

IMPROVING THE EFFECTIVENESS OF THE MANAGEMENT REPORT.

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New research is constantly appearing on what to include in a financial report. Debate continues over the place of the report and the function it serves. It is becoming clear that the old style 'financials only' report is about as much use as a chocolate tea-pot unless it is complemented with other data. Academic research has developed ways of valuing 'intangibles' bringing meaningful new data into the 'mix'. Until now the only intangible asset recognised in a financial report has been intellectual property and other acquired items like 'goodwill'. From now on it looks reasonably certain that other factors hitherto recognised as having an influence on outputs will also have to be included and measured. The theory is intangibles form part of 'value creation' and need to be understood.

It is argued that failure to understand and learn from value creation can lead to lower performance and inefficient resource allocation. This may make many readers 'cringe', especially those partners who already have 'issues' with the volume of financial jargon presented each month. A clear indication of change can be seen now that international accounting standards bodies are well advanced in developing models for reporting intangible measures. It is a safe bet many will be adopted.

What outcome is this likely to have on the legal profession or any other mature and sophisticated service provider? A possible answer is that when service providers better understand the underlying dynamics of value creation they will start measuring them and building them into performance statements (reports). The result will, in many cases, provide a new and robust measure of partnership worth, which should greatly assist any firm working through succession, merger or increasing partner numbers.

The so-called 'knowledge debate' has introduced a number of phrases that we are all going to get comfortable with, e.g., intellectual capital. Fortunately the IFAC (International Federation of Accountants) has already developed a classification system. It includes three principal areas: Human Capital (know-how, vocational qualification, occupational assessments etc), Relational/customer Capital (client loyalty, order backlog etc), and Organisational Capital (intellectual property, information systems, management processes etc.). Measurement systems for all of these are well advanced and already in use in the corporate sector.

What does all this mean for the 'average' firm of solicitors? Basically, management reporting processes will develop from a set of monthly/annual financials to include a range of intangibles. Clients are likely to drive change and expect to purchase services from providers able to demonstrate more than high quality legal skill. They are going to ask more questions about client retention, training, progress reporting and other matters to enable a more complex cost benefit driven analysis to be undertaken. It won't change the way houses are bought and sold or the management of simple debt driven litigation but it is inevitable that more complex and higher priced legal work is going to be subjected to more scrutiny and competition.

On the bright side, the more practices know about their business the better. Attention will be focused on investment appraisal and rates of return. The cost benefit analysis of marketing, training and client/staff retention strategies etc., will have more meaning when the 'returns' can be assessed, value measured and increased.

In keeping with many fundamental changes the 'early adopters' are likely to reap the greatest benefits.