

Budgeting for Profitable Results, Capital Retention and Bank Loan Compliance

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Agenda

- Reasons for preparing a budget
- Budgeting process
- Obtain “buy in”
- Monitor
- Loan covenant compliance
- Capital retention
- Questions and answers

Budgeting – the basic steps

1. Draft it
2. Analyze it
3. Edit it
4. Adopt it
5. Monitor it
6. Expand it

Start budget planning now to improve profitability

Budgeting – Questions to Answer

- How much money will the Firm make next year?
- How much cash will the Firm need in order to grow?
- How many FTE's will be needed to do the work?
- How much will you pay them?
- Where will the work come from?
- How do our bookings match up with our labor force?

Reasons for Budgeting

- Targets - Set Goals (expectations) for Revenue (Hours, Avg. Billing Rate, Realization, Billings, Cash Collections) and Expenses.
- Capacity - Determine people and space required
- Earnings - Set pre-discretionary profit goals
- Cash - Will the firm have enough cash?
- Bank - Meeting loan covenants
- Strategic - Retaining capital

Budgeting

- Revenues
 - Existing based on backlog
 - Increase in billing rates
 - Target new work needed
- Expenses
 - People and related costs
 - Other overhead costs
- Cash and cash flow
- Balance sheet

Budgeting Revenues

- Budget revenues according to three measures:
 - People: Hours X Rate X Realization %
(staffing capacity)
 - Clients: Which clients are growing, which are declining and by how much?
Backlog and bookings review to start
 - New Business: Origination targets – How much new business will we generate this year?
- Distinguish between cash basis and accrual basis revenues
- If firm is growing this is even more important as there will be a greater difference between billings and collections.

Budgeting Revenue – People

		NAME OF FIRM PROJECTED ANNUAL BILLINGS AND SALARY ANALYSIS For the year ending December 31, 2008						
TITLE	NAME	DRAWS / SALARY	BILLING RATE	BUDGETED BILLABLE HOURS	100% ESTIMATED BILLINGS	BILLINGS REALIZATION	NET REALIZED BILLINGS	ANNUAL BILLINGS/SALARY COVERAGE RATIO
PARTNERS								
	#1	\$500,000	\$450	1,800	\$810,000	95%	\$769,500	1.539
	#2	\$440,000	\$400	1,800	\$720,000	95%	\$684,000	1.555
	#3	\$350,000	\$350	1,800	\$630,000	95%	\$598,500	1.710
	#4	\$250,000	\$300	1,800	\$540,000	95%	\$513,000	2.052
		\$1,540,000		7,200	\$2,700,000		\$2,565,000	1.666
ASSOCIATES								
	#1	\$145,000	\$230	2,000	\$460,000	95%	\$437,000	3.014
	#2	\$130,000	\$210	2,000	\$420,000	95%	\$399,000	3.069
	#3	\$120,000	\$200	2,000	\$400,000	95%	\$380,000	3.167
	#4	\$115,000	\$200	2,000	\$400,000	95%	\$380,000	3.304
	#5	\$110,000	\$185	2,000	\$370,000	95%	\$351,500	3.195
	#6	\$110,000	\$185	2,000	\$370,000	95%	\$351,500	3.195
	#7	\$90,000	\$170	2,000	\$340,000	95%	\$323,000	3.589
	#8	\$80,000	\$160	2,000	\$320,000	95%	\$304,000	3.800
	#9	\$80,000	\$160	2,000	\$320,000	95%	\$304,000	3.800
		\$980,000		18,000	\$3,400,000		\$3,230,000	3.296
GRAND TOTALS		\$2,520,000		25,200	\$6,100,000		\$5,795,000	2.300

Hours

- What is prior history – last year’s performance?
 - Do you know your available capacity?
 - Does it match up with your backlog?
 - What is the average NSR per employee?
- What are expectations?
- What is required “ramp up” for new people?
- What is culture?

Rates and Realization

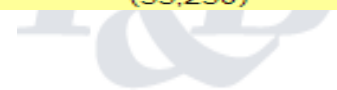
- Billing Rates
 - Don't budget for an increase in billing rates unless you are sure that you can increase them;
- Realization is defined as a %
 - The numerator is the value of hours billed
 - The denominator is the value of hours worked
- It should be the firm's goal to bill at least 95% of all work every month (depending on type of billings arrangements)

Revenues, Compensation and Profits

- What a person can generate in revenue will determine what you can pay that person.
- If you pay someone more than they generate in revenues, you will lose money.
- If you pay someone the revenue they generate less overhead costs, you will break even (not from a time and energy expended point of view)
- Track the multiples of what you pay them and budget a model that makes the firm profitable.

Budgeting Revenue – Clients and New Business

CASE STUDY, LLP SALES ANALYSIS BY CLIENT								
PARTNER #1	INDUSTRY	REFERRAL SOURCE	2004 ACTUAL	2005 ACTUAL	2006 ACTUAL	2007 YTD & Proj	2008 BUDGET	
EXISTING CLIENTS								
CLIENT #1		AAA	\$ 96,000	\$ 125,000	\$ 150,000	\$ 130,000	\$ 140,000	
CLIENT #2		AAA	34,000	1,000	-	-	-	
CLIENT #3		AAA	43,000	91,000	120,000	130,000	120,000	
CLIENT #4		BBB	36,000	76,000	115,000	110,000	120,000	
CLIENT #5		BBB	86,000	83,000	90,000	102,000	110,000	
CLIENT #6		AAA	63,000	2,000	3,000	5,000	-	
CLIENT #7		AAA	37,000	37,000	56,000	56,000	56,000	
CLIENT #8		DDD	10,000	13,000	18,000	18,000	30,000	
CLIENT #9		DDD	9,000	20,000	40,000	50,000	55,000	
CLIENT #10		DDD	8,000	18,000	32,000	35,000	35,000	
CLIENT #11		CCC		10,000	14,000	16,000	15,000	
CLIENT #12		BBB		70,000	130,000	150,000	140,000	
CLIENT #13		BBB		11,000	14,000	4,000	-	
CLIENT #14		BBB		13,000	16,000	5,000	5,000	
CLIENT #15		DDD			5,000	30,000	35,000	
CLIENT #16		DDD			4,000	5,000	5,000	
CLIENT #17		EEE			24,000	35,000	40,000	
CLIENT #18		DDD				23,000	35,000	
CLIENT #19		DDD				10,000	15,000	
CLIENT #20		DDD				5,000	5,000	
			\$ 422,000	\$ 570,000	\$ 831,000	\$ 919,000	\$ 961,000	a
GROWTH %				35%	46%	11%	5%	
NUMBER OF CLIENTS			10	14	17	20	20	
2004 AND BEFORE CLIENTS			422,000	466,000	624,000	636,000	666,000	
2005 CLIENTS				104,000	174,000	175,000	160,000	
2006 CLIENTS					33,000	70,000	80,000	
PROJECTED 2007 CLIENTS						38,000	55,000	
PROJECTED NEW BUSINESS				PROJECTED FEES	CHANCE OF CLOSING			
NEW CLIENT - A				35,000	80%		28,000	
NEW CLIENT - B				25,000	90%		22,500	
NEW CLIENT - C				30,000	50%		15,000	
NEW CLIENT - D				15,000	95%		14,250	
NEW CLIENT - E				40,000	75%		30,000	
NEW CLIENT - F				32,000	75%		24,000	
TOTAL NEW BUSINESS							\$ 133,750	b
TOTAL 2008 PROJECTION							\$1,094,750	a + b
TARGET							1,150,000	
EXCESS / (SHORTFALL)							(55,250)	



Budgeting Revenue

- Realistic revenue targets should be set and the firm should strive to achieve these goals
- What If? scenarios
 - Version at prior year trend
 - Version at standard for all
 - Version at standard for those who were below last year and actual at those above
- Don't just divide annual projections by 12 – consider seasonality
- However the firm must also have a realistic revenue budget.
- Monitor budget against actual - not only monthly, but also month to date

Budgeting Revenues

- Budget and track performance
- Determine if there is possibility of negative trends
 - Excess Capacity – too many people
 - Cash flow problems
 - Missed Loan Covenants
 - A Elm decrease or decrease in NSR/EE
- Then you can plan to offset those trends and get on right path
- The Firm's CFO should maintain some realism/skepticism so that the budget is realistic
 - Need to poke holes in revenue projections to see if they are realistic

Budgeting Expenses

- Budgeting expenses:
 - Current expense levels + % increase
 - Seasonality
 - New people
 - Additional space
- Compensation costs
 - Technical Staff Salaries – tie to Revenue
 - Administrative Staff
 - Payroll Taxes and Employee Benefits
- Rent
 - Space required for People?
- Marketing costs –
 - Any additional marketing required to grow business?

Budget – Revenue and Expenses

CASE STUDY, LLP ANNUAL BUDGET - 2 Years CASH BASIS															
	Year 1														
	Budget														
	Amount		Month #1	Month #2	Month #3	Month #4	Month #5	Month #6	Month #7	Month #8	Month #9	Month #10	Month #11	Month #12	TOTAL
INCOME STATEMENT															
REVENUES:															
% of standard															
Gross fees receivable (see Revenue Projections sheet)	\$4,015,750	100.00%	\$ 214,433	\$ 272,915	\$ 311,903	\$ 331,397	\$ 409,373	\$ 389,879	\$ 448,360	\$ 389,879	\$ 331,397	\$ 311,903	\$ 311,903	\$ 292,409	\$4,015,750
Less bad debts 0.4% of Revenue	(15,750)	-0.39%	(841)	(1,070)	(1,223)	(1,300)	(1,606)	(1,529)	(1,758)	(1,529)	(1,300)	(1,223)	(1,223)	(1,147)	(15,750)
Total Revenues	\$4,000,000		\$213,592	\$271,845	\$310,680	\$330,097	\$407,767	\$388,350	\$446,602	\$388,350	\$330,097	\$310,680	\$310,680	\$291,262	\$4,000,000
EXPENSES:															
Compensation:															
Associates	795,000	19.80%	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	794,988
Paralegals	40,000	1.00%	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,337	40,000
Contract Partners	0	0.00%	0	0	0	0	0	0	0	0	0	0	0	0	0
Support	280,000	6.97%	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,337	280,000
Employee benefits and payroll taxes	372,600	9.28%	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	372,600
Total compensation	1,487,600	37.04%	123,965	123,965	123,965	123,965	123,965	123,965	123,965	123,965	123,965	123,965	123,965	123,973	1,487,588
Occupancy	630,000	15.69%	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	630,000
Equipment expenses	110,000	2.74%	9,167	9,167	9,167	9,167	9,167	9,167	9,167	9,167	9,167	9,167	9,167	9,167	110,000
Reference materials	35,000	0.87%	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	35,000
Professional liability	45,000	1.12%	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	45,000
Professional and promotion	170,000	4.23%	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	170,000
Office expenses	135,000	3.36%	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	135,000
Other operating	45,000	1.12%	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	45,000
Total other expenses	1,170,000	29.14%	97,500	97,500	97,500	97,500	97,500	97,500	97,500	97,500	97,500	97,500	97,500	97,500	1,170,000
TOTAL EXPENSES	2,657,600	66.18%	221,465	221,465	221,465	221,465	221,465	221,465	221,465	221,465	221,465	221,465	221,465	221,473	2,657,588
INCOME BEFORE OTHER REVENUE AND EXPENSES	1,342,400	33.43%	(7,873)	50,380	89,215	108,632	186,302	166,885	225,137	166,885	108,632	89,215	89,215	69,789	1,342,412
OTHER REVENUES AND EXPENSES:															
Other revenue and expenses (including interest)	(22,400)	-0.56%	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,879)	(22,412)
INCOME BEFORE PARTNERS' DRAWS (TAXABLE)	\$1,320,000	32.87%	(\$9,739)	\$48,513	\$87,348	\$106,765	\$184,435	\$165,018	\$223,270	\$165,018	\$106,765	\$87,348	\$87,348	\$67,910	\$1,320,000
PARTNERS' DRAWS	(825,000)	-20.54%	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(206,250)	(825,000)
INCOME OR (LOSS) LESS PARTNERS' DRAWS	495,000	12.33%	(65,989)	(7,737)	31,098	50,515	128,185	108,768	167,020	108,768	50,515	31,098	31,098	(138,340)	495,000
CUMULATIVE INCOME (LOSS) LESS PARTNERS' DRAWS			(\$65,989)	(\$73,726)	(\$42,628)	\$7,887	\$136,072	\$244,340	\$411,861	\$520,628	\$571,144	\$602,242	\$633,340	\$495,000	

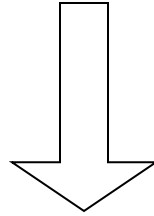
Budget – Revenue and Expenses

- Start with zero based budgeting
- Add in column for Prior Year Actual
- Add in column for “Change from prior year” in terms of dollars and % increases / decreases.
- Helps to make sense of budget

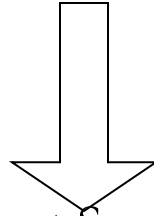
Budgeting Cash flow

- Revenues - Cash Collections

Budget Time Value (look at Hours x Rates)



Budget Billings (look at Realization, Seasonality)



Budget Collections (look at Seasonality, Av A/R & WIP Days)

Budgeting Cash flow

- Expenses - Cash Payments
 - No Depreciation and Amortization
 - Capital Expenditures
 - Profit sharing payments
 - Annual shareholder c-stock Bonus

Cash flow Budget

CASE STUDY, LLP														
ANNUAL BUDGET - 2 Years														
CASH BASIS														
	Month #1	Month #2	Month #3	Month #4	Month #5	Month #6	Month #7	Month #8	Month #9	Month #10	Month #11	Month #12	TOTAL	
CASHFLOW FORECAST														
RECEIPTS														
Gross fees without client costs	213,392	271,845	310,680	330,097	407,767	388,350	446,602	388,350	330,097	310,680	310,680	291,262	4,000,000	
Client Costs Reimbursed	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	240,000	
	233,392	291,845	330,680	350,097	427,767	408,350	466,602	408,350	350,097	330,680	330,680	311,262	4,240,000	
PAYMENTS														
Compensation:														
Associates	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	794,988	
Paralegals	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	40,000	
Contract Partners	0	0	0	0	0	0	0	0	0	0	0	0	0	
Support	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	280,000	
Employee benefits	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	372,600	
Expenses:														
Occupancy	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	630,000	
Equipment expenses	6,167	6,167	6,167	6,167	6,167	6,167	6,167	6,167	6,167	6,167	6,167	6,167	74,000	
Reference materials	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	35,000	
Professional liability	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	45,000	
Professional and promotion	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	170,000	
Office expenses	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	135,000	
Other operating	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	45,000	
Other expenses	0	0	0	0	0	0	0	0	0	0	0	0	0	
Profit-sharing	0	0	0	0	45,000	0	0	0	0	0	0	0	45,000	
Partners' Draws:														
Regular	55,417	55,417	55,417	55,417	55,417	55,417	55,417	55,417	55,417	55,417	55,417	205,417	815,000	
Additional - Prior Year	0	0	55,000	0	0	0	0	0	0	0	0	0	55,000	
Disability/Life Insurance	833	833	833	833	833	833	833	833	833	833	833	833	10,000	
Client Costs	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	180,000	
Capital Expenditure	0	0	0	0	0	0	0	0	0	0	0	0	0	
Finance Lease Repayments	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	48,000	
	293,715	293,715	348,715	293,715	338,715	293,715	293,715	293,715	293,715	293,715	293,715	443,723	3,774,588	
RECEIPTS LESS PAYMENTS	(60,123)	(1,870)	(18,035)	56,382	89,052	114,635	172,887	114,635	56,382	36,965	36,965	(132,461)	465,412	
OPENING CASH BALANCE	(200,000)	(260,123)	(261,993)	(280,028)	(223,646)	(134,594)	(19,960)	152,927	267,562	323,944	360,908	397,873	(200,000)	
CLOSING CASH BALANCE	(260,123)	(261,993)	(280,028)	(223,646)	(134,594)	(19,960)	152,927	267,562	323,944	360,908	397,873	265,412	265,412	

Seasonality

- Why?
 - Cash “crunch” months
 - Debt covenant compliance
- Revenue:
 - Known trends – Clients that pay slow
 - Growth and “ramp-up”
 - Historic seasonality
- Expenses:
 - Growth – i.e. New Space, New People
 - Capital expenditure requirements

Budgeting Balance Sheet – Cash Basis

- Cash
- Accounts receivable
- WIP
- Fixed assets
- Line of credit
- Project reserves
- Debt
- Accrued profit-sharing
- Equity

Budgeting Balance Sheet

CASE STUDY, LLP															
ANNUAL BUDGET - 2 Years															
CASH BASIS															
Year 1															
Budget															
←-----															
Amount	%	Month #1	Month #2	Month #3	Month #4	Month #5	Month #6	Month #7	Month #8	Month #9	Month #10	Month #11	Month #12		
<u>BALANCE SHEET</u>															
Cash and Equivalents		(260,123)	(261,993)	(280,028)	(223,646)	(134,594)	(19,960)	152,927	267,562	323,944	360,908	397,873	265,412		
Client Disbursements Receivable		372,134	365,267	413,400	351,533	344,667	337,800	355,933	349,067	342,200	360,333	353,467	431,588		
Prepaid Rent		150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000		
Notes receivable, partners and employees		0	0	0	0	0	0	0	0	0	0	0	0		
TOTAL CURRENT ASSETS		262,011	253,274	283,372	277,887	360,072	467,840	658,861	766,628	816,144	871,242	901,340	847,000		
Net Fixed Assets		116,000	113,000	110,000	107,000	104,000	101,000	98,000	95,000	92,000	89,000	86,000	83,000		
Other Assets		1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000		
TOTAL ASSETS		379,011	367,274	394,372	385,887	465,072	569,840	757,861	862,628	909,144	961,242	988,340	931,000		
Finance Capital Expenditure Leases: due within one year		44,000	44,000	44,000	44,000	44,000	44,000	44,000	44,000	44,000	44,000	44,000	44,000		
Retirement plan contribution Payable		45,000	45,000	45,000	45,000	0	0	0	0	0	0	0	60,000		
Accrued Expenses and Other Current Liabilities		0	0	0	0	0	0	0	0	0	0	0	0		
TOTAL CURRENT LIABILITIES		89,000	89,000	89,000	89,000	44,000	44,000	44,000	44,000	44,000	44,000	44,000	104,000		
Finance Capital Expenditure Leases: due beyond one year		56,000	52,000	48,000	44,000	40,000	36,000	32,000	28,000	24,000	20,000	16,000	12,000		
Required partners' capital		220,000	220,000	220,000	245,000	245,000	245,000	270,000	270,000	270,000	295,000	295,000	320,000		
Prior Year Undistributed Earnings		80,000	80,000	80,000	0	0	0	0	0	0	0	0	0		
Distributable profits and capital		(65,989)	(73,726)	(42,628)	7,887	136,072	244,840	411,861	520,628	571,144	602,242	633,340	495,000		
TOTAL LIABILITIES AND NET WORTH		379,011	367,274	394,372	385,887	465,072	569,840	757,861	862,628	909,144	961,242	988,340	931,000		

Budgeting – The Next Steps

- Develop a budget
- Analyze and then edit the budget
- Obtain “buy-In” to budget
- Monitor the budget
- Revise the budget quarterly / semi-annually

Budgeting – The Next Step

- Obtain “Buy-In” to Budget
 - Directors and partner heads agree with revenue growth targets
 - PIC’s to meet billing and collection targets
 - Engineers to meet hours, project and realization targets
 - Tie in new business development to the marketing plan
 - The more strongly the budget is approved and accepted, the more likely it is to be achieved
 - Align to business objectives, capital retention and tax planning needs
- Monitor
 - Budget to actual on a monthly basis
 - Compare actual figures, line by line against budget
 - Cash collections (see Cash Budget)
 - Variance analysis & explanations on a monthly basis

Monitor and focus on variances

- If expenses are exceeding the budget, consider cutting back on costs
- If revenue is below target, focus on why-who is not hitting their goals
- Monitor employees by periodically comparing their performance to the budget
- Meet with underperformers to review how to increase performance
- Keep super-performers on track.

Cash Budget

CASH - BUDGET TO ACTUAL FOR October 2007

As of: 10/20/07

STAFF	COLLECTION FOR <i>Oct-07</i>	% OF MONTHLY GOAL	* GOAL MONTH TO DATE/+	VARIANCE MONTH TO DATE (under) over	GOAL	MONTHLY TOTAL VARIANCE (under) over
Partner 1	\$ 23,000	104.5%	\$ 14,000	\$ 9,000	\$ 22,000	\$ 1,000
Partner 2	49,000	61.3%	50,909	(1,909)	80,000	(31,000)
Partner 3	10,000	25.0%	25,455	(15,455)	40,000	(30,000)
Partner 4	30,000	50.0%	38,182	(8,182)	60,000	(30,000)
Partner 5	28,000	46.7%	38,182	(10,182)	60,000	(32,000)
Partner 6	32,000	53.3%	38,182	(6,182)	60,000	(28,000)
Partner 7	35,000	58.3%	38,182	(3,182)	60,000	(25,000)
Partner 8	36,000	72.0%	31,818	4,182	50,000	(14,000)
Partner 9	41,000	82.0%	31,818	9,182	50,000	(9,000)
Total	\$ 284,000	58.9%	\$ 306,727	\$ (22,727)	\$ 482,000	\$ (198,000)

		14 Days to date
Last year's total	\$ 250,000	22 Banking days total
% change	13.6%	64%

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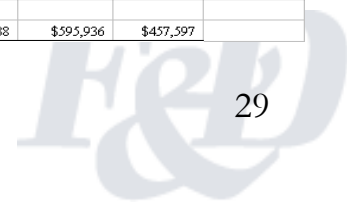


Budgeting

February Budget	February Actual	Variance		YTD Feb Budget	YTD Feb Actual	Variance
\$333,333	\$320,000	(\$13,333)	REVENUES:	\$666,667		
			EXPENSES:			
			Compensation:			
2,500	2,550	50	Associates	5,000		
1,250	1,250	0	Para-legals	2,500		
2,500	2,450	(50)	Law clerk	5,000		
4,583	4,583	(0)	Administrative	9,167		
50	50	0	Payroll taxes	100		
5,833	5,900	67	Employee benefits	11,667		
16,717	16,783	66	Total compensation	21,767		
7,500	7,400	(100)	Occupancy	15,000		
458	600	142	Office equipment	917		
125	350	225	Reference materials	250		
5,417	5,500	83	Professional liability	10,833		
5,000	2,200	(2,800)	Promotion & marketing	10,000		
1,000	750	(250)	Professional expenses	2,000		
3,750	4,500	750	Office operations	7,500		
2,083	2,100	17	Outside services	4,167		
42	100	58	Other costs	83		
25,375	23,500	(1,875)	TOTAL EXPENSES	50,750		
291,242	279,717	(11,525)	INCOME BEFORE OTHER REVENUE AND EXPENSES	594,150		
1,700	1,650	(50)	OTHER REVENUES AND EXPENSES:			
			Other revenues	3,400		
\$292,942	\$281,367	(\$11,575)	NET INCOME BEFORE SHAREHOLDERS' COMPENSATION	\$597,550		
17,000	17,000	17,000	SHAREHOLDERS' COMPENSATION	3,400		
275,942	264,367	(28,575)	NET INCOME OR (LOSS)	594,150		
\$292,942	\$281,367	(\$11,575)	CUMULATIVE NET INCOME (LOSS)	\$597,550		

Budgeting – Update for Actuals

CASE STUDY, LLP ANNUAL BUDGET - CASH BASIS		Year 1 Budget Amount		Month #1	Month #2	Month #3	Month #4	Month #5	Month #6	Month #7	Month #8	Month #9	Month #10	Month #11	Month #12	TOTAL	
				Actual	Actual	Budget	Budget	Budget	Budget	Budget	Budget	Budget	Budget	Budget	Budget	Budget	
INCOME STATEMENT																	
REVENUES:																	
% of standard																	
Gross fees receivable (see Revenue Projections sheet)		\$4,015,750	100.00%	\$ 225,000	\$ 211,000	\$ 311,903	\$ 331,397	\$ 409,373	\$ 389,879	\$ 448,360	\$ 389,879	\$ 331,397	\$ 311,903	\$ 311,903	\$ 292,409	\$3,964,402	
Less bad debts	0.4% of Revenue	(15,750)	-0.39%	-	-	(1,223)	(1,300)	(1,606)	(1,529)	(1,753)	(1,529)	(1,300)	(1,223)	(1,223)	(1,147)	(13,838)	
Total Revenues		\$4,000,000		\$225,000	\$211,000	\$310,680	\$330,097	\$407,767	\$388,350	\$446,602	\$388,350	\$330,097	\$310,680	\$310,680	\$291,262	\$3,950,563	
EXPENSES:																	
Compensation:																	
Associates		795,000	19.80%	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	66,249	794,988
Paralegals		40,000	1.00%	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	3,333	40,000
Contract Partners		0	0.00%	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Support		280,000	6.97%	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	23,333	280,000
Employee benefits and payroll taxes		372,600	9.28%	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	31,050	372,600
Total compensation		1,487,600	37.04%	123,965	123,965	123,965	123,965	123,965	123,965	123,965	123,965	123,965	123,965	123,965	123,973	1,487,588	
Occupancy		630,000	15.69%	45,000	46,000	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	52,500	616,000
Equipment expenses		110,000	2.74%	9,000	8,000	9,167	9,167	9,167	9,167	9,167	9,167	9,167	9,167	9,167	9,167	9,167	108,667
Reference materials		35,000	0.87%	3,000	3,000	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	2,917	35,167
Professional liability		45,000	1.12%	3,700	3,700	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	44,900
Professional and promotion		170,000	4.23%	16,000	12,000	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	14,167	169,667
Office expenses		135,000	3.36%	12,000	13,000	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	11,250	137,500
Other operating		45,000	1.12%	3,800	4,000	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	3,750	45,300
Total other expenses		1,170,000	29.14%	92,500	89,700	97,500	97,500	97,500	97,500	97,500	97,500	97,500	97,500	97,500	97,500	97,500	1,157,200
TOTAL EXPENSES		2,657,600	66.18%	216,465	213,665	221,465	221,465	221,465	221,465	221,465	221,465	221,465	221,465	221,465	221,473	2,644,788	
INCOME BEFORE OTHER REVENUE AND EXPENSES		1,342,400	33.43%	8,535	(2,665)	89,215	108,632	186,302	166,885	225,137	166,885	108,632	89,215	89,215	69,789	1,305,775	
OTHER REVENUES AND EXPENSES:																	
Other revenue and expenses (including interest)		(22,400)	-0.56%	(2,000)	(2,500)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,867)	(1,879)	(23,179)	
INCOME BEFORE PARTNERS' DRAWS (TAXABLE)		\$1,320,000	32.87%	\$6,535	(\$5,165)	\$87,348	\$106,765	\$184,435	\$165,018	\$223,270	\$165,018	\$106,765	\$87,348	\$87,348	\$67,910	\$1,282,597	
PARTNERS' DRAWS		(825,000)	-20.54%	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(206,250)	(825,000)	
INCOME OR (LOSS) LESS PARTNERS' DRAWS		495,000	12.33%	(49,715)	(61,415)	31,098	50,515	128,185	108,768	167,020	108,768	50,515	31,098	31,098	(138,340)	457,597	
CUMULATIVE INCOME (LOSS) LESS PARTNERS' DRAWS				(\$49,715)	(\$111,130)	(\$80,032)	(\$29,517)	\$98,669	\$207,437	\$374,457	\$483,225	\$533,740	\$564,838	\$595,936	\$457,597		



Budgeting – The Next Step

- Revise the budget
 - Update for year to date actuals
 - Recast budget quarterly
 - Early-warning for cash-flow or profitability problems

Loan Covenant Compliance

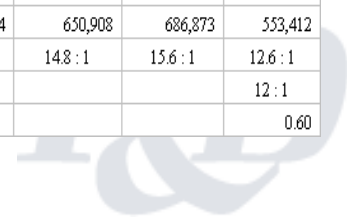
- Example Covenants-
 - EBITDA
 - Operating Cash Flows (OCF)
 - Debt Service Coverage ($\text{OCF} + \text{Interest} / \text{ST Debt}$)
 - Capital Retention
 - Pay down Line of Credit
- Budget, measure and track Covenants on a Monthly basis

Loan Covenant Measures

CASE STUDY, LLP																
ANNUAL BUDGET - 2 Years																
CASH BASIS																
		Year 1														
		Budget														
		Amount		Month #1	Month #2	Month #3	Month #4	Month #5	Month #6	Month #7	Month #8	Month #9	Month #10	Month #11	Month #12	TOTAL
INCOME STATEMENT																
REVENUES:																
% of standard																
Gross fees receivable (see Revenue Projections sheet)		\$4,015,750	100.00%	\$ 214,433	\$ 272,915	\$ 311,903	\$ 331,397	\$ 409,373	\$ 389,879	\$ 448,360	\$ 389,879	\$ 331,397	\$ 311,903	\$ 311,903	\$ 292,409	\$4,015,750
Less bad debts	0.4% of Revenue	(15,750)	-0.39%	(841)	(1,070)	(1,223)	(1,300)	(1,606)	(1,529)	(1,758)	(1,529)	(1,300)	(1,223)	(1,223)	(1,147)	(15,750)



INCOME BEFORE PARTNERS' DRAWS (TAXABLE)		\$1,320,000	32.87%	(\$9,739)	\$48,513	\$87,348	\$106,765	\$184,435	\$165,018	\$223,270	\$165,018	\$106,765	\$87,348	\$87,348	\$67,910	
PARTNERS' DRAWS		(825,000)	-20.54%	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(56,250)	(206,250)	
INCOME OR (LOSS) LESS PARTNERS' DRAWS		495,000	12.33%	(65,989)	(7,737)	31,098	50,515	128,185	108,768	167,020	108,768	50,515	31,098	31,098	(138,340)	
CUMULATIVE INCOME (LOSS) LESS PARTNERS' DRAWS				(\$65,989)	(\$73,726)	(\$42,628)	\$7,887	\$136,072	\$244,840	\$411,861	\$520,628	\$571,144	\$602,242	\$633,340	\$495,000	
BANK COVENANTS																
EBITDA																
Firm				(\$4,873)	\$48,507	\$140,722	\$252,354	\$441,656	\$611,540	\$839,677	\$1,009,562	\$1,121,194	\$1,213,408	\$1,305,623	\$1,378,412	
Required	\$	1,350,000		\$112,500	\$225,000	\$337,500	\$450,000	\$562,500	\$675,000	\$787,500	\$900,000	\$1,012,500	\$1,125,000	\$1,237,500	\$1,350,000	
Excess/(Shortfall)				(\$117,373)	(\$176,493)	(\$196,778)	(\$197,646)	(\$120,844)	(\$63,460)	\$52,177	\$109,562	\$108,694	\$88,408	\$68,123	\$28,412	
DEBT SERVICE COVERAGE (EBITDA less partners draws/ST Debt)																
				(61,123)	(63,993)	(28,028)	27,354	160,406	274,040	445,927	559,562	614,944	650,908	686,873	553,412	
Firm				-1.4 : 1	-1.5 : 1	-0.6 : 1	0.6 : 1	3.6 : 1	6.2 : 1	10.1 : 1	12.7 : 1	14 : 1	14.8 : 1	15.6 : 1	12.6 : 1	
Required									6.0 : 1						12 : 1	
Excess/(Shortfall)									0.20						0.60	



Budgeting, Strategy and Capital

- Develop a firm strategy
 - Proactive vs. Reactive
 - Focus on long-term “important” matters
 - What if scenarios
 - Shared vision – the “One Firm” firm
 - Evolutionary
- Develop a Five-Year Plan
- Build a Strong Capital Position

Five-Year Plan

NAME OF FIRM
REVENUE ANALYSIS
SAMPLE OF 5 YEAR PROJECTION

	ACTUAL		PROJECTED		PROJECTED		PROJECTED		PROJECTED	
	12/31/2006		12/31/2007		12/31/2008		12/31/2009		12/31/2010	
PART 1										
% GROWTH IN REVENUES			17.71%		7.94%		17.65%		10.00%	
REVENUES	\$13,380,000		\$15,750,000		\$17,000,000		\$20,000,000		\$22,000,000	
# OF ATTORNEYS	55		57		60		65		72	
# OF PARTNERS	17		18		18		19		20	
REVENUE PER ATTORNEY	\$243,273		\$276,316		\$283,333		\$307,692		\$305,556	
INCOME ALLOCATED TO PARTNERS	\$3,098,000		\$3,600,000		\$4,080,000		\$5,000,000		\$5,500,000	
% INCOME ALLOCATED / REVENUES	23%		23%		24%		25%		25%	
INCOME BEFORE PARTNERS' COMPENSATION PER PARTNER	\$182,235		\$200,000		\$226,667		\$263,158		\$275,000	
PART 2										
AREAS OF LAW:										
AREA #1	\$8,429,400	63%	\$9,607,500	61%	\$9,860,000	58%	\$11,400,000	57%	\$12,540,000	57%
AREA #2	\$3,345,000	25%	\$4,252,500	27%	\$4,590,000	27%	\$5,400,000	27%	\$5,940,000	27%
AREA #3	\$943,290	7%	\$1,417,500	9%	\$1,870,000	11%	\$2,600,000	13%	\$2,860,000	13%
AREA #4	\$220,770	2%	\$315,000	2%	\$510,000	3%	\$600,000	3%	\$660,000	3%
AREA #5	\$428,160	3%	\$157,500	1%	\$85,000	1%	\$60,000	0%	\$22,000	0%
	<u>\$13,380,000</u>	100%	<u>\$15,750,000</u>	100%	<u>\$17,000,000</u>	100%	<u>\$20,000,000</u>	100%	<u>\$22,000,000</u>	100%
PART 3										
BILLINGS BY ORIGINATING PARTNER:										
PARTNER #1	\$8,028,000	60%	\$9,135,000	58%	\$9,520,000	56%	\$11,200,000	56%	\$12,320,000	56%
PARTNER #2	\$3,345,000	25%	\$4,095,000	26%	\$4,930,000	29%	\$5,800,000	29%	\$6,380,000	29%
PARTNER #3	\$669,000	5%	\$1,102,500	7%	\$1,360,000	8%	\$1,600,000	8%	\$1,760,000	8%
PARTNER #4	\$669,000	5%	\$787,500	5%	\$850,000	5%	\$1,000,000	5%	\$1,100,000	5%
ASSOCIATE #1	\$669,000	5%	\$630,000	4%	\$340,000	2%	\$400,000	2%	\$440,000	2%
ASSOCIATE #2										
	<u>\$13,380,000</u>	100%	<u>\$15,750,000</u>	100%	<u>\$17,000,000</u>	100%	<u>\$20,000,000</u>	100%	<u>\$22,000,000</u>	100%

Capital

Firms with a strong capital position can:

- Make better business decisions
- Work through the unexpected loss of a client or sudden unanticipated expenditures
- Can consider strategic investments

Capital

The firm should strive to achieve the following:

1. Achieve positive equity in the firm
 2. Have Equity to Debt ratio of 2:1
 3. Have no debt
 4. Achieve 3 months of Operating Expenses in Capital
- Retain Earnings and don't distribute all income every year
 - Avoid pitfalls of recently restructured or dissolved firms
 - S Corps should only make distributions to pay taxes on allocated income until the firm has built sufficient capital
 - Retain capital for rainy day – purpose of loan covenants for capital requirements

Designing and Implementing a Capital Retention Plan

- What are the long-term goals?
- What are bank covenants?
- What may be available to distribute after considering the above?
- What should be the goals to retain in capital?

Designing and Implementing a Capital Retention Plan

- Next year's budgeted fixed assets additions
- Finance what you **HAVE TO**, not what you **CAN**
- Continuing principals in mature and growing firms should be required to contribute as well
- Definition of what it means to be a principal
- Make all principals contribute something every year

Designing and Implementing a Capital Retention Plan

- Capital retention plan should be part of
 - Overall strategic plan
 - Compensation arrangements
 - Buy-sell agreements
 - Current year budget

Designing and Implementing a Capital Retention Plan

- Should be related to current earnings
- Should be related to total compensation and balances in WIP and AR on accrual basis.
- Don't set base base salaries at 100% of budgeted for year.
- Consider 50-60% during year and rest at end of year
 - Just in case budget is too aggressive
 - So principals don't change monthly needs and life style
 - So you can retain some capital
 - So you don't rely too heavily on bank financing
 - To avoid salary reductions due to cash flow problems

Designing and Implementing a Capital Retention Plan

- Set a flat amount
 - Large fixed amount upon being an owner
 - Phase in for first few years and then adjust afterwards
 - i.e. \$10,000 year minimum for new partners
- or percentage of profits
 - 20% hold back

Questions and Answers

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