PROFIT-FOCUSED ACCOUNTING

Metrics to Help Your Contingent-Fee Law Firm Flourish

by KRISTEN REINKING, CPA, CFP, CFO
and JOHN C. SCOTT CPA, AEP/CGMA, CFO

anders™ VIRTUAL CFO

Published by Anders Minkler Huber & Helm LLP

anderscpa.com

TABLE OF CONTENTS

Law firms are relatively straightforward when it comes to setting financial goals.

But when it comes to growth, a lot of firms go wrong: they say things like, “We’re going to increase revenue by 10% next year,” without a clear sense of what it would take to achieve that.

That’s where Profit-Focused Accounting comes in: a system we created – and have used with clients for over 20 years – designed to help firms accomplish their financial goals by breaking down revenue into financial and non-financial drivers: elements of the business that are controllable and set through SMART goals (specific, measurable, achievable, relevant, and timely).

Unlike hourly or fixed-fee firms, contingent-fee law firms must make financial decisions long before revenue is realized. Growth is not about maximizing billable time — it’s about managing uncertainty, duration, and risk across a portfolio of cases. The metrics in this booklet are designed specifically for that reality, helping contingent-fee firms fund growth, survive volatility, and improve long-term outcomes.

Without knowing your drivers, you might try different strategies to boost revenue, including hiring more professionals, increasing responsibilities, spending more on marketing, cutting overhead or changing your case mix. Those approaches might be helpful – but until you understand your drivers, there’s no way to tell if it’s the best way to go.

Once you know your drivers, instead of chasing an abstract revenue number, you work towards doing the things that add up to your goal: We call this pulling “levers.”

In the case of a contingent fee law firm, the primary driver will be your professionals (how many cases do they work versus how many can they handle [% capacity]), and the expected value of their cases over time.

Here’s what it might look like to take a profit-focused approach.

- You might find that your professionals aren’t working at capacity and therefore you need to invest in training or technology, so they can handle their matters more efficiently.
- But you also might find that they aren’t working at capacity because there aren’t enough matters: which means you might need to improve your marketing.
- You might find that your staff is at full capacity, and the only way to reach your goal, aside from introducing efficiencies into their workflows, is to hire new professionals. You would use your metrics to figure out the number and timing of the hires.
- You might also decide to cut overhead – for example, you could think about evaluating marketing efforts and focus only on those that are working. The important thing is that you not make decisions based on your gut but rather based on the metrics. Cutting overhead is a less frequent strategy than you might expect: But we do recommend it, if your spending is above industry standard.

There are multiple “levers” available to you, once you identify them. The nice thing about levers is that you can pull them partially or fully, increasing or decreasing certain levers depending on your strategy and how it’s turning out.

Each of our three metrics has a variety of levers associated with it. In each section, we will explain the metric and then identify potential levers, specifically designed with contingent-fee firms in mind.

METRICS FOR CONTINGENT-FEE LAW FIRMS

1 Cash

Every business needs to keep the lights on and their payroll humming, but contingent-fee firms also need to finance on-going case costs while waiting on adjudication. Knowing the right amount of cash to keep on hand is essential: too much can be almost as bad as too little! After all, you need to make partner distributions, invest in your practice and limit your liability.

The cash metric starts with an assessment of your firm's risk – and comfort level. That will allow you to set a target – a percentage of your annual revenue – and work to achieve it. This might mean smaller partner distributions for a period of time, but it's part of ensuring financial health. Then, once you're there, you'll want to check in with that number and adjust it from time to time.

2 Production

Is your firm busy enough? Too busy? Can you achieve your goals as things stand today? Your attorneys and paralegals are your producers, so one key component of production metrics is: How many professionals do you have on staff? Then we look at things like: How many matters can each of your professionals handle, how many matters are they actually handling, and what are those matters worth? We can expect significant differences in production metrics if you are looking at motor vehicle accidents versus medical malpractice cases, for example.

These numbers show you the upper limits on expected case outcomes, unless you make more hires or add efficiencies to your process.

3 Financial

We want your financials to be consistent and prepared on a modified accrual basis. Contingent firms don't have Work in Progress and Accounts Receivable like hourly billing firms, but they do have Accounts Payable and prepaid case costs. (Of course you pay taxes on the cash basis, but we need accrual to see where things are headed.)

Clean financials let you know how you're doing on your journey, which will help you decide which levers you need to pull to stay on track. With clean financials, you know where you stand – in terms of your own performance and compared to your peers. Your top line revenue could have more zeros in it than you can count, but what is your net profit? And how does it compare to your peers?

Below we will dive into how to track the right metrics for your firm and how you can use them to increase profits. To make our explanations clear, we will use two example firms that use contingent fee billing:

FIRM A
works on motor vehicle accidents. They do a higher volume of cases with a lower dollar value and a short lifespan (typically 12 months or less).

FIRM B
works on medical malpractice cases. They do a lower volume of cases with a higher dollar value and a longer lifespan (18 months or more).

These firms will allow us to cover both ends of the spectrum in terms of risk: Firm A will have the lowest level of risk while Firm B will have the highest. However, we recognize that most firms will have a mix of cases, and in each metric, we will refer to the necessary calculations to take case type into account.

Before we get into the details, we'd like to call out that graphics and tables are for example only. These should not be taken as industry averages.

FIRM A

Motor vehicle accidents
Higher volume, lower payout

Yearly expectation per attorney	80 cases
Actual cases per attorney	60 cases
Average case value	12k
Revenue per professional	$720k

FIRM B

Med mal cases
Lower volume, higher payout

Yearly expectation per attorney	8 cases
Actual cases per attorney	6 cases
Average case value	120k
Revenue per professional	$720k

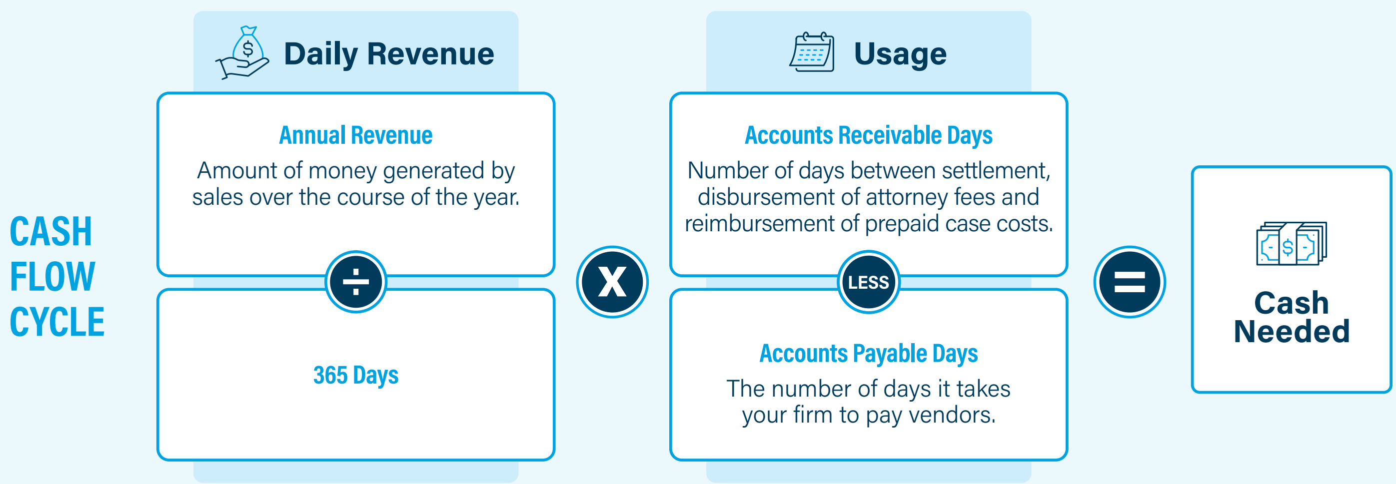
CASH

Cash is king. I'm sure you've heard that time and time again. That's why cash is a KPI category chock full of some of the most important metrics to be tracking.

Before we dive into the specific cash KPIs your firm should be tracking, let's cover some basic cash hygiene practices.

Every service-based business should have at least 10 to 30% of their annualized net revenue in a cash reserve at all times – and contingent-fee firms need to pay extra attention to this consideration, given the fact that smooth operations require a constant outflow of cash to pay for ongoing case costs, such as expert testimony and deposition fees.

10-30% is a range we give for easy math, but there is actually a formula to determine the exact amount of cash you should have in reserve. (See below.)



The size of your cash reserve depends on risk tolerance. Ten percent equates to basically two months of expenses, and 30% equates to six months. Below you can see an example of two firms with $3,497,232 in revenue and the cash they should have on hand depending on their risk.

Depending on other factors (some of which we outline below), Firm A would be a good candidate for being a 10% firm: With a high volume of cases whose average length is one month, they would expect a regular inflow of cash. They are also likely to have smaller outflows, when it comes to case costs.

But you can't just pick 10% as your target, without looking at other factors: for example, any firm in a high growth mode would want to increase their working capital to allow for additional expenses as they invest.

Other considerations:

- Do your partners have low personal liquidity?
- Do you have an unreliable referral network of client matters?
- Are you planning any big purchases / investments in the near future?
- Is your firm rapidly growing?

Any "yes" on this list would mean looking into an increase in working capital.

Firm B, on the other hand, would be a candidate for keeping 30% of revenue as working capital. Their cases are high value but slow to close, which means the cash flywheel will spin more slowly. There will also be higher outflows, as these high-value cases will likely require expenses like expert witnesses, travel costs and deposition costs.

However, as with Firm A, there could be reasons to keep lower amounts of working capital. If your answers to the above questions are "no," your risk profile is likely lower, which means you can consider having a smaller amount of working capital.

Once you have a cash target, you can work on building towards it: Essentially, instead of distributing all your profits to partners, you'll hold a percentage back until you reach the goal. You'll want to revisit the target regularly and adjust as necessary.

WHY WOULD YOU NEED 30%?

Working Capital Requirement

10%	30%
High recurring revenue	No recurring revenue
Consistent referral network	Inconsistent referral network
Younger partners	Retiring partners
Low growth	High growth
No big purchases in the near-term	Big purchases in near-term
Small partner group	Large partner group
Partners have high personal liquidity	Partners have low personal liquidity
Low dollar investment in pre-paid case cost	High dollar investment in pre-paid case cost

Cash on Hand

$3,497,232	$3,497,232
x 10%	x 30%
$349,723	**$1,049,169**

You will also want four separate bank accounts for your firm:

- an operating account
- a cash reserve account
- a client trust account
- and a tax reserve account.

Keep about two payrolls of cash in your operating account. The rest belongs in your cash reserve. Putting that money in a high interest savings account, money market, or CD will keep your money safe while allowing you to generate a bit more off of what is already in the bank. Your trust account should be kept separately to avoid any problems in case you are ever audited: Remember, this is not your money until it is earned.

Your tax reserve should include 40% of your expected net income. You will set this money aside every quarter to distribute to partners for their tax payments.

Whatever size cash reserve you decide on, secure a line of credit of the same amount. If you can get your line of credit to renew on a two-year cycle that will be helpful if an emergency or opportunity presents itself.

Now, we have reached one of the cash levers you can pull to improve profitability of your firm.

HOW MUCH CASH SHOULD I KEEP ON HAND?

Profit & Loss

Revenue	$3,497,232
Production	$1,632,000
Gross Profit	$1,865,232
Overhead	
Administrative	$629,502
Marketing	$122,403
Facility	$157,375
Net Income	$955,952
Owners Comp	$300,000
Adj. Net Income	$655,952

$262,380 divided by 4 equals $65,595

Tax Reserve

$655,952 x 40%

$262,380

CASH LEVERS

Contingent-fee firms have several opportunities to "pull" the cash lever, ensuring that their cash reserves are at healthy levels.

Closely monitor and track your prepaid case costs in your case management system to ensure reimbursement. Failure to account for case costs means a direct hit to your cash and your bottom line.

When financing cases with a line of credit, modify your engagement letter to charge interest back to the client (when in compliance with state ethics rules) rather than writing off the expense on your taxes.

Decelerate your accounts payable: Many vendors will let you negotiate payment terms, allowing you to keep money in your account longer if needed.

PRODUCTION

There are two main reasons to track your production metrics: to determine the efficiency of your firm and anticipate revenue. Unless you like pie in the sky, there's no point in forecasting a number if you don't know if it's reachable without major changes (hiring, new processes, moving upstream on matter types, etc.).

The revenue number will tie directly into your forecast, so you will want to understand how many matters each professional has the **capacity to handle** versus how many they **are handling**.

If you are not satisfied with how many cases are being handled, the first question is, Why? Do you need more cases? Or do you need to improve processes to increase client capacity? This may require an investment of time before you see results, so don't expect that pulling this lever will immediately yield profit.

CAPACITY RATE

Let's begin calculating one of my favorite production key performance indicators: capacity rate.

In an hourly billing firm, we would base this calculation on the number of weekly billable hours compared to the total available hours per week, but in the case of the contingent-fee firm, we look at capacity as a function of the **number of client matters** divided by the **expected capacity for client matters**. So if an attorney has capacity for 40 matters at any one time, but they are only working on 30, they would be at 75% capacity.

CAPACITY = 75%

Actual number of client matters	**30**
Expected number of client matters	**40**

In a contingent-fee firm, capacity is not about keeping professionals constantly busy. Lower capacity may indicate intake challenges — but it may also reflect strategic case selection, long-tail litigation, or intentional pacing. The goal is not maximum capacity, but balanced throughput over time.

If you start your calculation by estimating monthly expectation and then multiplying by 12 to get yearly expectation, don't forget that there will be seasonal factors that impact how many client matters a professional can handle—holidays, PTO, court closings, etc. Keep these limitations in mind when setting a realistic target.

The lower the capacity rate, the more room your firm has to grow without additional hires. When you see a low capacity rate, you want to ask yourself the following questions:

Is there work available?

- If not, do we need to increase our marketing?
- If yes (and assuming our expectations are reasonable), do we need to provide training, improve processes or adopt new technology?

Note: Different roles may have different capacity expectations, depending on other responsibilities, so don't get caught off guard if this fluctuates across your departments and roles.

PROJECTING FIRM REVENUE

How much revenue can your firm reasonably expect to realize over time? As a service-based industry, your firm revenue is simply the sum total of each professional.

Annual revenue per professional is a straightforward calculation:

Multiply the **expected value per matter** by a professional's **expected number of matters**. That's the maximum revenue they could earn—if they were working at top capacity. Then, multiply that number times their **capacity rate**, and you'll know how much revenue they can be expected to earn this year.

There should be a ratio between revenue generated and compensation of 2.5:1 to 4:1. (We will discuss this further later).

Once you know individual revenue per producer, add it all up to calculate projected **firm revenue**. We recommend grouping the calculation by team and case type, because—as we discuss below—that information will allow you to determine if there are inefficiencies to address.

PRODUCTION METRICS LEVERS TO PULL

The production metric is all about determining if you have enough professionals to meet your goals. If all your professionals are at 100% capacity for a sustained period, then there are only three ways to grow:

- Increase the average case value
- Increase the yearly case expectation
- Hire more professionals

Hiring more professionals is expensive and time-consuming. Before you commit to new hires, you need to make sure you have a steady pipeline of cases to cover the cost so it's important to evaluate your production metrics to see if it's really necessary.

In most cases, a firm isn't working at 100% capacity. That means there are inefficiencies that need to be uncovered. Production metrics will give you that insight as well: Is one team underperforming? Is a certain type of case a drain on resources?

Divide cases by type and analyze every step in the life cycle from intake to adjudication. Is there a bottleneck in your firm's workflow? By increasing efficiencies—which often starts by recording and optimizing processes—everything can flow more smoothly, allowing you to increase capacity without additional hires.

Maybe professionals are spending too much time on admin, and it would be more cost-effective to hire office staff or consider AI and automation options to handle non-legal matters, even though it adds to overhead. There are many ways to improve inefficiencies. For example, delegating certain tasks to non-legal staff — but you have to be willing to do some investigating to diagnose problems. It all starts with tracking the metrics.

You may also discover that—despite your best efforts—certain types of cases are more efficient than others. This kind of information can be leveraged when deciding how to grow and scale. If your firm naturally excels at a certain type of case, it makes the decision to invest your growth efforts accordingly. The last thing you want to do is to multiply inefficiencies.

FINANCIAL

Before we wrap up, we are going to discuss the hidden levers you may have in your financial statements.

REAL-TIME FORECASTING

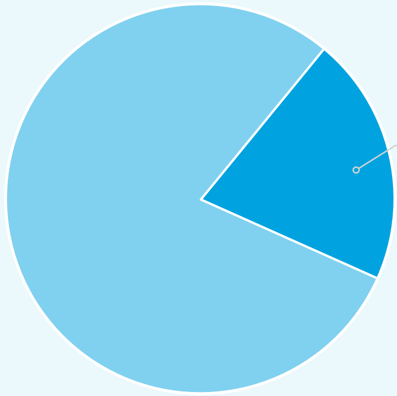
To understand the levers you can pull through cash flow forecasting, we first need to decide on your net income goals.

As a professional service firm, you will want to aim for a net income of no less than 10%, with an even better goal of 40%. Smaller firms might achieve higher percentages (up to 50%) due to lower overhead, while larger firms might have lower net income percentages, but the total dollar amount can be significantly higher, providing more resources for growth and variable staff compensation.

Next, we need to categorize expenses, breaking them down into four categories: production, administrative, marketing, and facilities.

One lever you have available is optimizing these costs. Are you spending too much money on certain marketing strategies that aren't proving successful? Are you hiring too many attorneys and paralegals when there isn't enough work? Once we have these expenses categorized, we can compare our expenses with industry benchmarks.

WHAT SHOULD YOUR INCOME BE?



10-25%

Net income as a % of Revenue

Next, we analyze production costs. This includes producer attorney and paralegal salaries and employee burdens like benefits, insurance, and taxes. Employee burden typically adds 25-30% to an employee's base salary.

Gross profit margin is a key long-term business metric and should range between 45-65% over time. Calculate gross profit margin by subtracting production costs from revenue, aiming to maintain or improve this margin for financial health.

Managing your net income is one lever you have at your disposal. For example, if you aim for a 25% net income on $10 million revenue, you can spend $7.5 million on costs. You can allocate spend across various departments, but spending heavily in one area (e.g., marketing) means you must compensate somewhere else (e.g., production).

NET INCOME

One sign of your firm's health comes down to net income. But what is a good range? Compared to other industries, law firms have a very broad range – somewhere between 10-40% of revenue. That's because law firms can look extremely different in terms of how they are managed and what they specialize in. Smaller firms tend to be leaner and could find themselves on the higher end of the spectrum, while larger or growing firms might see themselves on the lower end. It all depends on what kind of firm you have – and what kind of firm you want.

You're probably asking, "How do I calculate that net income percentage?" It's pretty simple. First, we calculate your **annual production.**

Annual Production

Average salary

X

Burden rate

X

Number of firm employees
(attorneys and paralegals)

FINANCIAL METRICS
ACCRUAL BASED ON PROFIT & LOSS

Revenue	$3,497,232
Production	– $1,632,000
Gross Profit	$1,865,232
Overhead	
Administrative	– $629,502
Marketing	– $122,403
Facility	– $157,375
Net Income	$955,952
Owner Comp	– $300,000
Adj Net Income	**$655,952**

Production Expense

Average Salary	$75,000
Burden Rate	x 1.28
Team Member	$96,000
# of Prod. Team Members	x 17
Annual Production	**$1,632,000**

Now, if you don't know your **burden rate**, take the average professional staff burden (add up all expenses beyond actual salary) divided by average salary. (In our example, we use a 28% burden rate.) We strongly suggest you go through this exercise to calculate your own firm's burden rate.

Once you have your annual production number, subtract annual production from revenue to get your **gross profit**.

After calculating gross profit, you will calculate overhead costs (administrative, marketing, and facility). Now, subtract overhead from your gross profit to get your **partner net income**.

Then, divide partner net income by revenue to get your **net income percentage**—which you can use as a benchmark against other firms (remember that 15-40% number above).

Determining Burden Rate

Average employee burden

÷

Average salary

A contingent-fee law firm has a lot of variables to keep track of. But with careful use of your case management system along with a strategic set of KPIs that offer levers to pull, it's possible to set — and meet — your financial goals.

ABOUT THE AUTHORS

Kristen Reinking
CPA, CFO

A Virtual CFO and CPA with nearly three decades of experience, Kristen enjoys working with each law firm's unique needs to create a solid financial foundation and provide the security they need to grow their firm and achieve strategic goals.

John C. Scott
CPA, AEP/CGMA, CFO

Leading the firm's legal industry efforts for the Virtual CFO team, John offers dedicated resources, financial insight and critical thinking to address complex issues facing law firms. John has extensive experience in helping clients be more efficient, competitive and profitable.

To learn more about how we can find the right KPIs and improve these metrics for your firm, sign up for a free virtual CFO consultation.

anders™
VIRTUAL CFO