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9 Tips for Setting Your Law Firm's 2022 Budget

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A **budget** is an estimation of revenue and expenditures for a specific period of time.

By thoughtfully creating a budget ahead of the coming fiscal year, you can better align anticipated revenue and expenses with your law firm's goals. Successful budgeting involves critically thinking about your financial expectations so that strategies can be implemented to promote greater profitability and prevent financial pitfalls.

Budgets also provide a measuring stick for periodic review throughout the coming year to determine whether desired milestones are being met and adjust as needed. With a comprehensive budget, you can be proactive in addressing your firm's financial issues before they become serious problems. This will provide a bird's eye view of financial performance on a monthly, quarterly, or yearly basis which will help facilitate adequate forecasting.

Therefore, law firms need a budget to help with managing, mitigating, and minimizing financial risk.

These nine tips will help you build a solid budget for your law firm as you wind down this year and prepare for 2022:

1. Remember Key Terms

- **Cost of Services** – These are the direct or indirect costs required to provide legal services. For example, a direct cost would be a payment made to a paralegal contracted to work on a specific case. An indirect cost would be the cost of administrative support services for making copies or traveling to the courthouse for filings.
- **Gross Profit Margin** – This is the percentage of total revenue that remains after the cost of services is deducted. Ideally, it is adequate to cover all operating expenses.
- **Operating Expenses** – These are the costs of keeping the firm up and running, such as rent, equipment leases, and marketing.
- **Profit Margin** – This is the percentage of remaining revenue after all operating expenses are deducted from the gross profit margin. It's also your firm's prime indicator of financial success.

2. Set Goals First

Setting goals is the first step in budgeting. Goals act as the benchmarks of every budget and dictate the allocation of firm capital. In an environment centered around putting out one fire after another, goals allow you to set your focus on something positive.

First, brainstorm all the goals you'd like the firm to achieve within a particular time frame. Classify them according to the following categories:

- **Short-term goals** that can be reached within the first six months of 2022.
- **Mid-term goals** that can be achieved by the end of 2022.
- **Long-term goals** that will likely take longer than one year to achieve.

Make sure these goals are specific, measurable, and realistic to current circumstances. Keep these goals in mind as you create your law firm budget. Look for opportunities to further them, in addition to identifying potential pitfalls that may derail your progress. Also, don't forget to review your firm's goals throughout the year, just as you would review the budget. This will help keep you focused and moving in the desired direction.

3. Identify Investment Opportunities

To grow, law firms must invest in areas like technology, people, marketing, and other revenue-building tools. Think about what your firm will need in the coming year to attract new prospects and continue providing high-level service to existing clients. Once you have identified those expenditures, include them in your budget.

4. Get Realistic With Your Revenue

Remember those realistic goals that we spoke about in tip #2? Well, the same concept applies to your revenue expectations.

Let's start with what you should classify as revenue. First, there's the revenue your firm will incur through daily operations before any deduction of related expenses. Then, there's the revenue that remains after all expenses are deducted. This is your firm's net income, otherwise known as profit or the bottom line.

Just like goal setting, start by thinking about an end result and what your firm will need to do in order to achieve it. For instance, how many clients will you need to service over the next three months to bring in the desired level of revenue?

One more point about revenue: be sure to consider its seasonality, as different practice areas may incur more or less work at different times of the year. With that awareness, you can account for these business patterns and budget accordingly, so that necessary funds are still available during the less profitable months.

5. Make Profit the Benchmark

Keep your eyes on the prize - and the prize is always the profit margin. The profit margin is the main benchmark that indicates the wellness of your firm's financial position. It measures the effectiveness of your firm's income and expenses. It also points you in the direction of the most successful revenue streams and the most problematic expenses.

6. Calculate Costs and Spending

Every budget includes costs and spending - there's no way around the fixed and variable costs of doing business. The goal is to tackle them in a way that makes the best possible use of revenue.

Fixed costs are expenses that remain somewhat consistent over time. These may include internet, telephone service, and software licenses.

Variable costs change depending on use and other factors. They may include travel costs, insurance premiums, marketing strategies, and continuing education fees. Incidental one-time expenses also fall under the variable costs. These are unexpected expenses that pop up from time to time, like equipment repairs or the cost of revamping your law firm website.

Both fixed and variable expenses should be factored into your 2022 budget.

7. Expect the Unexpected

If the past two years have taught us anything, it is to expect the unexpected. That's why it's necessary to budget up to 10% over the estimated figures for expenses and revenues. This will help ensure that your firm is adequately prepared for any unpredictable event that may occur during the coming year.

8. Consider Legal Budgeting Trends for 2022

The uncertainty of the times has resulted in some budgeting trends that reflect a legal environment still recovering from a pandemic. These include:

- **Office Return** - For law firms that have not yet undergone a full return to the office, the 2022 budget may include monetary investments necessary for this transition. This may include expenditures like increased spending for office supplies, increases in operational expenses like electricity, or the cost of office modifications to facilitate social distancing. It may also include reduced costs. For instance, firm leaders may decide to keep a percentage of the workforce remote, allowing for a smaller office workspace.
- **Diversity, Equity & Inclusion (DE&I)** - Growing demands for DE&I measures within the legal community may place an added financial responsibility on law firms in the coming year. Clients are increasingly calling on law firms to take an active DE&I stance. This is especially true for firms servicing corporate clients. Firms that make efforts to meet this demand may face related expenses that should be included in 2022 budgeting.
- **Business Development** - With business travel and events gearing back up, firms will likely want to ramp up their business development efforts. This means increased spending on marketing strategies, travel, and in-person gatherings. Business development will be a must in 2022, so it should be adequately represented within your law firm budget.

9. Take Charge of Readily Available Resources

In this digital era where information is just one click away, you're never alone when it comes to accessing knowledge and expertise in areas that benefit your law firm. Numerous budgeting tools are readily available and specifically customized for the legal profession. Access these tools for assistance with the budgeting process or reach out to an accounting professional for help with creating a solid budget that will put your law firm in the best possible financial position for 2022.

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