

Williams & Jacobs, LLC: A Deposition on Business

Monte Swain, CMA, CPA, CGMA, Ph.D.
Brigham Young University

Steve Smith, CMA, Ph.D.
Brigham Young University

Bill Tayler, CMA, Ph.D.
Brigham Young University

INTRODUCTION

As Carly Jacobs, senior partner at law firm Williams & Jacobs, LLC, drove home from the firm's annual golf tournament to meet her husband and go to the firm's family picnic that evening at Naperville Riverwalk, she was thinking very carefully about what she had observed that day. The golf tournament at the Springbrook Golf Course had always been a big hit with the employees. But, frankly, this year it seemed to Carly that the level of energy and laughter typical of this event was low.

Under Carly's direction, the firm's office manager had carefully designed the four-person scramble teams to help individuals from different law practice groups within the firm get to know each other better. Carly was therefore disappointed to see that most of her colleagues were choosing to sit with members of their own groups during lunch rather than with their golf teams.

Carly was concerned, but she was not really surprised as she reflected on the past year at the firm. She and her retired partner, Isaac Williams, had originally designed the firm's business model to create healthy competition between the professionals that form each practice group at Williams & Jacobs, LLC. The firm's annual bonus pool is substantial, and it is distributed based on operating profits for each practice group. Carly liked the competition. It kept everyone motivated to serve clients and grow business within the practice. It was supposed to help employees be more conscientious about costs in the firm. In Carly's view, however, costs continued to be too high, and overall firm

profits this year were essentially flat. This was affecting everyone's bonuses as well as the distribution of net income to the partners.

After handing out the bonus letters the day before, Carly was expecting some disappointed comments, and she was correct. The comments capped off a tough week for Carly. Earlier in the week, she had worked with the firm's full partners to review performance, and that process had been painful. There were grumblings about costs—specifically about the amounts some practice groups were spending on travel and training. The discussion revived old arguments about how costs were being assigned across practice groups.

Further, Arjun Singh, lead partner with the corporate group, raised a new concern about profit reporting and performance analysis in the firm. Arjun commented that his group did a lot of development work to acquire and upsell Williams & Jacobs, LLC, clients on other law services, particularly services from the tax, property, and bankruptcy groups. Arjun's point was that his corporate group was building business for other practice groups but receiving no benefit to its own bottom line. Arjun's frustration made sense to Carly—operating profits for corporate were down significantly from the previous year, and that was affecting Arjun's (and everyone else's) compensation.

In addition to Arjun's concerns, the complaints about travel and training cost allocations, and the disappointing overall profits, Carly's week received another blow in the club parking lot as she was putting her golf bags in the car. Her new law associate in the estate and trust practice, Malik Young, approached her and said, "Hey, Carly. I need

to let you know that I've received an offer a couple of days ago from one of the big downtown firms, and I'm seriously considering it."

Carly responded, "Wow, Malik. I know we've talked before about calls you've been getting from headhunters, but I had no idea you were considering offers. I really value your contribution here at the firm, and I thought you were enjoying the work."

Malik stammered a bit: "I do enjoy the work we're doing together, Carly, and I really appreciate you mentoring me in the estate and trust practice. This is the kind of law work I want to continue doing, and so I really hadn't taken seriously these headhunter calls." Malik paused. "It's just that we had such a disappointing year in our practice group. And my bonus check yesterday was a hard pill to swallow. I've got big law school loans I'm paying back, and I can't afford another year like this last one. You understand, don't you, Carly?"

Carly did understand. She thanked Malik for his honesty and asked him to give her 48 hours before taking the offer from the other firm. She promised to consider carefully what she might be able to do to hold on to one of the most promising new associates in the firm. Malik agreed and shook her hand, but his smile was a little thin, and Carly's concern about the overall profits at Williams & Jacobs, LLC, weighed on her even more heavily.

BUILDING THE WILLIAMS & JACOBS LAW PRACTICE

Twenty-three years ago, Isaac Williams and Carly Jacobs debuted their firm as an estate and trust law practice. Isaac had been a partner with one of the large firms in downtown Chicago, where Carly was a promising associate, having graduated three years earlier from Michigan State University near the top of her class. Isaac recognized Carly early on as a rising star and offered to become her mentor. As they worked together, he shared with Carly his dream to establish a small firm outside the city where he could build on what he had learned about successfully running a law practice. Carly was convinced, and soon they both tendered their resignations and signed a contract for a shared office space on Ferry Road in the city of Naperville, 40 miles east of Chicago.

Based on Isaac's reputation and financial resources, they were able to weather the first "thin" year as they began their practice in Naperville. Estate and trust work is based on a strong community network and reputation, which takes time. Potential estate and trust clients initially came to the firm seeking tax advice, which often involved filing amended tax

returns. Isaac and Carly both learned a lot about taxes, and the work certainly helped pay the bills that first year. More important, their relationships with these clients often evolved into long-term relationships involving ongoing estate and trust work. Nevertheless, neither Isaac nor Carly was a tax specialist, and Isaac was determined to stay focused on their core business. Carly worked very hard those first few years, and Isaac generously let her work her way into becoming a partner in their new firm at an early stage of her career.

Within five years, Carly was a full partner in the firm, and Williams & Jacobs, LLC, had opened its own standalone office on Naper Boulevard. The firm had grown to include two more associates and three paralegals. The initial work helping clients file amended tax returns was evolving into a full-fledged tax practice that complemented the estate and trust services. The tax practice became a second anchor for the firm with the arrival of a new partner who specialized in tax.

Isaac and Carly expanded the practice over the next 10 years to include family law services and corporate services for small to medium-sized businesses. The corporate services eventually grew to become the largest practice group in the firm. The firm also expanded by acquiring a small two-attorney specialty practice in property law.

One of the promoted associates also began a practice focused on bankruptcy, enlisting the help of her recently retired law school professor to serve in an "Of Counsel" role, which is a senior attorney who—while not actively involved in the day-to-day work of the firm—is either available for consultation related to his or her specialty or manages a particular practice or client(s) on a part-time basis. Part of the value provided by Of Counsel attorneys is the "star power" brought to the firm by associating the name of the individual with the firm (on stationery, the website, and so on) without requiring his or her full-time presence or compensation. Managing Of Counsel attorneys presents particular challenges (e.g., determining insurance and liability on the attorney's decisions, setting and managing expectations for performance and behavior, and more).

The bankruptcy practice is at an early stage and is still evolving. In fact, bankruptcy has yet to report an operating profit (though it is close), which means this practice group is not yet participating in the bonus pool. The bankruptcy group is obviously concerned, and other partners are worried about the drag on overall firm profits.

THE FIRM’S COMPENSATION MODEL

As the firm grows, the separation between the practices is becoming blurred. This blurring is generally a good result, as clients access multiple services and some of the firm’s professionals become skilled in multiple practices. One result, however, is a greater sharing of resources across practices. In particular, the estate and trust practice often crosses to provide combined client services with the tax and family practices. Estate and tax also occasionally require bankruptcy support. Similarly, the corporate practice often involves working with the tax, property, and bankruptcy groups.

When Isaac retired three years ago, Carly became the senior partner. Isaac continues to serve as an Of Counsel attorney in the original estate and trust practice. Carly often seeks Isaac’s advice on business development and employee management issues. Despite being retired, Isaac remains committed to the firm, and he continues to participate fully with all the partners in the firm’s net income. At this point, he is the only retired partner. The current headcount in the firm is shown in Table 1.

Early on, as the firm began expanding, Isaac introduced to Carly the idea that creating some competition between different practice groups could strengthen everyone’s focus on serving clients and building business. At the heart of the firm’s management model is the bonus pool. All full-time employees (excluding interns) participate in the bonus pool, including active partners. The bonus pool at Williams & Jacobs, LCC, is designed to create a sense of ownership for all employees, not just partners.

The pool is established as 30% of the firm’s total operating profit. The first 2% of the bonus pool is distributed to the office staff team. The remaining 28% is distributed to each practice based on relative operating profit. Each practice allocates its share of the bonus pool to employees based on their relative salaries or wages. Allocations to employees who support multiple practice lines are handled by determining their proportional work during the year. Since individual salaries and wages are known only to the full partners, it is not possible for most employees to directly compare their bonus computations to those of their colleagues. Nevertheless, employees generally have a good sense of how their total compensation relates to others in the firm. Table 2 provides details of the bonus pool allocation for the year just ended.

Active partners participate fully in the bonus pool (retired partners do not). Then all partners, including retired partners, are distributed an equal share of the available net

income, computed as operating profit less bonus pool. (Note: 10% of net income is reserved by the firm for contingencies.) Junior partners work through a significant buy-in period as a process of becoming full partners. Specifically, 50% of each junior partner’s net income distribution is withheld until the buy-in is completed. The junior partners’ holdback is distributed equally to the full partners. Currently, five of the 10 partners are junior partners. (Note: Of the ten partners who share in the available net income, nine partners are active in the firm business and one partner is retired.)

Williams & Jacobs, LLC, is rather unique in the extent it uses Of Counsel attorneys to enlarge its practice profile. This approach gives the firm flexibility to take on special projects or handle occasional spikes in client demand. But the model presents challenges when assigning costs. Of Counsel attorneys are paid at a rate of 55% of their billing rate. This works out to a higher annualized salary than even the most senior partner, but Of Counsel attorneys do not participate in the bonus pool as employees, nor do they receive a distribution of firm profits like partners do.

Isaac, who is now Of Counsel to the estate and trust group, only bills client hours occasionally. Most of his involvement with the firm is consultative, advising on firm management issues and occasionally on particularly difficult client issues. The two Of Counsel attorneys working with the estate and trust practice are almost entirely focused on billable client work and require very little overhead support by the firm. They work out of their home offices and handle their own client communications. The two Of Counsel attorneys who are involved in the family practice and the Of Counsel attorney working with the property practice maintain an office at the firm (despite working significantly less than full-time) and require significant staff and paralegal support.

FINANCIAL PERFORMANCE

Table 3 provides an analysis of the client revenue at Williams & Jacobs, LLC, for the last year. Billing rates are essentially based on published studies of law practice in the surrounding areas and are managed to be competitive with other offices. In terms of client services, associates carry the lion’s share of the load, which is typical of most offices. Partners spend substantial time nurturing client relationships and developing new client business, paralegals provide support work that is not always billable, and interns are somewhat protected from being overworked. In addition, associates, paralegals, and interns participate substantially in training events, both in and out of the office.

The last year's profit and loss report is provided in Table 4. There are significant differences in both client revenue and costs of service across the practice groups. There is also a significant difference in how administrative expenses are being reported for each practice group. But it is difficult to describe this as a "performance" management issue for practice groups since administrative costs are allocated based on an overhead rate computed using total billable hours. What is clear, however, is that the differences in these various administrative expenses are sizable when computed using a rate based on billable hours.

Williams & Jacobs, LLC, rents out some of its office space to a property title company for \$1,600 per month. This "other income" is also allocated across the practice groups as an offset to administrative expenses, resulting in a net overhead rate last year of approximately \$68.90 per billable hour. Clearly, the volume of billable hours does not actually create many of these costs. Otherwise, it would make no sense to ever bill clients less than \$69 an hour as this would create a net loss on the client hour.

Carly Jacobs is reasonably confident that even the average billable rate of \$61 per hour for the paralegals is making money for the firm. What is not clear to Carly is the actual value (or margin) provided to Williams & Jacobs, LLC, on each billable hour across the different practice groups and for each type of professional. The average net income distribution to partners for this last year was below expectations. Either the volume of billable hours needs to increase, or costs need to be reduced somewhere in the office since client rates are largely set by the market.

THE DRIVE HOME

Carly was thoughtful as she drove home. She had no regrets about the decision to leave the big Chicago practice so many years ago and start her own firm with Isaac. Overall, the firm has been a success, but profit performance over the last few years seems to indicate a leveling off, or worse.

As she drove, Carly resolved to gather the partners as soon as possible to discuss this situation. Before that meeting, Carly planned to spend some time with her old mentor to consider the firm's situation before it becomes a crisis. By the time she pulled into the driveway, Carly had specifically laid out in her mind the issues to discuss with Isaac. She also resolved that outside help is needed.

CASE QUESTIONS

You have been retained by Carly to help her analyze the following issues as she works with the firm partners.

1. Each practice group is responsible for its costs of service, but the allocation of administrative expenses is not clear. What factors need to be considered in how costs are assigned and used in profit analysis and performance evaluation? What additional information is needed for this analysis?
2. What should be done about the bankruptcy practice? Does Carly need to take a different approach in analyzing performance and profit for this practice group?
3. The overall management strategy at Williams & Jacobs, LLC, is based on competition for the bonus pool. Based on Arjun Singh's frustration about noncompensated work that benefits other practice groups, is this the best approach to incentivize the professionals at Williams & Jacobs, LLC?

ABOUT IMA® (INSTITUTE OF MANAGEMENT ACCOUNTANTS)

IMA®, the association of accountants and financial professionals in business, is one of the largest and most respected associations focused exclusively on advancing the management accounting profession. Globally, IMA supports the profession through research, the CMA® (Certified Management Accountant) program, continuing education, networking and advocacy of the highest ethical business practices. IMA has a global network of more than 85,000 members in 140 countries and 300 professional and student chapters. Headquartered in Montvale, N.J., USA, IMA provides localized services through its four global regions: The Americas, Asia/Pacific, Europe, and Middle East/India. For more information about IMA, please visit www.imanet.org.

Table 1: Firm Headcount

	Estate & Trust	Family	Tax	Corporate	Property	Bankruptcy	Total
Partners	1	1.6	2.4	2	1	1	9
Associates	2		1	3	1	1	8
Paralegals	2	2	1	3	2	1	11
Interns			1	2			3
Of Counsel	1	1			1	1	4
Office Staff							7
Total							42

Notes:

- One tax partner spends about 60% of his time working with the family practice.
- Most paralegals have flexible roles in the firm but largely work within the practice groups as listed above.
- The office staff supports all six practice groups and is composed of the office manager, the company accountant, a billings clerk, two office receptionists, and two secretaries.

Table 2: Bonus Pool for Last Year

	Estate & Trust	Family	Tax	Corporate	Property	Bankruptcy	Office Staff	Total
Bonus pool assigned to practice	\$12,223	\$37,950	\$82,999	\$47,851	\$32,054	\$0	\$15,220	\$228,297
Practice group compensation	\$536,640	\$395,520	\$612,000	\$872,640	\$364,320	\$337,560	\$294,000	\$3,412,680
Bonus percent of compensation	2.3%	9.6%	13.6%	5.5%	8.8%	0.0%	5.2%	6.7%
Practice group bonus pool %	28%							
Staff group bonus pool %	2%							

Note (see Table 3 for key data):

- Bonus percentage of compensation is computed by dividing the bonus pool by the group compensation. This represents the employees' bonus in addition to compensation.

Table 3: Revenue Analysis for Last Year

Average Billable Rates per Hour	Estate & Trust	Family	Tax	Corporate	Property	Bankruptcy	Total
Partners	\$320	\$320	\$340	\$360	\$300	\$290	\$329
Associates	175	N/A	180	190	170	160	179
Paralegals	60	50	65	70	60	55	61
Interns	N/A	N/A	80	80	N/A	N/A	80
Of Counsel	360	340	N/A	N/A	330	340	343
Total Billable Hours	Estate & Trust	Family	Tax	Corporate	Property	Bankruptcy	Total
Partners	1,390	2,320	3,588	3,020	1,530	1,380	13,228
Associates	3,900	N/A	1,857	5,850	1,875	1,710	15,192
Paralegals	2,100	2,120	1,090	3,930	1,970	1,052	12,262
Interns	N/A	N/A	1,690	3,170	N/A	N/A	4,860
Of Counsel	210	1,650	N/A	N/A	950	813	3,623
Total	7,600	6,090	8,225	15,970	6,325	4,955	49,165

Table 4: Profit and Loss Report for Last Year

	Estate & Trust	Family	Tax	Corporate	Property	Bankruptcy	Total	
Client Revenue								
Partners	\$444,800	\$742,400	\$1,219,920	\$1,087,200	\$459,000	\$400,200	\$4,353,520	
Associates	682,500	N/A	334,260	1,111,500	318,750	273,600	2,720,610	
Paralegals	126,000	106,000	70,850	275,100	118,200	57,860	754,010	
Interns	N/A	N/A	135,200	253,600	N/A	N/A	388,800	
Of Counsel	75,600	561,000	N/A	N/A	313,500	276,420	1,226,520	
Total Service Revenue	\$1,328,900	\$1,409,400	\$1,760,230	\$2,727,400	\$1,209,450	\$1,008,080	\$9,443,460	
Costs of Service								
Of Counsel payments (55%)	(\$41,580)	(\$308,550)	N/A	N/A	(\$172,425)	(\$152,031)	(\$674,586)	
Professional salaries	(436,800)	(296,640)	(563,040)	(727,200)	(276,000)	(291,000)	(2,590,680)	
Paralegal salaries	(99,840)	(98,880)	(48,960)	(145,440)	(88,320)	(46,560)	(528,000)	
Intern wages	N/A	N/A	(56,100)	(111,100)	N/A	N/A	(167,200)	
Payroll tax, benefits, etc.	(106,080)	(80,093)	(133,253)	(183,416)	(71,760)	(68,676)	(643,278)	
Travel and entertainment	(14,450)	(24,130)	(67,785)	(164,855)	(27,438)	(21,750)	(320,408)	
Court and filing fees	(61,130)	(39,765)	(21,980)	(119,876)	(21,444)	(87,650)	(351,845)	
Postage and delivery	(1,295)	(5,111)	(3,663)	(2,786)	(850)	(4,610)	(18,315)	
Total Costs of Service	(\$761,175)	(\$853,169)	(\$894,781)	(\$1,454,673)	(\$658,237)	(\$672,277)	(\$5,294,312)	
	Estate & Trust	Family	Tax	Corporate	Property	Bankruptcy	Total	Overhead Rate
Administrative Expense								
Office staff salaries and wages	(\$45,447)	(\$36,417)	(\$49,184)	(\$95,498)	(\$37,823)	(\$29,630)	(\$294,000)	(\$5.98)
Payroll tax, benefits, etc.	(5,908)	(4,734)	(6,394)	(12,415)	(4,917)	(3,852)	(\$38,220)	(0.78)
Supplies and travel	(89,565)	(71,769)	(96,930)	(188,203)	(74,539)	(58,394)	(579,400)	(11.78)
Marketing	(76,094)	(60,976)	(82,352)	(159,898)	(63,328)	(49,611)	(492,260)	(10.01)
Insurance (malpractice, etc.)	(138,428)	(110,924)	(149,812)	(290,880)	(115,205)	(90,251)	(895,500)	(18.21)
Training and licensing	(50,935)	(40,815)	(55,123)	(107,030)	(42,390)	(33,208)	(329,500)	(6.70)
Dues and subscriptions	(9,312)	(7,462)	(10,078)	(19,567)	(7,750)	(6,071)	(60,240)	(1.23)
HR development	(7,602)	(6,092)	(8,228)	(15,975)	(6,327)	(4,957)	(49,180)	(1.00)
Mortgage interest	(15,289)	(12,251)	(16,546)	(32,127)	(12,724)	(9,968)	(98,905)	(2.01)
Property tax	(3,055)	(2,448)	(3,306)	(6,419)	(2,542)	(1,991)	(19,760)	(0.40)
Building maintenance	(9,756)	(7,818)	(10,559)	(20,501)	(8,120)	(6,361)	(63,115)	(1.28)
Equipment purchase and maintenance	(30,069)	(24,095)	(32,542)	(63,185)	(25,025)	(19,604)	(194,520)	(3.96)
Utilities	(11,006)	(8,819)	(11,911)	(23,128)	(9,160)	(7,176)	(71,200)	(1.45)
Computer and technology	(18,983)	(15,211)	(20,544)	(39,888)	(15,798)	(12,376)	(122,800)	(2.50)
Offsite storage	(2,309)	(1,851)	(2,499)	(4,853)	(1,922)	(1,506)	(14,940)	(0.30)
Accounting and payroll	(12,266)	(9,829)	(13,275)	(25,775)	(10,208)	(7,997)	(79,350)	(1.61)
Bank interest and charges	(691)	(554)	(748)	(1,452)	(575)	(451)	(4,470)	(0.09)
Total Administrative Expenses	(\$526,715)	(\$422,065)	(\$570,030)	(\$1,106,794)	(\$438,352)	(\$343,404)	(\$3,407,360)	(69.30)
								Other Inc. Rate
Other Income - office rent	2,968	2,378	3,212	6,237	2,470	1,935	19,200	\$0.39
Operating Profit	\$43,978	\$136,545	\$298,631	\$172,169	\$115,332	(\$5,666)	\$760,988	
Bonus pool (30%)							(228,297)	
								Avg. per Partner
Net Income							\$532,692	\$53,269

Notes:

- Costs of service are traced directly to each practice group.
- Payroll tax, benefits, etc. in the Costs of Service are for professionals, paralegals, and interns. These similar costs in Administrative Expense are for office staff.
- Administrative expenses and other income are allocated based on billable hours in each practice group.