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Seigneur's Law Firm Valuation Checklist

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Seigneur's Law Firm Valuation Checklist

Law practices that have been successful over the years increasingly now face hard questions: Who are we? Where are we headed? Who is along for the ride, and who is driving? Individuals are asking themselves whether they should retire or go to a firm where the grass is greener. This state of transition that many law firms are in right now is creating opportunities for business valuation practitioners, said Ron Seigneur of Seigneur Gustafson, who spoke at the recent AICPA Family Law Conference in Las Vegas.

The opportunities arise particularly when attorneys are retiring or changing firms. "We're finding that if you have a book of business as a lawyer, you can get cash offers to jump firms, especially if you can bring along some quality people," says Seigneur. Law firms are litigious and are accustomed to fighting over the details, which present opportunities for appraisers and financial consultants, he adds. Here are three examples:

- *Law firms are dissolving, and there are disputes over partnership agreements:* Lawyers never quite want to resolve buy-sell agreements because they want to keep their options open.

- *There are often fights over who brought the business in:* Law firms are really big on rewarding people for bringing in work. It's not unusual to see it in other professions, but law firms sometimes live and die by the origination credit. They get a 15 percent or 20 percent override and royalty on every dollar that they bring in.

- *An attorney in a contingency fee practice is getting a divorce:* Valuing work in process is difficult when the attorney bills on contingency and future outcome is uncertain.

Based on his experience valuing law firms, Seigneur suggests requesting the following documents from the partners:

- Access to all available management reports detailing practitioner, practice unit, and firm-wide utilization and realization statistics for the periods to be covered in the analysis.

  Dive down into their management reports, depending on what technology and software they have. Most law firms have sophisticated time and billing systems that can provide well-formatted, useful management reports. Ask if the systems can generate reports on collection and billing realization by practice area, by client group, by office.

- Details of all compensation plans and formulas used for professional staff and members of ownership, including any special deals or arrangements with specific individuals.

  Look at the compensation plan. Do they have a formulaic, written compensation plan? How long has it been around and how closely do they stick to it? Are there special arrangements? There are a lot of side deals that go on at law firms, for example, half the partners own the building and the other

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half don't, and they're taking stock in lieu of fees.

- Details of the firm's client fee arrangements, including details on contingency fee work and the use of success fees and hybrid fees.

- Minutes and supporting documentation for any business planning retreats and related meetings, including any strategic planning initiatives and their status.

- Fringe benefit programs: Detail of employee fringe benefit programs and allowances, including automobile, computer, cell phone, and travel costs, continuing education allowances, and business development allowances.

  What else are they paying for? Are they paying for the owner's kid's cell phone? Is the wife on the books and getting an IRA deduction when she doesn't do any work? Do they have a satellite office in Aspen that's really someone's condo?

- Details on any soft costs incurred by the firm related to owner activities outside the business—such as sports tickets and vacation homes.

- Details of prior ownership redemptions and related commitments for future stock redemptions for retirement, disability, death, and withdrawal for competitive and noncompetitive reasons.

- Copies of all buy-sell agreements, including current agreements and agreements in force during the last five years.

- Information on any pending or threatened lawsuits or malpractice claims.

- List of any affiliated entities and related party business relationships, including investments in outside activities.

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- Detail on any honorariums, teaching stipends, directorship compensation, or related subsidies received by the practice or individual lawyers.

- Details on all bartering transactions, including stock in lieu of fee arrangements and direct or indirect investments third-party entities.

- Counsel arrangements.

  Lawyers are big on hybrid arrangements for people that are moving from firm to firm, and they have special deals for those types of partners.

- All available departmental, branch office, and client grouping performance data.

- Accounts receivable and work in process schedules.

  Look at their aging of receivables. Hopefully they've got aging and work in process records that go out to at least 180 days as of valuation date so you can see how much stale stuff they've got on the books and see if you need to adjust some of it.

- Trust accounts.

  For example, an attorney settles a big case in December and leaves the check in the trust account until January. Check their January statements.

- Details on all contingent fee work in process as of the valuation date and the methods used to evaluate the potential success of cases.

- Copies of firm brochures and other promotional sales literature.

- Copies of deferred compensation plans and commitments.

- List of major clients and client groups, including the top five and top 20 clients in terms of annual revenues for each of the past two years.

  Look at Martindale-Hubbell (www.martindale.com), a directory of attorneys, for information on the firm and all members of the ownership.

Doing your homework by getting the documents you need will pay off in helping you produce a bullet-proof valuation.