



## Law firm due diligence: a checklist

Many participants in the NZLS CLE Ltd's Stepping Up course say that they do not carry out any effective due diligence when they join a law firm. They say that they are not sure what questions to ask, and don't know whether it is appropriate to inquire. Many firms are not sure what information they should provide.

This is a generic list of questions which are intended to prompt inquiry into important issues. Potential partners should turn their minds to these things.

The issues covered here will be more important in some firms and less important in others, however, the decision to join a law partnership or an incorporated law business is a significant one. It may involve a significant financial investment. It also entails taking on crucial business, personal and professional commitments.

All law firms are different and so an incoming partner needs to have a good idea of the peculiarities of *this* firm.

It is also in the interests of the incumbent partners that any new partner fully understands what they are getting into. Surprises don't help anyone.

The term "partners" used here includes the directors of an incorporated practice.

Warwick Deuchrass  
Course Director  
Stepping Up  
July 2018

## **Strategic planning**

Does the firm have a written strategic plan, and have you seen it?

What differentiates this firm from other firms?

Have you done your own personal independent SWOT (strengths, weaknesses, opportunities and threats) analysis for the firm?

How do you think this firm will cope if the climate for legal practice continues to change at the present rate?

Is the firm's plan appropriate in the light of the current situation facing the firm?

How do your personal plans match the firm's plan? Are they consistent with each other?

Is the type of work done by the firm appropriate to you?

Can you describe the firm's client mix and is that mix appropriate for you?

What are you able to contribute to the firm in the short term and in the long term?

What will you get from the firm in the short term and the long term?

What are the potential succession issues for the firm and how will they be catered for?

Do all the partners disclose to one another what their intentions are in relation to their continuing membership of the firm for the next 5 and 10 years?

Are the partners technologically competent, or are they slipping behind?

## Law Firm Culture

Have you considered the personalities and behaviours of the partners and are they compatible with you?,

Is there compatibility between the partners, and between the partners and you in respect of the following matters:

- making money
- sharing profits
- dividend/drawing policy
- growth
- innovation
- use of technology
- work complexity
- client ownership
- work intensity and stress
- community responsibility
- partner autonomy
- partner performance management
- partner support
- collaboration
- work standards
- continuing legal education
- work standards
- pricing
- work types
- bottom lines for partner compliance

Does the firm operate as a firm or is it really a grouping of lawyers doing their own thing?

Is there any explicit statement of what is expected of a partner?

To what extent are gross fees the measure of partner performance?

Does that result in partners holding work to themselves or is work sent to the most appropriate person?

## **Management and Decision Structure**

Is there an established structure for the management of the firm?

Are there any undemocratic power dynamics in the firm?

How much do the partners contribute to management?

Are partners who are involved in management given credit for that contribution?

Is there a distinction between the governance role of partners and the management of the firm?

How much responsibility is delegated to staff?

What role will you play in the management and strategic decisions of the firm?

What partner/management meetings are held?

Do partner meetings operate on a consensus model or a majority vote model?

If a majority vote, are partnership decisions implemented by all partners, including any dissenting partners?

## **The Financials**

Have you seen the last three years of accounts?

What budgets have been done and have you seen them?

Do those accounts give a fair indication of the future financial strength of the firm or are there any factors which might cause them to change in the future?

Is the firm growing or shrinking?

Have you made an assessment of the quality of the debtors – ie how many will actually pay their debts?

How accurate is the work in progress figure – ie how much of that will be billed and paid?

How big is the total lock-up (ie the total of debtors and WIP)?

How much debt does the firm carry and is that manageable and appropriate?

What are the terms of any firm debts, lease arrangements or hire purchase payments?

What is the regularity and effectiveness of financial reporting to the partners?

Does the firm undertake any benchmarking of its performance against other firms, and if it does, have you seen those reports?

Are the partners' capital accounts equal, and if they are not, then is there any compensation for any differential?

Is there an agreed drawings/dividends policy, or does it happen ad hoc?

Are profits shared equally?

If profits are not shared equally then is the profit share basis fair?

Are there any perks or expenses paid to partners and are they fair?

Do partners fund their own income tax payments or does the firm fund them?

Are there any investments of the firm which are not purely related to legal practice – and if there are, are those investments owned by all partners on the basis of their share of the firm equity?

Have you taken competent independent advice on your personal provisional and other tax obligations?

Does the firm have any current or past income or other tax issues with the IRD?

How much will you have to pay to join the firm?

Are you paying goodwill?

How is the payment calculated?

Have you taken independent competent advice about the amount payable?

How will the purchase be financed?

Is this a lock-step model or is the firm providing finance in any other way?

Is the payment, or are the terms, negotiable?

Is the payment fair to you?

## **Staff**

What is your assessment of the quality of the firm's staff?

How good is the firm's relationship with its staff?

Is there anyone on the staff who should not be there and is that an important issue?

Does the firm have a good HR record?

Has the firm been involved in any HR disputes and what was the outcome?

Does the firm have a staff review process and is it consistently implemented?

## **Clients**

What are the firm's practice areas?

Are these widely spread or focused on a few areas?

Do these fit with its strategic plan?

Is there any data available as to work types and exposure to different parts of the legal market?

Are clients treated as belonging to individual partners or to the firm?

How does the firm acquire new business?

Does the firm have a policy to enhance client retention?

Would the departure of a partner or some partners result in the loss of a significant part of the firm's clientele, and if so, how is that managed?

Does the firm have a marketing plan, have you seen it and is it appropriate?

Is it being implemented?

Is the firm taking advantage of social media opportunities if that is appropriate?

## **Premises and Equipment**

Are the premises appropriate for the firm's present and future needs?

Are they at an appropriate standard or are changes overdue?

If changes are due how will they be financed?

If the premises are leased have you reviewed the lease?

Will you be liable under the lease?

Are partners released from liability under the lease when they leave the partnership, or is an indemnity given?

If the firm owns the premises how is the introduction and exit of partners financed – and will that impact on the practice?

If you are effectively buying a share in a building have you made the usual inquiries for that situation ,eg have you seen a LIM?

Is the computer hardware up to date and is there a programme to keep it that way?

Is the computer hardware owned or leased? What are the lease terms?

Is software used by the firm adequate and up to date?

How does the firm maintain its software and hardware? Does it employ someone or use an external consultant?

Is data held on site, externally or in the cloud?

If it is held externally or in the cloud how secure is the data?

Does the firm have a disaster plan?

## **Risk**

Does the firm have PI cover?

Have you seen the policy?

What is the level of excess under the policy?

Are there any current claims?

Have you seen the most recent insurance renewal and claims report?

Is the insurance appropriate, bearing in mind the type of work done by the firm?

Does the firm have systems in place and consistently used to minimise the risk of PI insurance claims?

Are passwords kept confidential or are they shared?

What is the firm's complaints process and is it observed?

Is there a policy to minimise conflicts of interest?

If there is a trust account is it maintained properly and to a high standard?

Does the trust account supervisor do their job diligently?

Have you seen the latest Law Society inspection report?

Have you reviewed any insurance policies for such things as plant, equipment, business continuation, sickness, key person loss, and death of partners?

### **Company or Partnership?**

Is the practice carried on by way of a partnership or a company?

Is there a current partnership agreement or shareholders' agreement?

Have you read them and are they fair?

What are partners entitled to in the way of ordinary leave, sick leave or special leave?

Is the payment made by incoming partners or to departing partners fixed or are they subject to negotiation?

Can partners be expelled and in what circumstances?

What are the provisions for admission or retirement of partners?

Will you be an equity owner or a salaried partner?

If you don't own equity how is your exposure to claims and firm debts managed?

If you get an indemnity from the equity owners, how good is that indemnity?

Are there any provisions for ongoing restraint of trade on a departing partner?

### **Succession**

What will the structure of the firm look like in 2/3/5 years' time?

Is there an agreed retirement age?

What is the risk of a number of partners retiring in quick succession?

What would be the consequences of that happening – for clients and the firm?

How much is payable when a partner retires and how would that be financed?

Does the firm have a continuing review of potential succession issues?