

LAW FIRM ECONOMICS 101

An Introduction to the Economics of Law Firm Practice

Glossary of Terms and Jargon

Accounts Receivable (AR) – An accounting term that refers to money due to the firm for legal services provided (invoices billed that have not yet been collected on).

Accounts Payable (AP) – An accounting term that refers to money that a company owes to its suppliers, but hasn't been paid yet. Accounts payable accounts typically hold bills for operating expenses.

Annualize – To budget/calculate income or expenses so as to reflect a rate that is based on a full year.

Associate – a lawyer who is an employee, as opposed to an owner of a law firm.

Billable Hour – Time billed to a client for legal services; typically billed in increments of tenths of an hour.

Billing Rate – The hourly (or alternative) fee charged to a client for legal services. There generally is a standard billing rate and a realized billing rate.

Budget – An operating tool or a guideline that is used to measure current performance against planned expectation.

Capital – An individual contribution to the firm's equity in order to participate in the ownership of the firm.

Closing Time – The periodic closing of books and finances to tally where you are. In law firms the period is a month.

Collections – The receipt of payment for fees billed to a client.

Contingency Fee – A fee for legal services upon successful completion of the services. This is usually calculated as a percentage of the gain obtained for the client.

Deferred Compensation – An arrangement in which a portion of an employee's income is paid out at a date after which that income is actually earned.

Expenses – Compensation, rent, insurance, debt services, technology, marketing and other administrative costs.

Fiscal Year – A 12-month period over which a law firm estimates/budgets its spending; the financial year. A fiscal year does not always begin in January and end in December.

Fixed Fee Arrangements – An Alternative billing arrangement where the fee is agreed upon in advance of a transaction and is the amount billed regardless of the actual number of hours spent on the matter.

Full Time Equivalent (FTE) – Annualizing of part-time individuals to compare them with full-time individuals.

Leverage – The partner to associate ratio; often refers to the work that partners delegate to associates and support staff. Optimal leverage ratios will vary by firm and practice area. Most often profitability increases as leverage increases.

Non-billable Hour – Time spent on any non-client, legal-related work.

Operating Expenses – Expenditures that a business incurs as a result of performing its normal business operations. Examples of typical operating expenses are rent, technology, insurance, utilities, compensation, and recruiting and training costs. Firms and law schools will often try to improve their financial position by reducing operating expenses.

Overhead – All operating expenses excluding timekeeper's compensation. The overhead is the cost to run the firm.

Partner – A lawyer who has become an owner of the firm and is paid a percentage of the firm's profits that reflects the lawyer's contribution to the firm. Also known as shareholder or equity member.

Pre-bill – A draft report of billable time and disbursements allocated to a client matter. A pre-bill is reviewed and adjusted by the billing attorney before a bill is produced in final format for the client.

Profit Margins – The profit after applying fee income less the compensation to produce the fee income.

Profits Per Partner (PPP/PPEP) – A performance statistic often used by law firms; calculated by dividing the firm's net income by the number of partners (most often equity partners).

Realization – The amount of fees billed versus fees collected.

Revenue per Lawyer – A performance statistic often used by law firms; calculated by dividing the firm's collected fees by the number of full-year equivalent lawyers.

Timekeeper – a person who keeps time records with the intention of billing hours worked to appropriate client matters.

Utilization – The number of billable hours an attorney works compared to the hours targeted for a given time frame; also referred to as productivity rate.

Work in Progress (WIP) – Time that has been worked but not billed to the client.

Write off – Billable client time that is subsequently not charged to a client. This is unbilled write-off. Billed write-off is when the time was originally billed to the client, but you do not receive receivables.