

Law Department Budgeting and Forecasting

How to Plan, Implement and Benefit From a
Formal Budgeting Process



Strategic budgeting in a corporate law department? Really?

Absolutely.

Although many law departments tend to think of budgets as primarily tactical tools, budgets do have significant strategic value for the department – as long as they’re the product of careful planning and proper implementation, that is.

Strategy is obviously very important to most legal department operations. And budgeting strategy is no exception. When thinking about implementing a budget process, it’s necessary to consider the various implications that stem from different strategic objectives. This white paper examines the critical nexus between departmental objectives and the budgeting process and outlines many of the benefits law departments can enjoy when the budget process is aligned with strategic objectives and implemented according to a carefully considered plan.

THE VALUE OF MATTER LEVEL BUDGETS

Establishing budgets at the matter level can be a valuable move for an organization in three important ways. The first benefit relates to cost management. If you think about a legal matter as analogous to a project you might undertake personally – building a house, for example – it’s clear that it would be foolhardy to jump into such a complex project without having a sense of what it’s ultimately going to cost. Having a budget up front gives you the opportunity to evaluate potential options for managing costs. And, depending on the process you ultimately employ, a budget can also establish accountability for the costs incurred.

A second benefit of establishing a matter budget is that it provides another important piece of information about a matter that should be part of discussions concerning the matter. Whether you’re using enterprise legal management software or managing matters more informally, you’re already talking with outside counsel regarding matter status. Adding information about a matter’s budget to those discussions makes the communications more robust and more useful, both for you and for your law firms.

The third benefit is that it strengthens the general counsel’s relationship with finance and the rest of the organization. The ability to budget and forecast with greater accuracy goes a long way toward helping to establish the legal department’s credibility in the eyes of department heads and upper management. It can also help to foster better intra-departmental communication and cooperation.

COLLABORATIVE BUDGETING

“ On the financial side, we’re a \$1.3-billion-a-year outside counsel spend, and about \$700 million of that is budgeted to detailed budgets. So we measured their [law firm] performance against the detailed budget. And we held them accountable for that...I think, we were within \$80,000 of our budget...”

- Richard Dwyer
SVP Legal Operations Support
Bank of America

STRATEGIC OBJECTIVES

Before you ask law firms to start providing matter budgets, you should first consider your objectives. If your primary objective is cost management, for example, you will likely want to capture more information about the drivers of the overall budget so those responsible for approving them will have the information they need in order to collaborate effectively with the law firms regarding their budgets.

A second objective focuses on metrics. If you have specific initiatives within your organization that you'd like to evaluate – such as whether a firm is more or less successful in sticking to a budget – it's important to determine which metrics to include in the evaluation in order to ensure that you capture the data needed to report on that metric.

For some law departments, the objective for establishing matter budgeting is more about improving accuracy in anticipating how much they'll spend on outside counsel, rather than strictly trying to manage costs, per se. Although less granularity is required in such instances, it's still necessary to build a means of managing variances into the process and to work with firms to help identify the causes of budget variances and to eliminate them going forward.

A fourth objective that often factors into budget implementation is meeting the budget and forecast requests of the finance department. If finance wants data aggregated in a specific way, it's important to make sure that your process supports the department's unique requirements.

A fifth (though by no means final) objective relates to efficiency and time-savings. For law departments that are gathering budget information manually, the goal should be to automate and streamline the process and establish easy-to-follow procedures and accountabilities.

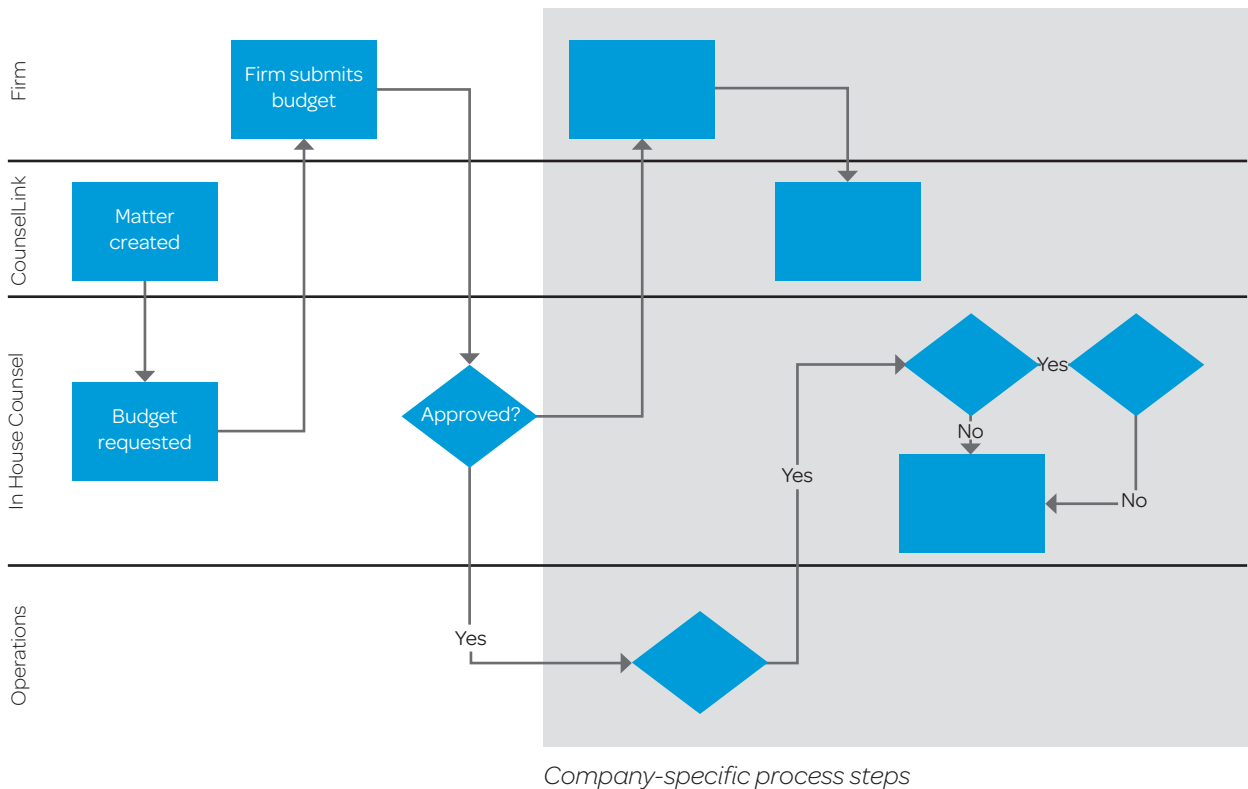
The bottom line is that one or more of the objectives listed here may be important to you, and that requires a plan of action to ensure that the budget process you implement aligns with and fully supports each of your objectives.

STRATEGIC BUDGETING vs. FORECASTING

Although the terms “budget” and “forecast” are sometimes used interchangeably, they are not the same thing. To avoid confusion, when this white paper uses the term “budget,” it’s in reference to an established estimated cost that never changes. In contrast, a forecast, which is an update to an estimated cost after a period of time has elapsed, can change many times depending on the circumstances. Additional updates are referred to as re-forecasts.

If your process is going to require elements of both budgeting and forecasting, be sure to think through the process for each of them. And keep in mind that when measuring actual costs of a matter versus a forecast, your expectations regarding accuracy should be considerably higher than when comparing against a budget, as a forecast is the result of knowing much more about the matter.

THINK THROUGH THE ENTIRE PROCESS AND DOCUMENT IT



FIVE TIPS FOR EXECUTING AN EFFECTIVE BUDGETING STRATEGY

Corporate law departments can attack the challenge of budgeting from any of several different angles. And while no single approach will necessarily prove better or less effective than another, there are several caveats to keep in mind that will help you avoid potential missteps and optimize both the efficiency and the effectiveness of the budgeting process.

1 Don't reinvent the wheel

Many in-house counsel already request budget information from their firms, albeit informally. In these situations it's a good idea to talk to in-house counsel to ascertain what amount of detail they ask for in budgets. Ask questions, such as what's the most important piece of information they need in order to have confidence in a firm's budget, and what distinguishes the firms that do a good job submitting budgets from those that don't.

Once you've determined what information is important to inside counsel, you'll want to build a mechanism into your process or template that allows outside counsel to provide it. If your inside counsel discovery sessions reveal that there is considerable variability by matter type or by practice area concerning what's important in a budget, it's useful to factor that into your process as well – or possibly even develop slightly different budgeting processes for different practice areas or matter types.

If you already provide a budget file that's configured to meet the specific needs of your finance department – and it's working for them – make sure the budget process you design will feed into the existing file so you don't have to build that piece of the process from scratch.

2 Determine which matters will benefit most from a budget

Deciding what your primary objective for budgeting is will help you narrow the scope of your efforts. If your primary objective is cost management, for example, you'll do well to focus on budgeting the matters that will likely have higher costs associated with them. Doing so will provide a higher return on the effort you put into managing the budget. On the other hand, if achieving greater forecast accuracy is the goal, it would be better to apply budgets to those firms or matter types that tend to catch the organization off guard with higher than expected costs.

If you have a high volume of commodity-type work, the most effective way to budget for those matters is in aggregate. Of course, if efficiency isn't a high priority for your firm and your primary goal is to hold firms to a budget, this would not be the best approach. Instead, you might consider asking firms to budget every one of their matters to put them on notice that you will hold them accountable for variances.

Keep in mind that the decisions you make about matter budgeting can easily evolve. Many firms start small and expand their matter budgeting process as they become more comfortable with it. This type of pilot approach has proven very successful by allowing both internal staff and outside counsel to adapt to the process slowly and incrementally. Once it becomes apparent to stakeholders that the process is indeed adding value, it's relatively easy to implement more comprehensive budgeting across additional types of matters.

3 Define the budget time period

This is an important consideration. In some cases, a life-of-matter budget may make the most sense – this is especially true for smaller-dollar, high-volume matters, or if one of your objectives is to strengthen the dialogue and collaboration about matters with your law firms. If frequent adjustments to the matter forecast are anticipated – when dealing with a complex matter, for example – implementing a life-of-matter budget will provide accommodation for updates and reinforce the message that outside counsel has a responsibility for helping to manage matter costs.

Other budget time period options include those that align with an organization's fiscal period, or more rarely, monthly budgets, which make the most sense for very complex, high-exposure matters that have high visibility within the organization. Regardless of the budget time period selected, keep in mind that when you're budgeting or forecasting for what's billed or approved in a given time period, there is likely to be a lag between when the firm actually performs the work and when they submit an invoice for it.

4 Select relevant metrics

The metrics used to evaluate law firm performance relative to budgets can vary widely between, and even within, organizations. Again, it all depends on the nature of the specific budget objectives. Examples of common budget metrics include measuring accuracy of what was spent versus the original budget, or comparing the accuracy of the amount spent versus the most recent forecast. You could also measure whether a firm submits budgets for the matters they are required to, and whether they do it in a timely manner.

The point is, what you choose to measure should support your budget objectives. You have to determine which metrics will be required as you set up your process and then ensure that you'll have the data you need to create those metrics.





5 Make budget discussions a part of matter management

Although incorporating budget topics into discussions about cases would seem like common sense, many companies miss the mark in this respect. Going to the trouble of requesting, reviewing and approving a budget without subsequent follow-through is wasting a valuable opportunity that should become an essential piece of the matter management process.

Communicating budget information and sharing relevant metrics with law firms is an effective way to improve the partnership and engage the firms' help in anticipating and managing costs. On the other hand, don't lose sight of the fact that if you ask for information you don't use, it can be detrimental to the relationship. It takes a good deal of effort for firms to accurately predict the volume of hours expected for certain tasks. Discovering that the effort was wasted because the organization ends up ignoring it doesn't help relationships and can potentially undermine adoption of the budget process.

Deciding What to Approve

Once you've decided to ask firms to submit budgets, it will fall to in-house counsel or someone in the legal operations department to assume responsibility for approving them. But how do they determine whether or not a budget is reasonable? If the assumptions that went into the budget request are sufficiently detailed, that may be all that's required. But it may also be helpful for the approver to have a list of historic matters of a similar type and range of costs over a similar timeframe to use as context for making intelligent budget approval decisions.

Another key consideration is how strictly you intend to enforce budgets. At the strictest level of enforcement, you could set up an automated process that rejects any invoices that exceed the agreed upon budget. At the most flexible (and time-consuming) end of the budget enforcement spectrum, you could decide to adopt an ad hoc process that involves discussing every variance with the law firm to identify the cause and determine whether or not the variance is justified.

Regardless of the level of enforcement you implement, bear in mind that process, whether automated or otherwise, shouldn't take the place of conversation. If a firm is consistently submitting invoices that are rejected because they exceed their respective budgets, you should make an effort to understand why outside counsel is under-budgeting and communicate the importance your organization places on adhering to agreed-upon budgets.

Management Reporting

One of the benefits of capturing matter budgets within an enterprise legal management system, rather than doing it offline, is that it provides the opportunity to conduct reporting and analysis. Ranging from very basic, to increasingly sophisticated and data-heavy, management reports provide a real-time window into the fiscal status of matters.

One of the most important and basic management reports is the **matter-level budget report**. A simple list showing matters, their associated budgets and any variances versus budget, this type of report should be available to everyone in the firm who is responsible for managing matters.

A second category of report is the **exception report**. It includes a more targeted list of matters that should be brought to someone's attention for any of a variety of budget-related reasons – when a matter is over budget, under budget, unapproved, etc. Some level of exception reporting is useful for every organization, regardless of its size.

Although you might not think of it as a report in the traditional sense, a **matter dashboard** is an additional type of management report with particular utility in regards to budgeting. If you're already using a matter dashboard of some sort to graphically display information related to matters, including information about budgets and forecasts will make it an even more valuable management tool. Although reports don't necessarily have to be expressed graphically, visual reports such as those presented in dashboards are very valuable, especially for executive-level reviewers who typically prefer the easily digested, at-a-glance insights into key metrics that graphic reports provide.

A **scorecard** is yet another reporting tool commonly used by organizations to compare matters or firms against specific metrics. Budget metrics lend themselves very well to the valuable reporting utility that scorecards offer and should therefore be considered for inclusion on an existing or planned scorecard.

Best Practices Add Value to the Budget Process

Although there is no single correct way to implement a budget process in a corporate law department, there are a number of proven best practices that can help departments optimize the value they derive from budgeting. Based on our years of experience working with hundreds of corporate legal departments and their outside counsel, we recommend the following:

Document the process

Creating and updating a roadmap of your budget process is useful for thinking through the various decisions that go into it. Flow charts are important tools with proven utility for guiding, documenting and communicating activities and progress related to processes.

Start small and scale up

Starting with a pilot approach allows you to work through the details of the budget process, identify any problematic issues and resolve them before widespread implementation. It's a good practice to select one in-house counsel or just a few law firms and test-drive your process first. Based on what you learn at this early, small-scale phase, you can make adjustments and then roll out the budgeting process more broadly across in-house counsel and your panel of firms. Doing so will eliminate the need to re-educate or re-communicate to the parties involved that you've altered your process.

Provide a cheat sheet

It's a relatively small thing, but if you're going to ask law firms to submit budgets, providing a cheat sheet that highlights what you expect of them can be very helpful. It not only saves the firm time and avoids confusion about the budgeting process, but it also helps ensure that you will acquire the information you need to feed your analytics.

Plan the process beforehand

Having to introduce a number of post-implementation tweaks to a budget process undermines a law department's credibility – in the eyes of its outside counsel and in the eyes of its organization's management. This underscores the importance of planning, anticipating what's needed and avoiding the confusion and frustration that result when a series of changes are required to address problems that are identified after the launch of a budget process.

Determine what's reasonable before approving budgets

Failure to get a handle on what constitutes a reasonable budget for a specific matter or group of matters before approving it can lead to problems. If a firm knows it's going to be judged harshly for going over budget it may decide to sandbag the numbers to avoid ending up with a negative variance. But, since the law department's objective should be to pursue budgets that are accurate, that means instead of rewarding a firm for coming in under budget, it should treat the variance the same way it would if the firm had exceeded the budget.

The solution, once again, is to maintain effective communication. Make certain that law firms and the law department's budget approvers understand that accuracy is paramount and work together to develop realistic budgets, monitor and manage them closely and identify potential problems before they get out of hand. Having good management reports in place and sharing them with stakeholders is crucial in this respect.

A Worthwhile Investment

Establishing and implementing a successful budget process requires a combination of planning, cooperation, coordination and commitment. Based on our years of experience working with hundreds of corporate law departments to establish effective processes for matter management, budgeting and analytics, it's clear that those willing to invest the time, energy and oversight required to succeed consider the effort worthwhile.

About CounselLink

The CounselLink solution is an Enterprise Legal Management solution suite for matter management, legal spend management, legal hold, analytics and strategic consulting services. LexisNexis CounselLink Solution is positioned in the “Leaders” Quadrant of the Gartner’s Magic Quadrant for Enterprise Legal Management and has earned an industry reputation for helping to improve legal department performance and outcomes.

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