

Ep #78: Build Financial Clarity into Your Law Firm with CFO Danielle Hendon



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John E. Grant

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John: Most law firm owners I talk with feel like they should probably be paying better attention to their financial numbers. They get their QuickBooks reports, they look at their profit and loss statement, and those things help them understand what's happening in their practice, but only at a very high level. And that has a lot to do with how your financials are structured to begin with.

Today, I'm talking with Danielle Hendon, a fractional CFO who specializes in helping law firms transform their relationship with their finances and understand the story your numbers can tell. Danielle brings a refreshingly practical approach to financial management that goes way beyond basic bookkeeping or tax accounting. Danielle and I explore how to organize your financials so they give you more actionable insights for strategic decision making, why not all expenses deserve the same treatment, and how budgeting can become a strategic tool rather than just an annual exercise you dread. This conversation improved how I think about some aspects of my own practice, and I think it'll do the same for you.

Also, this episode is eligible for a 1-hour MCLE credit in Oregon as a practical skills offering. And if you're not in Oregon, most US states and even jurisdictions in other countries offer CLE Academy, so you can probably claim a general credit. Instructions will be in the show notes at agileattorney.com/78.

You're listening to the *Agile Attorney Podcast*, powered by Agile Attorney Consulting. I'm John Grant and it is my mission to help legal professionals of all kinds build practices that are profitable, sustainable, and scalable for themselves and the communities they serve. Ready to become a more Agile Attorney? Let's go.

John: Alright everyone, welcome back. I often say that I'm excited to have a guest on the podcast, and I am, but I am especially excited this week to talk

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with Danielle Hendon. Danielle and I haven't known each other all that long, but we just clicked on a number of levels in the few conversations that we've had. And specifically, I wanted to bring on Danielle, and Danielle will introduce herself in a minute, but Danielle is an outside CFO for law practices.

And I wanted to bring on Danielle to offer some reflections on the interview I had a few weeks ago with RJon Robbins and Profit First for Lawyers, which was a fascinating episode. It was a fascinating episode from my perspective in the chair. I've heard from lots of people that it was a fascinating episode to listen to. And I think Danielle has an approach to the numbers of a law firm, the finances of a law firm that is probably a lot more in line with the stuff I talk about in terms of Agile practices and other things than the stuff that RJon was talking about in that episode. So that's why I've brought on Danielle. We're going to talk about numbers for law firms and I will quit rambling and let Danielle introduce herself.

Danielle: I'm so excited to be here. What John didn't tell you guys is we got on a networking call and I think we talked for 2 hours. There is just so much that we agreed on and had to share with each other.

A little background on me, I come from oil and gas. Actually, I'll take it a step further because I love surprising people with this. I actually started my college career as a music major. I thought I was going to be an opera singer and I had an English professor that had me write all about the future of my career path and realized very quickly I was going to be broke and that didn't sound like fun. So I went over to the business school because I had friends over there and I knew they weren't going to be broke.

There's this really odd alignment between music and numbers, and I loved everything about accounting, stuck with it, got my master's, did like everyone does and went into a firm. I went to public accounting. So I can

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definitely, while I don't have a law degree, can relate to what it's like working in a firm and working for that big firm mentality when I'm working with owners that are trying to kind of buck that system.

So I went into public, decided to have a baby, started a family, and realized I didn't want to be working 60-80 hour weeks with a newborn at home. Again, totally relate to the firm mentality. In that, I landed at an oil and gas company in Houston. That's where a lot of my experience was in public. It's what I honestly enjoyed doing. I didn't think I was going to leave except they went through bankruptcy, and the financial bankers started slicing and dicing.

And then the pandemic hit. And I never want to take away from the pain or the trauma that people went through during that time. But I think there's a silver lining that a lot of us can agree on in the sense that life slowed down in a way that we don't often do in America. And I got a completely different perspective of parenting. Before the pandemic, we were looking to hire a nanny to help get the kids to all their things. After the pandemic, I was the one driving the kids around, getting to know the coaches, getting to know the friends, getting to know the parents and the teachers, and I didn't want to give that up. I wanted to figure out how to keep doing what I love doing because I honestly love, and I know that you're all going to think I'm crazy, I love accounting and finance and numbers and it just lights up my day.

But so do my kids, and I wanted the best of both worlds. So I was lucky enough when the business shut down to get a little bit of a parachute and be able to take a step back and say, what do I really want to do? And in that, I have built 4 Corners CFO to not just help small businesses understand their numbers, but to really help them build a livelihood and a legacy and remember to put themselves first.

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John: Yes. Oh, I love so much about that. And for me, it wasn't the pandemic, but, you know, I've structured my consulting business really around my parenting for 10 plus years now. And similar story, I was working in a consulting firm for a while. This is after I had my law firm, and I, you know, kind of switched careers into legal consulting and then realized I didn't actually know how to like build and sell a legal consulting business, which is a good thing to learn, and went and worked for an actual consulting firm. And that actual consulting firm, I learned a ton. It was great, but they also kept giving me placements on site at places that were 30, 40, 60 minute commutes away. And that wasn't sustainable for me. Like I, by that time I was coaching my kids in various sports and helping out in the home and all the stuff, right?

And I think that's part of why you and I click, obviously. I also think it's part of why, you know, a lot of the folks listening to me, listening to this podcast, they realize that value and profit are not just financial terms, right? They are terms that apply broadly in our lives. I can't remember if I said this before in the podcast, but I certainly say it a lot. There's this very esoteric book called Towards an Anthropological Theory of Value. And I can genuinely say I read a good chunk of it. I cannot say I finished it. It's really dense.

But the thing that resonates with me from it is he talks about how it is super common in cultures all across the world for people to use the same vocabulary to talk about personal values as they use to talk about economic value, right? They are inextricably linked. They are completely intertwined, and yet something about, as you said, American culture, sort of hustle culture, that we tend to want to pull them apart, and we tend to think, oh, we have to have value and money in our work life and we have to have value and money in our personal life.

And I love that you made the choice. I've made the choice. Again, I think a lot of my listeners are trying to make a choice or have made the choice, but

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trying to find that balance between, okay, how can I generate economic value doing something that I love and doing something that I'm good at, but also still have the balance in my life to be able to be effective in other aspects. And it's just so important.

Danielle: Well, and I'll say completely separate from our topic of conversation today, but as a business owner, being able to give that to other employees in my business and hire people, you don't have to work 60 hours a week to be a really, really good accountant or lawyer. You can be amazing and work 20 and still be generating money for your house and for the company.

John: Absolutely. Yeah. And part of that is understanding what are the economic drivers, the practices that are driving value inside of your law practice, and then, you know, I talk about it a lot and I even think I talked about it a little bit in the episode with RJon where when you understand what the numbers are telling you, you then are empowered to make intentional choices about the thing that I certainly talk about a lot on this podcast, which is the honest reckoning with capacity, which leads to the brutal assessment of priorities. Because once you recognize your capacity is finite, you have to figure out how am I going to fill up that capacity, which means I have to choose some things over others. And when you understand your money story, your numbers, then you make better choices, full stop.

Danielle: I love how you put both of those together because, and I say this a lot on other podcasts or on my own little clips, that there's a story your numbers tell, and our whole goal as a CFO is to help you understand the story that your numbers are telling. And it's not just financial. There is a whole backstory in your head that goes with the story that those numbers are telling. I could tell a client all day long that they need to go get a line of

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credit, but if they're debt averse on the Dave Ramsey wagon and want zero to do with it, we've got to have a completely different conversation.

John: Okay, so I want to back up. So you are a fractional CFO, and you're as fractional CFO to small businesses, but a lot of those small businesses, as it turns out, are now small and mid-sized law firms. And so almost every law firm knows what a bookkeeper is, and I think almost every law firm owner knows what the basic reports you get out of QuickBooks can be and that those numbers are things we're supposed to be paying attention to and they do tell a story. But let's back all the way up and what's the difference between a fractional CFO, which sounds like a big expensive thing, and a bookkeeper, which sounds like a simpler, although not always cheap thing, but, you know, a simpler thing.

Danielle: So, it's really easy for me to define because we actually don't do bookkeeping or taxes as part of our CFO firm. A lot of accountants will do it all. They'll be the one stop shop for you. While that is all great, the ex auditor in me is a big fan of what we call segregation of duties, which really just means the more eyes you can have on it, the better. And that is the whole reason we do not do the books or the taxes, because your bookkeeper and your tax preparer, honestly, are both looking at the past. The job of a CFO is to help you look into the future and really where I like to say our sweet spot is, is to help you take the next step in the future and take it with confidence.

So it's not just about understanding the numbers, it's understanding you so that when you need to hire that employee, which is almost always a yes for law firms, you are confident doing it and you know what your runway is and you know how much time it's going to take and you know when to expect revenue from them.

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John: Right. Okay. So let's talk then about how you do that. What are the tools? What are the ways that you engage with, and, you know, thinking of hypothetical podcast listener, but I think this is actually pretty squarely in my listenership wheelhouse. I think it tends to be law firm owners, tends to be small-ish practices, and that might be the attorney plus a couple of people and maybe they're the only attorney. It might be 5, 10, 15 attorneys and all of the various support staff. There's others, right? There's folks that are practice group leads inside of their own teams and I think even they could use some of the work that you do, right? There's team leads inside of in-house legal departments, etc., etc. But like the core thing is that small business owner. What does a new engagement with you look like? How do you even get started with somebody?

Danielle: So I will say for us specifically, it is a little bit different than a lot of CFOs that I network with. You are going to find, if you're looking for a CFO, there's a couple of different types out there. When you search up a CFO, you may find a CFO that is focused primarily on banking and funding and financing and helping you in that area. That is not what we do. You will also find CFOs that come in on a project basis. They're going to tell you that they need to know more about what's going on in your business and then they can tell you what they think you need.

I'm going to tell you that I don't need to know anything about anyone listening today and I can tell you what you need because we use a very strategic six part framework to work with our firms, to go from basic bookkeeping to budgets and cash flows and forecasting. And we do that in six parts. So the very first part is checking your balance sheets. It's making sure that whoever's doing your bookkeeping is doing it right. And I'm going to hit on a bit of a pain point here because if you look at your balance sheet and you should all be looking at your numbers, not just relying on somebody else to do it. If you look at your balance sheet and your IOLTA bank account doesn't equal your trust liability, you have a problem. And I'm

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not even going to get into whether or not it matches Clio or whatever you're using for CRM purposes. But if that bank account doesn't match the trust liability, and you will be surprised how many clients come to us that don't, you need to talk to your bookkeeper about what they're doing.

John: Well, so number one, I think lawyers certainly understand that. Number two, trust accounting is hard and time consuming and lawyer trust accounting is particularly wonky because of the individual nature that we have to do where we're keeping individual accounts on all of this money that's in one actual bank account. And number three, I can't tell you how many lawyers, and I've even experienced this myself in different contexts, how hard it is to find a bookkeeper that actually understands it as opposed to saying they understand it.

Danielle: Oh, I get it. We, like I said, we don't do the bookkeeping, so I refer clients to, I literally have two that I love and trust and they have a wait list because it's hard to find really good law firm bookkeepers. But if you don't have a good balance sheet, if your balance sheet doesn't reconcile, your P&L is probably wrong. So we always start with balance sheet because if that one doesn't make sense, you're either missing or over accounting for numbers on that P&L.

John: I don't want to go too, too deep into the basics, but like, what are you looking at when you look at a balance sheet? What are you looking at when you look at a P&L, which is a profit and loss statement? Because I think even, you know, again, I think there's folks listening who maybe are thinking about starting a firm, and so maybe these terms are new, and I think even for those, right? We don't get trained on it in law school. So this is all stuff we got to learn as business owners.

Danielle: And I'm going to start by saying you don't have to learn it all. That's why people like me are here. I tell our clients when they sign up, if

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you ever don't understand something I'm saying, you need to stop and tell me because if you don't understand it, you can't use it. So we try our hardest to be very non-jargony in our firm. You will never hear me use jargon other than a balance sheet is a balance sheet and I really don't know what else to call it.

John: Right, is going to say, yeah, you got to be able to Google some stuff. You just got to use the words because like, there's a term.

Danielle: Yeah, so when you're, if you're thinking about starting a firm, if you've just started a firm, when you're getting with that bookkeeper, because I do not want you jumping down the rabbit hole of trying to actually understand all of this yourself. Your hourly billable rate is worth far more than hiring a bookkeeper, and you do not need to understand the nuts and bolts of this. You just don't. They didn't teach it to you, you don't have to, but what you do need to know is your balance sheet should be reconciled. And I'm going to date myself a little bit here and say it's kind of like checking on your checkbook. And for those of us that have had a checkbook at some point in our lives, you know that when you write a check, it doesn't immediately clear the bank.

So there is a different balance in your bank than what's actually available. And that's what reconciling the balance sheet does. It says, hey, the bank shows this, did we actually book all of it into the accounting system? Is it all there? And that's why I say if your balance sheet isn't being reconciled and your bookkeeper can, should, and will know all of this, even if they're not familiar with trust accounting, they know how to reconcile the rest of it. If it's not reconciled, there's a strong possibility that you're missing stuff on that profit and loss statement. A lot of times it's a check that you wrote to a client as a reimbursement and they haven't cashed it. So it's sitting in outstanding items and we just want to make sure that gets flushed through. Or you might have a check that came in and it hasn't been moved to

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earned income and you need to book that. Those are the things that can affect your profit and loss statement if they're not reconciling. So that's why it's our very first piece of this structure.

John: Okay. And so moving on then, step one is making sure that the balance sheet is reconciled. Where do you go from there?

Danielle: The second part, especially with law firms, is one of my favorite, we go to revenue. And when I say we go to revenue, I fully understand most of the people listening to this podcast right now, when I say revenue, probably have one line item that says legal fees or legal services or legal income or something along those lines, which is fine, especially if you're using Clio or something like that, it's going to integrate to one account when it does what it does. You have more than one revenue stream. I don't care if you're a solo, I don't care what you do. You have more than one revenue stream.

And the goal of our revenue conversation is to understand what are those revenue streams? And in what format do they make the most sense to you? So you may have different matter types, you may have different locations, or you may have different fee types. And whichever one is what you want to be focused on as the owner, whichever is going to give you the information you need to make decisions in your business, that's what we want to focus on when separating those revenue streams.

John: Yeah. Okay. And I'm going to drill on this one for a minute because I think this is part of where you and I really clicked the first set of conversations that we had. But also, I can give a very specific example where this made sense. So, again, my listeners know that I helped found a nonprofit law firm called The Commons Law Center. We're coming up on our 10th year, which is amazing. We've made it this far. But back in the early days, we just booked one line of revenue, but we had four different

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practice areas that were rolling up to that, that revenue. And the fact that that was what we were doing hid a lot of problems and potential pitfalls inside the larger organization.

And we were fortunate enough to have a board member in our early going who is a CFO. Well, actually had gone to law school, but I don't think he ever practiced as a lawyer. He decided he liked the numbers better. So it was an interesting and I'll give a shout out. Frank Dane is his name. I think he's mostly retired now, but he was amazing. And one of the things that Frank, when he came on the board was like, you have to split your balance sheets, your profit and loss, you have to do this by practice area was the one that made the most sense to us. And it took us about two and a half years to actually agree with him and get it done.

And then once we did, not just a light bulb came on, it was like a whole like street at Christmas time. Like light bulbs started showing up everywhere because we just had such better information about how the family law program was performing relative to the estate planning program, which we split as different from the probate program, which, like, even that is interesting, right? Because a lot of people think, oh, estate planning and probate, that's a practice area. It's like, no, that's actually maybe multiple, like maybe 5 or 6 practice areas inside of that because, you know, your wills practice might be different from your trust practice, and that's on the formation side, and you might be doing a little bit of business formation work adjacent to that. And then the administration practice, whether it's probate or trust administration or simple estate affidavits, whatever it happens to be, each of those is its own thing.

And the numbers for, you know, I tend to call them product lines. I know of people, I think this is actually a how to manage thing, that call them SKUs, which I think is confusing because that's out of the retail world. We don't need to work in SKUs in legal, but product lines is what makes sense to

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me. And by tracking and pulling apart and understanding, oh, this is how we do it, then we can make all kinds of interesting decisions, including in the sake of the com or the case of the Commons, changing the revenue model for some of our things. So we started out as primarily hourly for most of our work, and now the vast majority of our work is not hourly work. It is flat fee or phased flat fee or different sort of non-hourly approaches. And I don't think we could have made that call because the needs of each practice area were different, we couldn't have made that call without having split them out.

Danielle: Well, and I'll be honest, matter type or practice area is usually the most common that we see with law firms because a lot of times it also encompasses your fee style. I'm going to use estate planning again because it's a really accessible one for people. If you're doing wills and trusts, you're probably doing those on a flat fee most of the time versus I know a lot of estate planners still stick to hourly for probate because they struggle to gauge what that hourly is going to look like.

John: Yes, or there's even other reasons where certain courts just don't know how to actually calculate attorney's fees if you haven't, like, come up with an hourly rate and multiplied it and that's a whole different topic, but the legacy embedding of hourly thinking into the overall practice is a little bit...

Danielle: Which kind of takes me to one of the next things because you and I, another area I think we agreed a lot on that hits in this revenue side is when it comes to cost of goods sold and thinking about how we budget revenue because this is all baked into revenue. And I will say when people work with us, we're doing a lot of this behind the scenes. You don't have to do all the doing, but it's figuring out in conversation what those revenue streams are and then figuring out what I like to call your revenue generating costs.

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If you did listen to the RJon episode, you would have heard this is cost of good sold or direct labor. But most law firms have payroll sitting in payroll, which is okay, but there is a large portion of your payroll that is responsible for generating revenue, which makes it a revenue generating cost, aka a cost of good sold. So when you're looking at those people, I've had some clients that are like, well, but what if not all their hours are billable? And I'm like, I don't care if their role is to generate revenue, then they're a revenue generating cost. We're going to move the whole dang salary up there.

John: Yes. Yeah. So that is another interesting two things again, to call out right is we're talking about different ways and different places where you allocate numbers so that you can tell better stories with those numbers. And cost of good sold is, you know, again, we talked about with the Arjan episode, I kind of got lost a little bit in his coffee shop example. So we can like keep it tighter to lawyers, but it's basically what are the raw materials that are required to build the widget? And because we don't have actual raw materials in legal, the thing that we really use is the labor cost.

Danielle: Although I will say the other big area that we see some of our clients struggle to keep track of or some of their bookkeepers struggle to keep track of is also those client reimbursables. So yes, payroll, let's move those salaries up there. But there's another section where you guys are paying fees, you're, I can't even think of my words right now, but sending things to people and couriers.

John: Hiring third party experts. Any number of stuff. Yes.

Danielle: Yes. So you have these client-reimbursable expenses, and a lot of our clients are really good at booking them. Not all of them are really great at making sure that they're invoicing for them separately because your client-reimbursable income and your client costs, they're never going to

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equal. You're going to have timing differences all day, but they should be relatively close to each other.

John: Right. Yes. Okay. The other thing I want to point out is that in terms of the finance terms, right? So cost of goods sold, the other place where you can book expenses is usually called SGNA, right? Which is sales, general and administrative.

Danielle: Yep, we like to call those non-revenue generating, they're all in your operating expenses. So for us, that's part three. Once we've understood the revenue, the revenue generating costs, that piece of it, and I'll get into budget in a minute because we kind of do that on its own layer. All those operating expenses, there's a ton of them. And what we like to do is group them in one of three buckets. You're going to have what I like to call the required costs. I don't know a business that runs without access to a cell phone and internet. I don't know how you could. Then you have what I like to call the personal perks.

My favorite example to give people here is my kids are on my payroll. It is a defensible tax deduction. They do not add a lick of value to my business. It is completely personal perk. What you could also lump in here sometimes is those passion projects, those charitable contributions, the things that matter to you as a business owner. Everything else, if it's not absolutely required to keep the lights on and it's not a personal perk or passion project, it's an investment in your business. And every single investment should be returning time, money, or both back to your business.

John: And so you and I would probably both qualify in terms of where we hit people's books and our, you know, coaching, consulting work. What are some other examples of that?

Danielle: Oh, one of my favorite for attorneys because it's less about honestly, you guys are really, attorneys, law firms, business owners in

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general, you are not a business owner without being pretty darn smart. It's not figuring out what is or isn't a good investment. It's identifying what is or isn't an investment that becomes the interesting part here. And I'll give you an example specifically for law firms. I had a law firm approach us and we were doing this very exercise in a strategy call. And she had a lot of conference fees. And I know as a CPA, you have to get continuing education units. So I know as an attorney, you have to have CLEs. And that feels like a required cost. It is required. You have to get the CLE to maintain your license.

However, I know I can go to a website for like two hundred fifty dollars and get unlimited CPEs that are boring as can be, but they satisfy the continuing education requirement. And they do not cost five thousand dollars. So that conference is actually an investment. It's an investment that's either is teaching you something so that you can come back and implement it and save time or make more money, or it's an investment in networking and increasing your pipeline so that you can make more money. But it is not a required cost.

John: So, and I'm tempted to like go into the weeds and like, okay, well how do you do that? And I probably some of our listeners are too, but I'm going to stop that urge and I'm going to let you go. Actually, I do want to come back to something because I don't want too much time to go by. I want you to maybe reiterate something you said a minute ago, which is back on the cost of good sold thing, if you have hired someone whose job is to be in a revenue generating role, we're allocating all of their salary even if they're attending meetings, even if they're doing some marketing, even if they're maybe helping with, who knows what, right? screwing in light bulbs, doesn't matter.

So 10%, 15%, maybe even 20% of their job, going back to Clio, right? The Clio Legal trends report tells us that the average time keeper is only logging

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about 3 to 4 hours a day of billable work. So, but what you're saying is that 100% of that person's salary is going into cost of goods sold, not taking it and saying, oh well, 50-50 because yeah, they change a light bulb or they, you know, change the printer toner or whatever it happens to be every so often.

Danielle: I do this with our clients because it also helps us when it comes to budgeting. I don't want to over complicate. We could definitely get into what accounting calls direct labor allocations. At the size and scale and style of businesses and firms that we work with, it's just not cost beneficial to do that. So we're going to put that whole salary there and then when we get to the budgeting piece, which is actually part four, we're going to say, okay, so how much revenue should this employee be bringing in and where should that revenue be?

So if, again, I love when revenue streams are by matter type because a lot of times your attorneys are also by matter type. So it's very easy for us to align that salary with estate planning and say, hey, this person's working on wills and trusts 90% of the time. Their salary should be covered by it. We want them making, and I'm going to super simplify this. This is not actually how we do budgets. I want them making three times their salary. So we're going to throw that in the budget. That's one way you could budget. It's not the way I recommend, and I can get into more detail on that too. But theoretically, you can estimate what that profit margin should be for that attorney and book your budget based on that.

John: Okay. And I'm going to ask you a preference because I actually don't know. Going back to Frank, we at The Commons, we did in fact have some people that were like 50% estate planning, 50% probate. And we're still booking 100% of their salary to cost of good sold, but we actually are allocating it kind of 50-50 between those two practice areas.

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Danielle: Simple, yes. But the like, oh, they randomly worked 5 hours on this other project to help somebody. No.

John: Yes. That's really consistent with Frank's message too, which was you're not splitting nickels here. Like, basically, if you can't round it to 25%, don't bother. Is kind of where he went was his general rule of thumb and he wouldn't have been super disappointed if we went 80-20, but 80-20 is even like 75-25. You don't have to be 100% accurate. You're not getting audited for this information. Number one. And number two, it's about generating insight that you can use down the road in the budgeting process...

Danielle: It's not about making your accounting perfect. It's about getting information that's going to help you make decisions.

John: Okay. Let's hit that just really quickly before we go to budgeting, because I think that maybe this is sometimes a mental block with lawyers, right? Because we're good at compliance, right? And we're worried about risk. These are the things and a lot of CPAs also good at compliance, worried about risk. So, like, we get aligned in those places. But we're not talking about compliance. So we're talking about trust accounting, yes, compliance, it's got to be right to the nickel, right? We can get in trouble and, you know, I think it's something like 20 or 30% of bar disciplinary actions begin with trust account problems, or at least involve trust account problems. So we're not talking about that now. We're really talking about, okay, how do we set up our financial story and our record keeping and our allocation so that it can be useful to us in our business owner decision making going forward.

Danielle: And it's all, I like to think of it as a formatting exercise. The trust accounting is an actual accounting exercise. Where we put cost of goods sold or allocations or another example that I use with a lot of law firms, as we progress with them over time is we will get to a point where we're

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allocating unbilled time back to the month it belongs in so that we can see true profit margins. Not an immediate, and if you're listening to this, just like throw that out. Don't even worry about it. But those are all about formatting. They're not about booking the actual thing. You need to book the actual thing correctly into the books.

But then where we see it on the financial statements, I mean, we're not working with big C corps. You guys are not public entities. You're not reporting this out to anybody unless you have a bank loan. And most banks understand that financial statements are not going to all look exactly the same unless you've got one that wants an audit, and then we get down these other paths. But, really not normally going to happen for law firms of the size that we're talking to.

John: Okay. So, again, the number story and sort of the level of angst that we should have over some of this stuff, it varies in different contexts inside of.

Danielle: If you have a loan, then you probably have some form of requirement. They usually want a financial statement and a receivables report or a trust or an IOLTA. Like they want to know what money is out there and what money is coming in and that you're a feasible business, you're not going to go under. But they're also not going to care about the formatting as long as it's reasonable. And what we're talking about here with these allocations, they're going to care that it's sitting in cost of goods sold or in payroll. If it's in one of those two and it actually matches what got paid out, you're good. Whether it's in cost of good sold for wills and trusts versus probate, they don't care.

John: Got it. Okay, great. So, let me get back on the tracks. So, we've looked at expenses that are part of revenue generation. We've looked at

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expenses that are part of general overhead. I think we're moving on to budgeting, but you tell me.

Danielle: We are. Now we get to build a budget, and I'm a firm believer in what I call bottom-up budgeting. My team and I go with a fine-tooth comb and identify the frequencies and the trends and the recurring items so that we can quite literally go into your SGNA or your operating expenses and say, your cell phone is two hundred dollars a month. We're going to have a budget that says cell phone, two hundred dollars a month that rolls up into your communications account, because we want to be able to go open your books and say, oh, AT&T was two hundred fifty dollars. Did you add a new phone? And know exactly what's off. It's super easy that way.

Expenses are all based on frequency, trend, and what you know is coming up. Revenue's the fun place when it comes to budgeting for a firm.

Revenue and payroll. So I'm going to go down revenue and get into a slight tangent of what we call revenue affiliated personnel because we talked about revenue generating people. You probably have people that are not generating revenue and I want to give a moment to talking about that.

But I want to focus on and John, I know you and I differ a little bit in how we think about this. I think of every revenue generating person with their salary as a cost of good sold. And then I want to know how many hours do you expect them to bill or to work on billable work? I don't care if it's hourly or flat fee or contin- how many hours do you expect them to be physically working on legal work? And what should that hourly rate be? Even if they're working on flat fee stuff, at their tenure and education level and experience, what should you be billing for them? And we take and we generate a revenue budget based on that. Because regardless of whether or not it's flat fee or hourly, if you are running flat fee services that are not at minimum covering the same as the hourly rate, we're doing flat fees wrong.

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John: Yes. One of our differences on that for just a second, and I'm not going to go deep down this, but that won't necessarily be true the first time you do a piece of work on a flat fee basis.

Danielle: Yes. Right, absolutely. And it also should be less than true. So we calculate the budget this way and we will set it that way for a couple of months. And then we revisit the trend. Have they historically done this many hours? Are you bringing in double the amount on flat fees? And we adjust your budget based on what those actual trends and profit margins are. But at a minimum, I want to make sure that each revenue generating person is covering their what should be billable work hours and rate.

John: Yes. And I think the source of our difference, and it's funny because I have similar discussions with Melissa Shanahan who, I specifically don't like hourly billing, right? And I'm not shy about saying it. I recognize that it's where a lot of people are. I recognize, right, I'm not immediately trying to jump into getting people out of hourly billing.

Danielle: There's so much upside on flat fee billing.

John: Oh, yeah. And so this is it, right? Is I like I accept hourly billing as it arrives, but I think it is almost in 80 to 90% of practice areas, I think it is suboptimal. I think there are better ways to be doing it. But there's an investment in order to get you to those better ways of doing it. And whether you're ready to make that investment and do the work and the learning and the angst and all of it, because it does take some time. And so I'm fully there. Like, if you're hourly and you're happy with hourly, I'm not necessarily going to try to talk you out of it, but I am going to carry a doubt around in my mind about whether you should be doing something else.

Danielle: And it doesn't stay there. Like you just said, if you are somebody and most of the firms I work with have a combination of flat fees, hourly, and sometimes even contingencies. When you have those layers, we still

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want to set your baseline budget based on somebody's capacity and what that capacity should earn. And then based on the trends of those flat fees and contingencies, we can layer on top a 2x flat fee amount or a 2x contingency amount.

John: Yep. And I think you and I actually see it the same way. I just get to it a slightly different place, which is I'm looking at it through the lens of margin because I find that effective hourly rate is also a suboptimal measurement. I recognize that it's the easy one because with people that are so used to using hourly billing, then effective hourly rate gets you close to that apples to apples comparison, but my experience in doing the true conversion to flat fee is that, actually, two things are true. One is that it does wind up sort of clouding that comparison.

The other thing is that if people start getting into an effective hourly rate that is significantly higher than their actual hourly rate, then something goes wonky in their head sometimes about their own money story and they start to think, oh, that can't be worth it. I must be doing something wrong or I must be doing something unethical because the market is allowing me to charge this thing that is so much more than I would be making had I been billing it hourly. And I will say, even some regulators will fall into that. So it's it's not a totally warrantless fear. But the market will bear what the market will bear. And value without taking a left turn into pricing theory, and I talked about this a little bit in my episode with Jonathan Stark, right?

But we price the client not the work. Value is through the lens of the person receiving the value and what they will exchange in terms of cold hard cash for that outcome really is an individual determination for them. It's not for you to basically tell them what they should be paying. Now, again, I could go way down a rabbit hole. We could go way down a rabbit hole and I'll stop.

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Danielle: Quick what I love to tell clients who struggle with that is your flat fee is priced to bake in all of the unbilled hours that went into learning how to be that fast.

John: Absolutely, yes. And the investments you make again, maybe in people like me, in systems building, in template development, all of the things that say I shouldn't be penalized for having made this investment. Right. And this gets in again to the Jonathan Stark and the hourly billing is nut stuff. So anyway, let's pull back.

Danielle: So revenue generating employees, you want to know how many hours you're going to expect them to be working on billable work, whether flat feet, regardless of what the fee structure is.

John: Sorry, let me hit one other thing. At risk of going down a whole other tangent, but this is the amount of hours you expect them to actually work on it, or is this the number of hours you expect to wind up on a clock client bill for it? Because as we know, when you're hourly billing hours...

Danielle: No. Hours you expect them to work on it. Because if you have an employee that you're expecting, let's say out of a 40 hour week, they're expected to work 30 in billable work. So if that employee really is working 30, but you're not able to bill some of it and your revenue's coming in shy of that number, that's a different problem we need to discuss, but we need to identify it to be able to discuss it.

John: Perfect. So when we set the budget, we're setting the effort, we expect people to expend and we're calculating a revenue based off of that effort to go into the budget, recognizing full well that even if you're working 80% of your time, you're not going to necessarily be billing 80% of your time.

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Danielle: And this has nothing to do with whatever you've offered them. So I will say on like a slight side tangent, when we work with clients on actually giving offers to these associates or these attorneys, a lot of times people have a hard time getting away from billable minimums. So that will be baked in there somewhere. But we are also, if we're going to do what I like to call mixed model pricing, where we're paying them for work, but then also paying them for going above and beyond. So you have a salary and a bonus component. That bonus component needs to be based on dollars, not hours.

John: Okay. Yes, great. Yeah, we are 100% aligned on that.

Danielle: So, now, pivoting slightly, revenue-affiliated employees, people like your intake team, are not directly generating revenue, but they are huge and critical to your ability to generate revenue. So in that situation, again, I love what I like to call mixed model compensation. So when we're talking about hiring a new intake person, we're going to say, okay, what's the normal pay for an intake? What do we want to pay them for the hours worked? Then what do we want to bonus and incentivize them for the KPI that is revenue affiliated, KPI being key performance indicator. So for intake, I want to know how many of those you converted to consults. How many went from call to consult? And that's what I want your bonus based on so that we are incentivizing the revenue affiliation.

John: Yes. I 100% agree. I can like, again, tempted to go down some rabbit holes and I'm going to I'm going to avoid it. Yeah, and it is, it's what you're using revenue affiliated, I sometimes think about empowering functions or enabling functions. We don't have hours to bill if we don't have clients to bill it against. And if we don't have clients to bill it against, then that's what the intake team is helping you do. And, you know, whether they are the end of your sales and marketing pipeline, the beginning of your delivery pipeline,

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really they're the coupler between those two pipelines to torture a metaphor. But critically important role.

Danielle: And count as when we went through those expenses, they are an investment in your business. So we were going through and we're saying, how do they give time, money or both? And that's what we want to make sure we're incentivizing when it comes to people is that time, money or both.

John: Great. What are some other things that you work with folks for when it comes to budgeting for their law practice?

Danielle: I think we've hit some of the biggest budget things, but I will say, so the next part we go into, once you have a budget, is a budget should never be set it and forget it. That's a waste of time. Once you've got that budget, the next piece of our structure, our framework, is to compare it to your actuals because that's where the magic happens. The purpose of a budget isn't actually to hit the budget. The purpose of a budget is to understand why you didn't hit the budget. Because then you can either make adjustments to your expectations, which is your budget, or you can make adjustments in your business and get back to budget.

John: Right. I love this because I do the exact same thing in the delivery pipeline when I'm talking about stuff like service level expectations. How long should it take to deliver an estate plan? If it's not taking that time, either because we're going way faster, or more than likely, we're taking way longer, why is it taking longer? What parts of the workflow is it getting stuck in? Sorry, I'm tempted to like go into my whole stick. So I'll stop, but I'll but like the whole point of saying, hey, yeah, we think we can deliver an estate plan in 6 weeks or 8 weeks or 6 months, whatever makes sense for your firm.

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And again, I have a very similar process where I'm going to look at your history and I'm going to say, well, how long has it been taking you? We obviously don't want to go start talking about if it's been taking you 6 months, we don't want to start promising 6 weeks, right? That's a ridiculous jump. We can then start to run some initially sort of mental model experiments and eventually some actual real world experiments which would be, okay, on average it's been taking us 6 months. What things would have to be true in order for us to deliver an estate plan in just 4 months? What are we missing, right? And I think you can do the same thing with budgeting, right? What things would have to be true in order for us to have revenue that looks like this or get expenses that look like this.

Danielle: Or bring on a new team member and what does that do to everything? Yep.

John: Mhm. Okay. So talk then a little bit about because I think that's probably getting into the next. So we look at budget to actuals because that tells us, again, the point isn't to like land the plane on the head of a pin, right? The purpose of the budget and the budget to actuals is like, hey, something changed. Some assumption you made in the budgeting process wasn't quite right, which is totally normal, right? We none of us have crystal clear crystal balls. So what's going on here? What do we need to know? What do we need to pay attention to? What do we need to adjust? Is it our behavior or is it our budget? Why is it different?

Danielle: Because you could blow your revenue out of the water. And I'm going to say, okay, wait, is this a seasonal thing? Did you finally invoice for that guardianship that you did all last year? Like, what caused this to be off? Do we want it to be a recurring thing? Is revenue actually going to be higher month over month? Or was there one big thing and we didn't actually catch it over the last year? Or if you're under revenue, our team is going to say, hey, send me your Clio report or whatever CRM you're in.

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Send me those reports. I want to see everybody's hours. And like you said earlier, if so and so is coming 10 hours under, did they bill it? Did they work it? Do they need help? Do they need more training? Did we have the wrong intake process? Did we not identify a client problem that is eating into this? Like there are so many reasons for it, but if you don't even know that it's a problem to dig into, we don't know what they are to solve.

John: Right. Well, and I'll come back to something you said a minute ago with respect to booking certain types of revenue or when it comes in. That's another advantage to pulling your different practice areas apart. And we'll stay within the estate planning and probate example where with estate planning, I mean, my experience with my clients is that flat fee estate planning is typically, number one, pretty profitable and number two, cash flows pretty well. And by that I mean it generates revenue in a relatively short amount of time.

Danielle: It turns over pretty fast.

John: Yeah, whereas probate can be good from a profitability standpoint. It's often hourly and again, often hourly profit margins aren't as good as they can be with flat fee. But the biggest problem with probate is that the revenue recognition timeline is painfully long in a lot of situations.

Danielle: I'm going to say it depends on your state and especially I have one client where we go to every monthly meeting and I'm like, did you invoice the courts? Because if you get behind on that piece, you're going to be waiting who knows how long for cash to hit.

John: Yes, exactly. And, you know, contingency attorneys have this problem where it's a little bit more like agriculture than it is other businesses where you have to invest and invest and invest and then you harvest once, and you've got to make that harvest pay for next year's crop, so to speak. So different, obviously there are lots of different sort of archetypes across

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lots of different practice areas. But pulling them apart and really running their own almost mini books and mini budget across different practice areas is what gives you, again, number one, the insight, but number two, the confidence, right, and the sort of the peace of mind to be able to make decisions about your practice overall that is going to then put you in a better position with respect to your money story.

So, with that, I actually want, because I think we're starting to run a little low on time, which is amazing, as you said, you and I can go on this for a long time. But I want to hit on the topic of our mental models around money and the money story and how someone like you can help people get a healthier, more transparent, more sort of reasonable relationship with their finances and the stories that their finances tell.

Danielle: It really tends to come up fairly organically when we're talking about the numbers because like I said, that budget to actual is going to lead to, do we want to change the budget or what can we help you figure out how to change in the business? Something didn't happen the way it was supposed to. If it's a one off, we usually are like, okay, let's watch and see if it happens again. But if it is continuous, then it's our job to step in and say, okay, we can't keep running this budget if you're running this actual. It's not realistic. It's giving you unrealistic expectations. How can we help change that? If it's hiring a new employee, a lot of times it's the mindset piece that is keeping you from taking the business action.

So two of my favorite examples are hiring an employee or getting a line of credit because one of my biggest things to any business, whether you're a law firm or I don't care who you are or what you do, you deserve a line of credit for your peace of mind. There is almost no cost to having it and it is exponentially beneficial when something happens because something will inevitably happen at some point. It gives you time and space to breathe and make the next best decision. But if you are debt averse, and I've had

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clients that are, then we spend an entire hour talking about the benefits of this and looking at the difference and what numbers it can change for you.

Similarly, hiring is one of the hardest things you do in a business. As a business owner, being responsible for somebody else's livelihood is a burden that we don't take lightly. And you don't want to hire and not be able to keep them. You don't want to hire and not be able to support them. You don't want to not be able to pay the bills. You don't want to not be able to pay you, and I'm going to remind you that you come first. All of that. So we have a spreadsheet that we can walk through and look at and say, with this salary, how many hours do they realistically need to bill?

How much money do you need to have saved so that you can cover those, I usually tell clients it takes about 3 months for someone to be fully ramped up and billable to make sure that you've got all the work to give them. How much money needs set aside? How many hours do you need to be ready to give? And a lot of times, this is why I say hiring for attorneys is almost a no brainer. If you've got work coming in, you need like 5 or 10 hours out of these people to actually cover their salary. I mean, it's ridiculous sometimes.

John: Yes. So lawyering when done well and when done thoughtfully is sort of insanely profitable, right? There aren't many businesses that you can use your license and your skill and experience to generate a better profit margin, should you choose to, right? And again, different people are different levels of where they feel like they need to be supportive of their communities and again, the Commons Law Center runs on a very thin profit margin because of the intentional choices that it's made.

All the more reason to have our books in a row and have our financial story really, really clear because I can't remember the exact saying, but they say revenue forgives a lot of sins or however it's said, right? But it can also

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cover up a lot of problems, right? Because we do tend to cash flow reasonably well or we tend to be reasonably profitable. We don't always cash flow well, but and that's where the line of credit comes in.

Danielle: And for those value-driven businesses, and that's a lot of what we both work with, I love helping you improve profit margins so you can go do discounts and pro bonos and help the people that need it the most.

John: Absolutely and be intentional about it, right? I like to say getting back to capacity, we need to limit if we're going to do that, we still have to have a practice that supports ourselves, our team, our families, right, our bigger goals. And if one of those goals is to be able to do low bono pro bono work for the community, that's great, but you've got to budget for it. You have to budget for how much of your capacity you're going to allocate to that work in order to maintain the other parts of the business that are going to support that particular set of values that you have.

Danielle: Absolutely.

John: Okay. I had something else I was going to say, but I just lost it. So we got to wrap up. We can go on for hours.

Danielle: I know.

John: Anything that we haven't covered yet that law firm owners, small firm owners, even practice group leads really should be thinking about that you, in your experience out in the world, that most lawyers or law firm owners are just kind of missing or not quite getting it right.

Danielle: I think we've hit it a lot already today with those revenue streams and those revenue generating costs. I don't care how big or small you are. I have a hopefully fifteen million dollars this year firm that is, we're literally revisiting payroll for that exact reason. It is too big as a percentage of

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everything. And they've been running fine. They do a ton of marketing, everybody's busy, but payroll just isn't adding up right. And we've got to be able to say, okay, this needs to align here, here, and here.

John: Yeah. So the fundamentals are the same whether you are going to that first quarter million or whether you're into that, you know, 10 million and up range, like the volume might be different, but the fundamentals really are the fundamentals no matter how you're cutting it.

Danielle: Yeah, I mean, this, the framework we've built is what I know from corporate. It makes big business bigger and it's why I know every single business needs this. And it doesn't matter how big or small you are. I will also say there are CFOs accessible and available. We do strategy calls for three hundred dollars an hour. Like you can get help, you don't have to know it all. You're not meant to know it all.

John: Yeah, okay. So, if someone wanted to get a little bit smarter or maybe a lot smarter and starting to work with you, what is the best way for folks to get in touch with you?

Danielle: We will have a website set up just for you guys, so it'll be 4cornerscfo.com/agileattorney. And you'll be able to book a consult call, you can book strategy calls, you can download a quick freebie to get to know us a little better and have more info on the six parts.

John: Perfect. Okay. And I love that from a marketing standpoint, but that is a whole another discussion. So, but you're tracking, right? You're keeping track of, okay, this you've just made this investment of an hour of your time in order to come and chat with me and chat with these folks, and we're going to be able to figure out what's the return on that investment, and that's all part of it, right? So these practices of finance, right, they don't just apply in your sort of getting paid pipeline part of your workflow, they apply in your getting the work part, they apply, as I said a minute ago, in your

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delivering the work, right? We're trying to create feedback loops and this is one of the core the core practices of Agile.

Danielle: Yep, you got it.

John: Okay. Well, Danielle, thank you so much for spending that time and I really look forward to talking with you some more. We've started referring clients back and forth with each other, so Danielle and I are like in touch all the time now, and I appreciate it. The stuff that's coming my way and hopefully you've got some good stuff coming yours.

Danielle: Thank you, John. I really love being on the podcast today, and I hope the listeners got a couple of gold nuggets that they can implement with or without help.

John: Great. Alright, thanks so much.

Danielle: Thanks.

John: All right, that's a lot of information, but let me give you three key takeaways. Number one, your numbers tell a story, but only if you organize them well. One of the big mistakes Danielle and I see law firm owners make all the time is lumping together all of your financials from all of your different types of work. When you pull things apart, whether you do it by practice area or by product line, you get a much richer and ultimately more actionable sense of what's going on in your law practice. It doesn't need to be perfect, but I guarantee you that starting to split things out will improve your understanding of your law practice overall.

Number two, not all expenses are created equal. I really like Danielle's framework looking at required costs versus personal perks versus business investments. As a useful lens for evaluating the things you're spending money on and what they accomplish for you and your practice overall. That

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conference you attended, it's not a required cost, but maybe it's a personal perk. Ideally, it should be an investment that will return time, money or both to your business.

Number three is the importance of budgeting. and I'll admit this is one I need to be better about myself. But the core takeaway is that budgeting isn't about hitting the numbers you've budgeted for, it's about understanding why you missed them. And when your actuals don't match your budget, that's where the real insights live. The variance is what tells the story, but you have to set that budget as the starting point. The common thread through all of this is intentionality. Whether you're deciding how to structure your revenue tracking, evaluating a new potential expense or like planning to hire a new employee, the clear financial data helps you to make confident decisions rather than emotional ones.

If you missed Danielle's contact information, you can find it in the show notes. Also, as I mentioned at the top of the show, this is another episode that qualifies for MCLE credit in Oregon. This time as a practice management credit. And I've put instructions for claiming that credit in Oregon and elsewhere in the show notes as well.

If you have questions for me about how to structure your law practice delivery workflows based on the insight you're getting from your financials or how to arrange them so that you get better financial insights, don't hesitate to reach out. As always, you can find me at john.grant@agileattorney.com or use the contact form on my website to set up a discovery call. This podcast gets production support from the fantastic team at Digital Freedom Productions and our theme music is Hello by Lunara. Thanks for listening and I'll catch you next week.