RulesProfCondpage_en.jsp.

3 The Law Society of Upper Canada by-laws are available at www.lsuc.on.ca/services/services_bylaws_en.jsp.

4 This section is based in part on the Financial Management Guideline prepared by the Law Society of Upper Canada (www.lsuc.on.ca/services/pmg_summary.jsp).

- money advanced as a retainer for disbursements not yet made;
- money paid to a lawyer that belongs in part to a client, in part to the lawyer, where it is not practical to split the payment of the money; or
- money that, by inadvertence, has been inappropriately drawn from a trust account, not in accordance with By-Law 19, s.4.

Money not to be paid into trust accounts

Lawyers are not required to pay into a trust account money received in trust for a client if:

- a client so requests in writing;
- a lawyer pays the money into an account to be kept:
 - in the name of the client;
 - a person named by the client; or
 - an agent of the client; or
- a lawyer pays the money to a person on behalf of the client immediately upon receiving it from the client, in accordance with ordinary business practices.

Although not required to pay these funds into a trust account, lawyers shall include all handling of such money in the lawyer's records in accordance with By-Law 18.

Lawyers shall NOT pay into a trust account:

- money that belongs entirely to the lawyer or to another member of the lawyer's firm;
- money that is received by a lawyer:
 - as payment for fees for services for which a billing has been delivered;
 - as payment for fees for services already performed for which a billing will be delivered immediately after the money is received; or
 - as reimbursement for disbursements made or expenses incurred on behalf of the client.

Withdrawal of money from trust accounts

Lawyers shall only withdraw the following from a trust account:

- money properly required for payment to a client or to a person on behalf of a client;
- money to reimburse the lawyer for money properly expended or incurred on behalf of a client;
- money required for, or toward, payment of fees for services performed for which a billing has been delivered;
- money directly transferred into another trust account and held on behalf of a client;
- money that should not have been paid into a trust account but was inadvertently paid into a trust account; or
- other money if authorized to do so by The Law Society of Upper Canada.

Manner of withdrawal

Lawyers shall only withdraw money from a trust account by:

- cheque drawn in favour of the lawyer;
- transfer to a bank account kept in the name of the lawyer and is not a trust account; or
- electronic transfer according to the procedure set out in By-Law 19, s.7.

Withdrawal by cheque

Lawyers shall ensure that cheques drawn on a trust account shall not be:

- made payable to either cash or to bearer; or
- signed by a person who is not a lawyer, except in exceptional circumstances and if conditions exist as set out in By-Law 19.

Withdrawal by electronic transfer

Lawyers shall only withdraw money from a trust account by electronic transfer if the conditions in By-Law 19 are met. Conditions to be met include:

- electronic system requirements;
- timely production of confirmation of certain information relating to the electronic transfer; and
- use of electronic transfer requisition, Form 19A.

Automatic withdrawals from trust accounts

Lawyers may authorize Teranet to withdraw from a trust account certain funds required to pay document registration fees and land transfer tax, provided that all the conditions set out in By-Law 19 are met.

Proper handling of credit card payments

Lawyers may enter into agreements with financial institutions that offer credit card services provided that certain conditions are met:

- all service charges, discounts and other fees payable by the lawyer to the financial institution are deducted from the general account and not the trust account;
- credit card payments for retainers shall only be deposited directly into trust accounts and credit card payments for payments on account shall only be deposited directly into the general account;
- client confidentiality is maintained – the sales slip shall not indicate the nature of the legal services only the words *legal services* plus a file number and dollar amount;
- amount of the charge is inserted at the time the client signs the slip;
- the words *trust account* appear on the original credit card slip;
- sales slip is presented for deposit in the appropriate trust account in accordance with the by-laws; and
- credit card company's discount or fee is not charged to the client.

required financial records

By-Law 18 requires that lawyers maintain financial records for all money and other property received and disbursed in connection with the lawyer's practice. Review this By-Law to ensure you are keeping all required records in the appropriate form and for the necessary time period.

put it in writing

Lawyers too often practise the adage: "Do as we say, not as we do" when the time comes to put it in writing. Partners and associates should have a written agreement with their firm, as should lawyers who share space. A written agreement helps to ensure that everyone knows exactly the terms of the arrangements between them – the expectations, the consequences and the means to implement those consequences.

It can be awkward and indeed even difficult to negotiate a partnership, associate or sharing space agreement. However, negotiating such an agreement in advance is often far easier than sorting out the issues later! And in the long-term, having a common framework of expectations can make for a more compatible and successful firm.

Partnership agreements: Every partnership agreement should cover:

- management issues;
- capital contributions;
- income-sharing/compensation issues;
- disability;
- adding additional partners;
- voluntary partner withdrawal;
- partner expulsion; and
- dissolution.

Furthermore, every partnership agreement should incorporate the requirement for adequate life and disability insurance, to ensure that a partner who has

become disabled or the estate of a partner who has died can be compensated for a share in the partnership, and that the firm can pick up the pieces and carry on the business. Inadequate insurance can leave the deceased partner's family and remaining partners financially stuck or worse – in litigation.

Associate agreements: When associates join a firm, large or small, it is just as important to put in writing the responsibilities and obligations agreed to by each party. A sample associate agreement is available at www.practicepro.ca/financesbooklet.

Office sharing agreements: These cover issues between lawyers sharing the same office suite. The common issues include management of the suite, lease payments, confidentiality, signage, and sharing the costs and services of common employees.

preparing your finances for the unexpected

Any disruption of your firm's revenue stream, especially a disruption that lasts for some time, could have a significant impact on your practice. As well as the usual ongoing expenses, such as payroll, you may have to finance a myriad of disaster-related costs. To prepare, include the following measures in your disaster recovery plan:

- **Regularly back up all financial and billing programs:** This will insure that you have access to all critical financial information, including accounts payable, accounts receivable, dockets, and client WIP and disbursements.
- **Store some blank cheques in a secure, off-site location:** A small supply of firm cheques may help you continue to disburse funds, and help communicate that it's "business as usual."
- **Arrange a line of credit:** A line of credit can be a lifeline, ensuring cash flow until you can get your billing and collection procedures back in place.
- **Protect critical documents and files:** Having off-site copies of critical, practice-related financial documents could be helpful if your office is destroyed or can't be accessed.

- **Have an up-to-date inventory:** Your office, and everything in it, are critical for the operation of your practice. A detailed inventory of ALL office contents is essential for your disaster recovery plan and insurance purposes.
- **Have adequate insurance in place:** Having adequate insurance in place is one of the best things you can do to prepare for a disaster. Consider all types of insurance, including:
 - property insurance (if you own your building);
 - contents insurance, including extra riders for computers or other equipment of significant value;
 - commercial general liability for third-party bodily injury or property damage;
 - business interruption insurance;
 - crimes coverage; and
 - disability, life, or other appropriate personal coverage.

For a more comprehensive review of other steps you should take to prepare for unexpected minor and major practice interruptions, see practicePRO's *managing practice interruptions* booklet.⁵

excess malpractice coverage

One area of insurance coverage that deserves special attention is excess insurance. It provides an additional layer of insurance protection should your defence and indemnity payments exceed the \$1 million per claim/\$2 million in the aggregate limits provided by the primary LAWPRO insurance program. It is important to remember that both expenses and indemnity payments go against these limits.

Depending on your circumstances, the \$1 million coverage limit of your primary program could be seriously eroded, leaving you potentially liable personally for any claims costs that exceed your coverage limits. To assess your exposure, consider the following:

⁵ *managing practice interruptions* is available on the practicePRO Web site at www.practicepro.ca/practice_interruptions_booklet.pdf or from LAWPRO Customer Service at 416-598-5899 or 1-800-410-1013 or e-mail service@lawpro.ca

- What do you know about the law practices of others – tenants, associated law practices, co-counsel, back-up or previous counsel, ‘of counsel’, and others, past and present – for whom you may be held responsible?
- How carefully have you assessed the exposure relating to the areas of law in which you – and those affiliated with you – practise or practised? Matters in the securities, tax, pensions, real estate and estate areas often have higher stakes.
- Have you assessed the exposure that comes from potentially high-stakes transactions?
- What checks and balances are in place for your firm’s trust accounts?
- In today’s environment, it’s not unusual for a single claim to require substantial defence costs. Similarly, pre-judgement interest on a claim that arises out of services provided years earlier can take a major bite out of funds available for an indemnity payment to satisfy a judgement or settlement.
- What other excess insurance may be in place for your benefit?

LAWPRO has created a series of questions that will help you more fully assess your potential exposure to claims – and your need for Excess Insurance coverage. It is available at www.lawpro.ca/insurance/Excess_Stress_Test.pdf.

LLPs and excess insurance: One of the requirements of a Limited Liability Partnership (LLP) is that the partners advise clients about the limited extent of their liability within the LLP under the Partnerships Act. Lawyers in LLPs will want to be able to reassure clients that the firm – an LLP – carries substantial insurance protection. Excess insurance is one way for you to be able to provide that assurance, and protect yourself against excess exposures – for your own legal services, for services provided by others under your direct supervision or control, for firm exposures predating the LLP arrangements, and for protection of the LLP firm assets.

Law corporations and excess insurance: If you are practising in a Law Corporation, remember to insure for your full exposure, since the traditional protections associated with working in a corporate entity do not exist in a Law Corporation.

Active management of your practice finances is just as important – and takes just as much work – once your practice is up and running. Keep a close eye on issues such as: retainers, retainer replenishment, time docketing, and billing.

retainers

Fee advance

Often mislabeled, a “retainer,” a fee advance is payment in advance by a client to secure the immediate services of the lawyer. The unearned portion of this fee advance is always refundable. Despite being refundable to the client, the financial security of the fee advance is highly desirable. It provides assurance to the lawyer that the client desires to move forward to resolve the legal matter, and gives the client a stake in the matter.

Retainers

A retainer is a fee to ensure that the lawyer keeps time available for the client should the need arise during the period of the retainer. There is no expectation that services will be rendered, only that they will be available. This fee is usually non-refundable (not necessarily paid in advance and placed in trust).

Before accepting a retainer, you should carefully evaluate the credit-worthiness of every client at the initial interview. Apply sound, objective business judgment to the question of client’s willingness and ability to pay. Before extending a significant amount of credit to a new client, obtain credit information, such as name and address of employer and bank, and amount and status of other debt. Do a credit check. Ask for credit references. This is very important as you will be investing your time and money in this client – due diligence would require that you have determined that your investment is warranted and that you will receive a reasonable return.

Get adequate fee advances, especially in litigation matters. Lawyers who fail to ask for a large enough fee in advance, for fear of scaring off the client, often end up as bill collectors. There are several types of fee advances. They include:

- **Up-front retainers:** This is the most common type of retainer. The money is paid up-front by the client, then used by the lawyer as legal services are performed and billed. A retainer for the full amount of the services, fees and costs (disbursements) is of course the ideal. Often, however, the retainer doesn't cover the full cost of the services and is not replenished. The end of the matter approaches with a substantial account owing. The lawyer may want to withdraw, but if it is too close to trial, it may not be possible to ethically do so. If this has happened to you, consider changing your fee agreement to allow one of the next three retainer types.
- **"Evergreen" retainers:** The client pays an initial lump sum fee advance, which is billed out for fees and costs on an ongoing basis. When it has been exhausted, the client is given 30 days notice to deposit the same amount again, failing which, subject to ethical rules, the lawyer stops working and withdraws.
- **Security retainers:** The retainer stays in the lawyer's trust account until the end of the matter, like a tenancy security deposit. The client is billed as the work proceeds and must pay each bill; if the client does not pay a bill within 30 days, the outstanding bill is paid from the retainer and, subject to ethics provisions, the lawyer withdraws. The amount outstanding when the matter is completed is paid from the retainer.
- **Split retainers:** The retainer is *split* in two; one half is used as a replenishing retainer and the other half as a security retainer. After the first half of the fee advance has been spent, the client is billed and must pay each bill. Any amount that is outstanding when the matter is completed is paid from the remaining half of the retainer.

Accepting credit cards

In the past several years, the number of lawyers accepting credit cards has grown dramatically. The fee charged by credit card companies to accept such

payments – between one and three per cent of each transaction – may be well worth the cost. By accepting credit card payments from clients, you shift the burden of being the client’s banker over to the client’s banker. Ask your banker or check the Internet about opening a “Merchant Credit Account.” Also, be sure that fee advances or retainers that are paid by credit card are properly deposited into your trust account, and those payments for services already performed and billed are deposited into your operating account.

Contingency matters

Of course, some files can be handled on a contingency basis. The key here is to select clients carefully so that you are reasonably confident that the file will be paid once the litigation is concluded.

Collecting unpaid accounts

If you do have an unpaid account, do something about it – quickly. Make early attempts at collection and determine whether or not further time and energy is warranted. Recall that attempting to collect an unpaid account against an unhappy client can lead to professional conduct complaints and malpractice claims – which can be emotionally and financially draining as well as public relations nightmares. By acting quickly and decisively and staying within your written credit policy, you can minimize your exposure to bad debts.

fee agreements should be written and comprehensive

It is important to communicate in writing with a client during (or immediately after) the initial consultation to define your professional relationship. State clearly whether or not you are acting on behalf of the client to avoid any misunderstandings about the timing, scope and cost of your legal representation. Misunderstandings about the lawyer-client relationship often led to the souring of the relationship, and to costly collection and malpractice suits.

A well-written fee agreement encompasses more than your hourly, flat or contingent fee; it should define the parameters of the work to be completed, and address your obligations to the client, and the client's obligations to you. It should also address your rights (e.g., to seek withdrawal) and your client's rights (e.g., to terminate representation). Be clear in the language you choose. Avoid legalese. Use common language that is clear to your clients. Remember, because you are the person drafting this document, it is possible that any error or ambiguity may be resolved against you if a fee dispute later arises.

A comprehensive written fee agreement should address the following issues:

- **Define the scope of your services:** Be specific about the legal matter on which you are representing the client. You should stipulate the exact nature of the relationship, what role you are taking, what functions you are to perform, and what your ongoing role and responsibilities will be. This is particularly important in the case of a limited retainer.
- **Define the timing of your services:** Make your services contingent on cooperation and payment from the client. If you want payment before commencing work, clearly state that your services start after the client has paid the advance or the flat fee. State that your services may cease if the client fails or ceases to pay your bill.
- **Explain the fee arrangement:** For your client's edification, explain the type of fee arrangement you are using. If it is a flat fee, expressly state that your fee is a one-time, up-front payment before services begin. For an advance fee, explain in the agreement that you will be charging your services against the advance fee on an hourly basis, and write in that hourly amount. Let the client know that when the advance fee is exhausted, you will cease to work on the file immediately, and you will require more money within a set period of time, failing which you will withdraw from the file.
- **State examples of the services to be billed to the client:** For your clients who are billed on an hourly rate basis, explain that they will be billed for your time on all aspects of the case, and cite several types of billable services, such as examinations for discovery, telephone calls, drafting correspondence, pleadings, trial preparation, etc. State the amount of

your minimum time increment: one-tenth of an hour, one-quarter of an hour, etc. Clients will appreciate knowing these details in advance, and such disclosure will save you numerous headaches over time.

- **Explain the client's obligation for costs:** There are two types of costs usually billed to the client: Costs incurred in your office, such as copying charges, postage fees, long-distance telephone charges, etc., and costs billed by outside vendors, such as court filing fees, messenger services, and process fees. Some lawyers pay all costs and pass them along in their bills to the clients. Other lawyers charge clients for the in-office costs, and have the clients directly pay the costs incurred by outside entities. Still other lawyers require funds in advance from clients to pay for costs incurred during the course of the matter. Decide how you want to bill your client for costs and so state in the agreement.
- **Explain your billing practices:** Let your client know how often he or she can expect to receive your bill (preferably monthly), then make sure you stick to the promised schedule. Also explain when payment is due (upon receipt; within 30 days, etc.).
- **Allow your client time to question your bill:** Discussing your bill with your client will ease client concerns when the bills start to mount. Let your client know in the fee agreement that he or she may discuss the bill with you at any time.

Sample fee and retainer agreements are available at www.practicepro.ca/financesbooklet.

Lastly, remember that client perceptions are very important. You might consider calling your retainer agreement a "legal representation agreement." A client-friendly label for an agreement that spells out your and the client's respective obligations and expectations will go a long way to building a better lawyer/client relationship.

Non-engagement letters

In cases where you have decided not to take on a file, send a non-engagement letter and return all documents to the person in question. Make it clear that you

will not be performing any services on their behalf, and that they should immediately take all steps necessary to protect their rights as the passage of time may bar their rights.

retainer replenishment

After you have clearly explained your billing practices, stick to them. Do not continue to work on a file where the client has neglected to refresh the funds in trust. Asking a client to replenish a retainer when necessary is critical for the success of your practice. You should be prepared to halt work until a retainer is replenished. Be certain to remain within your ethical requirements on withdrawing services or removing yourself from a file. If a client is truly unable to provide further funds, you need to explore what alternative arrangements can be made. If the client is unwilling to provide further retainer funds, you must be prepared to withdraw from the matter.

You or your staff person should carefully monitor the amount of unbilled work on individual files, and the sufficiency of retainers to cover that work. Many law office accounting and case management products automate this function by notifying you when billable time reaches a set limit on each file, when trust balances approach zero, and when lawyers have not billed a certain amount per month. This information should trigger an account or a warning when appropriate, and catch files on which retainers need to be replenished.

docketing

Traditionally lawyers wrote out their dockets by hand, and someone else entered them on a computer. Today, modern law office accounting and practice management software products make it easy for you to directly enter your own dockets on the computer. The efficiency, extra speed and greater accuracy of electronic dockets makes this a necessity for successful law practices today. Studies have shown that lawyers gain up to 20 per cent in their billable time when time dockets are created contemporaneously with task

completion. Once entered on a computer, dockets can go directly into accounting programs, correspondence or accounts as is necessary.

Docket in detail

Many accounting software programs have standard billing codes, for example, "conference with client", or "review of correspondence." While these codes are convenient, they don't include enough detail. Having detailed dockets is critical as a record of the work you did on a file, and for communicating to the client the details of that work.

A detailed docket should look something like this: "telephone conference with client re details of weekend access problems." Or, "drafting of correspondence to client confirming instructions to skip zoning search."

You will find that detailed dockets give a client much less opportunity to complain about their accounts, and you will be far more successful in defending your account in the event you end up before an assessment officer.

Docket every minute you spend on a file

Don't judge and write off time spent on a file as unnecessary by not docketing it on the day it was done. Wait until you final or interim bill the file, at which time you can properly judge all the factors that determine what should be billed, including the time that was spent on it. Trying to create dockets for work done in the distant past is very time-consuming, and not likely to be very accurate or complete.

Docket throughout the day

It is universally recognized that lawyers who contemporaneously create dockets end up capturing a significantly greater portion of the work they have done. Docket your work as you go. Spend a few minutes at the end of the day reviewing your dockets, and make any necessary corrections or additions while things are still fresh in your mind.

Docket all administrative and other non-billable time

It is important that you understand how much time you are spending on non-billable tasks, and what they are. You can't do this without a complete record your time.

Lastly, remember that docketed hours or time is not the same as receipts. Even if you docketed 100% of your time, that amount will not be transferred to receipts. Some of the time may not be billed, and the amount that was actually billed may be further reduced by a failure to collect on the account.

billing

Clients do not like surprises, especially if they relate to the size of an account. To avoid this, tell the client at the first meeting what you charge, how you charge, when you charge and what you expect from the client. Do not be afraid of scaring off the client: If they are unwilling to face the cost of a legal procedure at the outset, they are unlikely to change their mind at the end of the file. Your time is better spent marketing and attracting the type and class of client that will pay your accounts than working on a file on which you are not going to get paid.

Billing procedures

There are several methods that you can use to keep on top of your billing:

- **Establish billing cycles:** With regular clients, check with them on how, when and in what form they prefer to receive accounts – and stick to that schedule and format (e-billing, detail of billable time, detail of disbursements, uniform task based billing system). For other clients, the common understanding is to arrange your office procedures so that accounts reach your clients on the first of the month, enabling your clients to include them in their payment cycle and to avoid the excuse that your invoice didn't reach us in time.

There may be good and valid reasons for billing on cycles that are more or less frequent than monthly. For clients whose ability to pay is in question, billing twice a month may be reasonable. Certain clients may wish to be billed every two months or even on some other schedule, but you must be reasonably assured that these are not merely methods to defeat the payment of your account.

 **Establish one or more systematic approaches:**

- bill your clients alphabetically, billing each in turn;
- obtain a print out of your billable time, rank ordered in size, and start billing from the greatest outstanding work in progress (WIP) downwards. You could do the same using outstanding disbursements; and/or
- bill clients immediately after securing a positive result for a client, on the theory that you are then on the top of the client satisfaction curve. It is well known that the ability to collect on accounts diminishes with the passage of time after securing a positive outcome for the client; and


 **Consider alternative billing methods:**

Depending on specific circumstances, you may want to explore other options that may be more acceptable to the client such as:

- flat fees (a set amount for the complete file or each stage in the proceeding);
- contingency fees;
- results-based billing (where your final fee is based in whole or in part on the outcome of the file); or
- other alternative billing methods⁶.

Account formats

The following items should appear on all accounts:

-  the date, words that indicate that it is an invoice ("For Professional Services," "Statement", "Invoice"), the due date (net 10 days);

⁶ See *Winning Alternatives to the Billable Hour – Strategies that Work*, published by the ABA Law Practice Management Section, by J. Calloway and M. Robertson, editors, 2002, (www.abanet.org/lpm/catalog).

- the interest rate (expressed in an annual rate) that applies to overdue bills (you should ensure that your legal representation agreement mentions that your overdue accounts bear interest); and
- your signature (even if the ethical rules allow a secretary to sign an invoice).

Your accounts should contain a detailed description of the work that was performed (use your detailed time docket) along with a detailed description of disbursements incurred on the file, and any trust funds applied towards the payment of the account. Some lawyers believe that billing for in-office disbursements such as fax charges and photocopies only enforces the belief that lawyers nickel and dime' their clients and they increase their hourly charges appropriately to cover these charges. This is a matter of personal preference. All invoices should be clear, easy to read with all calculations simple and straightforwardly set out, with delineation of sub-totals and the total amount due. Consider putting "E.&O.E." on your accounts so that you reserve the ability to correct or adjust an account if an error is discovered at a later stage.

Avoid legalese – use language that sets forth the results you have achieved and your progress towards the client's goal. Before sending the account, consider defending at an assessment – and if there is any aspect of the account that makes you uncomfortable, make corrections before the envelope is sealed.

how am I doing? – cash flow planning/statements

How do you assess how you are really doing? The key is cash flow management: You must understand what monies are coming into your practice, and where money is flowing out.

Each month, you should review the following ten reports from your accounting system:

#1 – Overall and projected monthly billings: What are your overall monthly billings, measured against your projected billings? This tells you if your gross

⁷ Cotterman, James D., Capitalization, Debt and Taxes, Report to Legal Management, June 2000.

income is meeting projections. Related to this figure is the percentage of collected monthly billings that should be a lawyer's income. According to Cotterman, this amount should be 55 to 60 per cent⁷.

#2 – Projected billings versus cash flow: Review collected billings measured against your budgeted cash flow needs for the month. This tells you if you are in a projected positive or negative cash balance for the month. Studies have indicated that you will have approximately a 105 day 'lag' between the date you incur an expense and the day you collect that expense from your client⁸. Accordingly, it is important to keep a handle on your potential cash deficit.

#3 – Actual versus budgeted costs: What are your actual costs as compared to your budget? This tells you if you are managing to run your office within the financial constraints that you anticipated. If your costs are high as compared to your budgeted amounts, you will be required to cut other costs to compensate, or increase your collected billings. To be on the safe side, look at cutting your costs first before trying to increase your income, as cost cuts take effect immediately, but income is subject to the collection 'lag'.

#4 – What is your WIP? Is your work in progress increasing or decreasing? If it is increasing, is it due to time being put into contingency files that have the potential of paying off at some point in the future? Or is it building, as you have not been billing as regularly as you should? On files that can be billed monthly, you are doing yourself a disservice (and potentially digging yourself into a financial hole) if you fail to bill for the work done. WIP over 180 days/ Total WIP = 20 to 40 per cent⁹.

#5 – What are your unbilled disbursements? They represent credit that you have extended to your clients, and therefore capital that is unavailable for you to operate your practice. If at all possible, bill these out to recapture the necessary operating cash for your office. Disbursements can be one of the biggest components of total firm debt. Total debt/net fixed assets = 50 to 80 per cent¹⁰.

⁸ Ibid.

⁹ Ibid.

¹⁰ Ibid.

#6 – What are your receivables? Are they increasing or decreasing? What percentage are they of your annual billings? Fifteen per cent is high – five per cent is within the range of acceptability. Uncollectable accounts represent holes in the bottom of the financial boat – that will sink the ship if not plugged. If you do have an unpaid account – do something about it – quickly. Make early attempts at collection and determine whether or not further time and energy are warranted. Recall that attempting to collect an unpaid account against an unhappy client oftentimes leads to professional conduct complaints and malpractice claims – both of which can be emotionally and financially draining as well as PR nightmares. By acting quickly and decisively and staying within your written client credit policy you can minimize your exposure to bad debts.

#7 – What is your realization rate? The realization rate is the percentage of actual income paid to the firm from the billable hours of each timekeeper. For example, Partner X bills 200 hours per month at \$200 per hour for a total amount billed of \$40,000. Of that amount, 10 hours are written down (taken off the books) for various reasons, and clients pay a total of \$30,000. Partner X's realization rate is 75%. Partner Z bills 150 hours at \$200 per month, but she has no "write downs", and her clients pay 95% of that for a total of \$28,500. Although Partner X bills more hours, because of the low realization rate, Partner Z with far fewer hours billed is generating almost as much income for the firm. Your computer-based time and billing program should be able to create this report for you. Examine the results and use it to help guide any discussion of compensation for partners and associates. A low realization rate indicates that a lawyer is using resources of the firm inefficiently – which is usually a sign of poor client or file selection. Realization rates should be no lower than approximately 90 to 95 per cent¹¹.

#8 – What are your unbilled fees and disbursements by lawyer, client and area of law? Although some may not like it, firms should look at unbilled fees and disbursements aggregated separately by lawyer, client and area of law. Look for trouble-spots in these categories, and take steps to correct them as soon as possible.

¹¹ Ibid.

#9 – What are your daily lawyer time summaries? Daily time summaries by lawyer are also important. To make this analysis accurate, all lawyers should be accounting for all their time – billable, firm administration or management, education, pro bono, vacation etc. Look for aberrations or time summaries that don't make sense or indicate poor time management or failure to meet minimum billable time requirements. A quick way to determine how many hours you should be billing is as follows: Take your desired annual income, say \$150,000. Collected billings should be approximately twice this figure – \$300,000. Factor in bad debt at 10 per cent. That indicates that you should be billing approximately \$330,000 per year. There are approximately 231 working days/year (365 minus: 21 days vacation, 104 weekend days, 9 statutory holidays). This indicates that you must bill approximately \$1,400/day (\$330,000/231). If you bill at \$250/hour, this indicates that you must log 5.6 billable hours/day – every day.

#10 – What are your client trust account balances? Review the trust account balances for every client. Are there funds in trust that can be applied against unbilled time or disbursements? Are there clients/files that are approaching the exhaustion of their retainers or funds in trust? Do you need to write to these clients and warn them that they need to bring in further funds?

These are just a sample of the financial reports that can be generated by most computerized accounting systems. It is important to understand the role that each one can play in the running of your practice and how they can indicate small problem areas before they get to be big problems.

don't fall behind – avoiding bankruptcy

It is surprisingly common and deceptively easy for lawyers to end up in serious financial difficulty, and even bankruptcy. One of the most common causes of financial difficulty is not making sufficient quarterly payments to Canada Customs and Revenue for income tax. At tax time this can leave you with a huge payment due, not to mention penalties and interest, which will add up very quickly. Other large periodic payments can be equally troublesome (GST payments, Law Society dues, LAWPRO premium payments).

To avoid this from happening, you need to carefully monitor and assess your tax and other upcoming liabilities through the course of the year; make sure that you are setting aside sufficient funds and/or making necessary installment payments.

The option of declaring bankruptcy should be carefully considered as it can have a serious impact on your practice, not to mention your ability to practice law. Declaring bankruptcy will likely tarnish your reputation, and it will result in your losing the ability to sign cheques for a client trust account.

succession and retirement planning

Planning and preparing for your retirement is something that you should be doing almost from the day you start practice. This process involves far more than simply maximizing contributions to your RRSP. It will involve numerous decisions, some of which must be dealt with five and even ten years before your retirement. These will include things like withdrawing from partnership or office sharing arrangements, and particularly removing yourself from the tax and other liabilities for which you may be responsible. As you prepare to wind down your practice it makes sense to leave the partnership and practice in some kind of shared arrangement with the firm. The wrap-up and transfer of files will be very time consuming.

One of the major issues facing smaller firms is dealing with the introduction of new partners and the funding of the buy-out of existing but aging partners. Not having a succession plan in place that compensates the aging partner over time by establishing a retirement fund leads to the firm being unable to attract new partners – as any interested new partners who are on the upswing are most likely unwilling to contribute their billings to fund the exit of a diminishing partner. Furthermore, the lack of any retirement planning results in partners staying on in practice simply to maintain a cash flow and not for any compelling business reasons. Make this planning part of any partnership agreement.

wrapping up and selling a practice

In looking at the marketability of a law practice, buyer and seller must be able to value both the tangible and the intangible assets of the practice. The tangible assets would be the computers, desks, filing cabinets etc. These are fairly easy to value based on market value of the used equipment.

The intangible assets would be the expected return from the tangible assets when combined with the existing staff and the new owners – commonly

referred to as goodwill. Goodwill is the expected immediate ability to start earning money by taking over a lawyer's existing practice as opposed to starting up a practice from scratch.

However, goodwill is difficult to transfer from one lawyer to another, due to the inherently personal relationship between a lawyer and client. General wisdom holds solicitor practices as being easier to value and transfer as opposed to litigation practices that are by nature, very dependent on the personality and reputation of the litigator.

There are at least two general methods for paying out the retiring lawyer by the purchasing lawyer.

#1 – Estimate the cash flow from the practice for a year and discount this amount to allow for client loss and other contingencies and paying out the retiring lawyer a figure based on the discounted cash flow plus the value of the tangible assets.

#2 – Pay the retiring lawyer a fixed percentage of the amount recovered on each file on a monthly basis for a fixed period of time (called earnouts). Several contingencies should be taken into account in each situation. Look carefully at the practice and consider the ability of the practice to generate new clients and referrals.

professional liability insurance coverage after you retire

Your retirement will not magically prevent malpractice claims from arising against you. This fact, and the need to make sure you have sufficient coverage in place after you retire, should cause you to carefully review your options for coverage after you retire.

In considering the appropriate amount of insurance protection you need, remember the following two factors:

#1 – A claims-made policy: All LawPRO policies are claims-made-and-reported policies. They provide coverage under the presently in force policy for claims that arise out of past and present services. The key is that the focus is on when the claim is made and reported by you, not the year in which services are provided and the alleged error or omission is said to have occurred. If a claim is made against you two years after you retire, for services which you provided five years before you retired, your run-off policy responds, not the policy that was in place when the work was done.

#2 – The time lag for claims to surface: LawPRO's claims data indicates that claims surface on average two to three years after legal services were provided. Moreover, up to 10 per cent of claims are not reported until five or more years after the services were provided. In some areas of practice such as wills, estates, and real estate, it can take even longer before claims surface. Thus, it is quite possible that claims may arise after you retire, so you need to consider what malpractice coverage is in place.

Standard Run-Off Coverage

When you leave practice, you become eligible to exempt yourself from the requirement to purchase ongoing LAWPRO practice coverage. Choosing to exempt yourself on the basis you are no longer practicing brings the standard Run-off Insurance coverage into force. It provides only \$250,000 per claim/aggregate coverage for all claims made against you while you remain exempt. There is no coverage for legal services provided while you are exempt (excepting certain pro bono services which you provide for approved programs affiliated with Pro Bono Law Ontario).

Run-Off Buy-Up Coverage

Run-off Buy-Up Coverage insurance enables lawyers who have only standard Run-off Insurance Coverage to increase their insurance coverage limits. The premium for Run-off Buy-Up varies from lawyer to lawyer, depending on the number of years you practised, area(s) of law in which you practised, and how long it has been since you were in private practice, among other factors. You should also look at buying up your Innocent Partner Coverage.

For more information on your post-retirement insurance options visit the LAWPRO Web site at: www.lawpro.ca/insurance/run-off_coverage_buy-up.asp or contact Customer Service at 416-598-5899 or 1-800-410-1013 or e-mail: service@lawpro.ca.

LAWPRO encourages lawyers to be proactive in managing the finances of their practices, because it fundamentally strengthens individual lawyers and their practices, and well-managed practices have fewer claims. More than anything else, taking an active role in managing the finances of your practice is key to building a successful law practice.

No matter what stage you are at in your practice, with some planning and effort you can easily improve its finances.

This booklet is but one tool to help you better manage the finances of your practice. It can help you organize your finances, establish controls and prepare you and your practice for the rapidly changing legal environment. Consider the suggestions and steps outlined in the previous pages. Take time to review carefully the longer-term financial planning issues you need to consider in preparation for the day you wind up your practice.

Appendix 1 lists other resources that you can use to help you work to better manage the finances of your practice.

other resources on practice finances

Books

How to Start and Build a Law Practice - Millennium Fourth Edition;
by Jay G. Foonberg; ABA Law Practice Management Section, 2002

An ABA bestseller with 128 chapters, it covers all aspects of starting, building and running a practice, including financial issues. 606pp.

Flying Solo: A Survival Guide for the Solo Lawyer, Third Edition;

by Jeffrey R. Simmons; ABA Law Practice Management Section, 2001

An ABA bestseller with 55 chapters, it has helpful information for anyone wanting to start and run a solo practice. 816pp.

Winning Alternatives to the Billable Hour: Strategies That Work,
Second Edition;

by Mark A Robertson , James A Calloway; ABA Law Practice Management Section, 2002

Everything you need to know about billings, including communicating with clients on billing issues and alternative billing methods. 282pp.

Collecting Your Fee: Getting Paid from Intake to Invoice;

by Edward Poll; ABA Law Practice Management Section, 2003

Reviews billing basics and the systems to set in place to ultimately increase your bottom line and keep your clients happy. 150pp with CD.

practicePRO managing practice interruptions booklet

A comprehensive review of the steps you can take to prepare for unexpected minor and major practice interruptions. It is available at www.practicepro.ca/practice/Practice_Interruptions_booklet.pdf or you can call LAWPRO Customer Service at 416-598-5899 or 1-800-410-1013 or e-mail service@lawpro.ca.

Web sites

Financial Management Guideline, Law Society of Upper Canada:

www.lsuc.on.ca/services/pmg_financial.jsp

This Law Society Guideline summarizes mandatory and recommended practices relating to the financial management of a law practice.

Canadian Government Business Startup Assistant:

<http://bsa.cbcs.org/gol/bsa/interface.nsf/engdoc/0.html>

The Federal Government site is a good starting and reference point that combines business start-up information from all levels of government, the community and many other sources.

US Small Business Administration:

www.sba.gov/index.html

A US government site that has some helpful information on running and managing a small business.

Office Depot Small Business Handbook:

www.officedepot.com/BusinessTools/sbh/default.asp

Extensive information about starting and running a business.

Articles

Cotterman, James D., *Capitalization, Debt and Taxes*, Altman Weil, Report to Legal Management, www.altmanweil.com/about/articles/lfma/econ_fm.cfm?jsenabled=True, June 2000.

Cotterman, James D., *Fiscal Management of a Law Firm*, Altman Weil, Report to Legal Management, www.altmanweil.com/about/articles/pdf/fiscalmgmtjdc.pdf, September 2001.

Hildebrandt, Kenneth M., *Capitalization for Lawyers – It takes More than Brains to Keep a Firm Afloat*, [www.hildebrandt.com/home/pubresearch/?&id\[1\]=275](http://www.hildebrandt.com/home/pubresearch/?&id[1]=275) September, 2000.

Rose, Joel A., *Firm Capitalization*, www.joelarose.com/articles/firmcap.html.

other tools and resources from practicePRO

practicePRO provides lawyers with a variety of tools and resources, in both print and electronic formats, designed to help your practice grow and thrive.

The “managing” series of booklets

These booklets provide insights and checklists to help lawyers better manage the risk associated with specific practice issues. Titles include: *managing the lawyer/client relationship*; *managing conflicts of interest*; *managing the practice of investing in clients*; *managing a mentoring relationship*; and *managing practice interruptions*.

The Online COACHING CENTRE (OCC)

The OCC is an online, self-coaching tool, comprising more than 150 modules, to help lawyers become more productive and effective in their professional and personal lives. Topics covered include: communicating powerfully; managing stress; overcoming procrastination; managing practice more efficiently; developing new business opportunities; and capitalizing on emotional intelligence.

Technology resources

practicePRO helps lawyers integrate technology into their practices through: the practicePRO Technology Roadshow; practicePRO Technology Breakfasts; and a biweekly practicePRO Technology Tip.

Wellness resources

The practicePRO Web site provides an extensive listing of links to assessment tools, guides and resources to help lawyers address wellness and balance issues.

Special Reports

Special Report on Litigation explores the increase in litigation claims, the forces driving change in litigation practice and the types of errors that underlie litigation claims, and provides practice management tips to help reduce exposure to claims.

Special Report on Fraud examines the new real estate fraud, which increasingly targets lawyers, and provides tips to help lawyers avoid being caught.

For more information visit www.practicepro.ca or call 416-596-4623.

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