

## Experts' Corner

### **Featured Article:**

### **Increase Profits and Control Risk by Managing the Revenue Cycle**

By Jack Eagles, Founder of Cash Management Solutions

Due to recent economic constraints, many law firms have reevaluated their internal processes and methodology related to new client/matter intake, timekeeping, work in progress (WIP) management, billing, and collections.

Facing pressure to both acquire new clients and support current ones - firms are making potentially jeopardizing compromises. While some firms are relaxing their up-front screening, unknowingly increasing their risk for bad debt and malpractice suits, others are experiencing higher billings but slower receivables turnover, thus creating tighter cash flow and unwanted investment in receivables and unbilled time.

The following points are best practices to help strengthen cash flow, decrease bad debt and write-offs, and reduce historical "over investment" in receivables and WIP, while also minimizing the potential exposure to malpractice suits that incorrect receivables management triggers.

### **New Client/Matter Intake**

When looking for long-term solutions to improving cash flow and minimizing loss potential and risk, firms should start by focusing on client intake. Lawyers, who typically spend more time talking about evaluating new clients and running credit checks than actually doing so, often shy away from discussing clients' financial status for fear of alienating those clients. These same lawyers, however, would never suggest that their client extend credit to his own customer without first evaluating the customer's financial capabilities and intentions.

Ironically, law firms do just that. Unless a firm is paid a replenishable retainer, it is in effect making an unsecured loan to clients, performing work and hoping for later payment. Additionally, clients that cannot pay their bills are far more likely to "invent" pricing and quality-of-service issues, at times even filing malpractice suits to halt collection efforts. Knowing their histories up front forces firms to recognize clients' potential risk.

What can you do?

- Check potential clients' credit histories. If a client is switching firms, inquire about his previous attorney relationship and why he is moving his business. You do not want to be the next firm he does not plan to pay.

- Do not assume that the client will be offended by such inquiries, since other professionals routinely ask for this information. If he balks at these questions, proceed cautiously if you intend to keep his business, understanding that he carries a great loss potential.
- Establish checks and balances within the firm to ensure that new matters for existing delinquent clients can be reviewed and approved from outside the practice area. Using the employee that issues new matter numbers to be the “control point” can help minimize loss exposure. If the existing client’s balances are beyond a preset percentage over 60 days, the number should not be issued, and the information should be forwarded to the collections department for review.

You must make a conscious decision not to accept more business from previously slow non-paying clients. It does not make good business sense to throw potentially good money after bad.

### **Engagement Letters**

Attorneys can make a profound long-term impact on cash flow by verbally outlining the firm’s expectations — and the repercussions if those expectations are not met — with new clients, hopefully avoiding later litigation. This is especially useful for clients with little or no previous experience with legal representation.

An engagement letter, or fee contract, should define the billing, payment practices and procedures (including the firm’s response to non-compliance) as well as the scope of the firm’s services. The client should sign and return the form before billing commences.

### **Timekeeping**

Another way to enhance a firm’s cash flow and avoid fee disputes is to adopt rigorous timekeeping procedures and to require compliance from all timekeepers. Most importantly:

- Make sure employees turn in time reports daily; half hours lost here and there add up quickly. For example, if each lawyer in a 100 attorney firm lost half an hour of billing each day by entering time weekly instead of daily, the firm would lose 250 hours/week. If the firm bills at an average rate of \$175/hour, the firm could lose a staggering \$2,275,000/year.
- Require detail in all time entries so that invoices may be appropriately descriptive and itemized. Several one-hour entries of “reviewed file” can look questionable to a client whereas a thirty-minute “analyzed deposition testimony” or “read court ruling and planned next steps” entry shows for exactly what service the client is paying. This practice makes customized cover letters for each invoice needless, allowing faster bill generation, speeding up cash flow, and generating more time for the lawyer. The financial impact is dramatic.

### **Billing Process**

Law firms tend to experience substantially more investment in WIP and accounts receivable than is realized. The degree varies, but it is not unusual for firms to have 30 percent or more of their

total receivables over 120 days. WIP often exceeds 60 – 90 days of a firm’s activity as well. Establishing benchmarks and efficient processes could lessen a firm’s investment to 45 days of activity in WIP (unbilled time/expense, excluding contingent fee), and 60 days of investment in receivables.

Especially if over \$1,000, all WIP bills should go out at least monthly. This practice creates a predictable billing cycle and keeps bills low for the client, making payment easier and more likely.

Long delays between bills or between work performed and bill issued increase the likelihood that clients will dispute a charge, as the perceived value of the work diminishes over time.

Often, firms end up with tight cash flow because partners have no incentive or set procedure by which to issue bills. Firms should standardize the billing process and better their support system and internal reporting, expediting the billing process for their attorneys.

### **Invoices**

For many firms, retooling its invoice format is enough to significantly improve cash flow. Too often, legal bills look like letters “informing” the client of his current balance, rather than like the invoices they are. To avoid confusion, invoices should have invoice numbers, a title that says “Invoice,” and should clearly state a payment due date (10 days beyond the date of issue is a good rule of thumb). This form clearly communicates that payment is expected upon receipt of the bill and makes punctual compliance easier.

If being paid a retainer, the agreement should include the right to issue an edit report when combined accounts receivable and WIP equals 75 percent of the retainer. Thus, because the balance can be replenished before it reaches zero, the firm avoids working while the account is dry and thereby essentially advancing credit to the client. An “evergreen” retainer — where the initial retainer amount is designated for application to the final invoice and the client pays current invoices directly — is another option.

Once the representation concludes, the retainer is used to satisfy the final remaining balance. Such a set-up provides the lawyer with some protection should the client fail to keep up with mid-representation invoices. Whatever approach is implemented, the goal is to stay ahead; once billings surpass the retainer, recovering the advance-cash position a retainer should provide is difficult.

### **Collection**

Even with all these procedures in place, clients will still fall behind in payments. Every firm has to consider how best to collect delinquent fees. In most firms, the duty falls to the billing attorney, but this policy is frequently ineffective. Attorneys tend to have difficulty pursuing collections due the preexisting client/partner relationship.

Firms that give the collection responsibility to a firm administrator or CFO also face challenges. Lawyers often thwart administrators' efforts, apologizing to clients for a collection call rather than reinforcing its message.

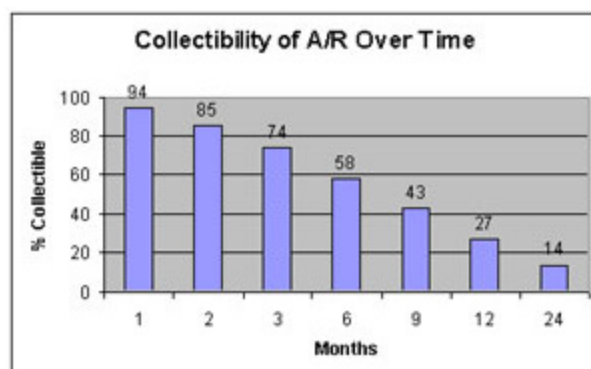
In other firms, attorneys only refer the smallest outstanding bills to these financial and administrative departments, keeping the big accounts or especially important clients to themselves and undermining the benefit of having these resources in the first place.

Because attorneys often fail to complete the collection or ask for help, it is effective to set up a date (initially 180 days) where if an invoice is not paid, it automatically becomes the firm's responsibility unless a pre-designated firm official exempts the partner.

Collection is generally most successful — and least risky — when done by those with specific training and experience, people who won't alienate the client. If a firm frequently considers or institutes fee-related suits, or if fee delinquency is more the norm than the exception, collaborating with professional consultants is prudent.

Time is also critical. The first client contact should be made no later than 45 days after the issue date of the invoice. Early identification and intervention of difficult accounts equates a higher percentage being paid, as the graph below from the United States Department of Commerce illustrates.

Everything a firm does to shorten the cash flow cycle, from new client/matter intake, timekeeping, WIP management, regular billing, and more efficient invoicing procedures to better and earlier follow-up on delinquent accounts, leads to fewer malpractice suits, increased revenues, a less need to rely on outside assistance for recovering fees.



*The author, Jack T. Eagles, is the founder of Cash Management Solutions. CMS pioneered onsite receivables management for law firms some 18 years ago. Clients include 60 of the top 100 law firms as well as two of the "big four" CPA firms. CMS's diagnostic services help firms operate more efficiently, reduce the historical over-investment in receivables and WIP, and reduce the likelihood of a malpractice suit as it relates to the collection cycle. You can reach Jack at 800-878-6522 or by email at [jeigles@cms-group.com](mailto:jeigles@cms-group.com).*