



## Law Firm Administration

A Special Report

### Um, Partners, Don't Forget to Get Paid

In tough economic times, law firms need to pay careful attention to their accounts receivable.

BY JAKE KROCHESKI

With the economic downturn, businesses and individuals will likely be seeing a decline in demand for their products and services and thus may become short on cash.

Because of these problems and the general financial uncertainty, many may thus want to hold on to their cash reserves and not pay certain vendors on time.

Cash flow problems have always been the No. 1 reason why clients do not pay their bills to law firms. And now with the economic problems, this problem risks becoming more prevalent for law firms.

Bills perceived as nonessential to business operations are last to be paid. The harsh reality is that legal bills typically fall into this category. For many businesses and individuals, paying legal bills does not carry the same urgency as paying other bills.

Clients are smart. They know that nothing will happen if they don't pay their legal bills on time. Law firms have conditioned their clients to pay at their own convenience, without penalty. Clients can use delay tactics to buy more time or even avoid paying altogether.

At the same time, law firms now should have a sense of urgency to shorten the time it takes them to collect payment. The economic downturn causes uncertainty for law firms as well, and it is critical for the firm's own cash flow to determine if and when clients will pay.

#### WHAT TO DO

These tougher times demand that law firms take action

regarding the overall management of their accounts receivable. Specifically, firms should:

(1) *Not make the mistake of thinking they can collect themselves out of the true billing problem.*

Taking steps to collect overdue bills may help cash flow in the short term, but without fundamental changes to prevent collection problems, the billing lawyers will quickly return to bad habits, and the firm will find itself in the same quandary down the road.

To prevent this, the firm must evaluate its client/matter intake process and identify problem accounts early, so it can take action before it is too late. Firms frequently look at their older unpaid bills and admit to having a collection problem. The real problem, however, is that the problem has long existed, but the firm did not take the time to recognize it earlier in the ageing process or before the work even started, and then failed to take effective action to deal with the problem.

(2) *Establish effective accounts receivable reports.*

At a minimum, you need to know if an account is actively being pursued, what the payment status is, who is pursuing the collection efforts and whether they are getting results, why clients are not paying, and what needs to be done to get them to pay. Firms that are successful in managing accounts receivable are those that regularly review updated information on the client's payment status to act quickly.

At a minimum, firms should categorize receivables to determine:

- Is the bill collectible? If so, when can we expect payment?
- Is it problematic? How good are the chance we will get paid?
- Is it simply not collectible?

Reviewing various financial reports is essential to managing receivables. But the goal is not just reading the numbers but also

using the reports to understand clients' stories and the relationships behind the numbers.

*(3) Start digging for information.*

Typically, for most firms and practices, the 80/20 rule applies: 20 percent of your clients are responsible for 80 percent of your bills that are more than 90 days overdue.

Run various reports of balances due from levels of \$5,000 to \$50,000 to determine which clients are overdue. Don't depend on historical patterns of bill collections to measure your progress. In economically stable times, you can safely assume that collections increase as the year progresses. An unstable economy can disrupt payment patterns. So measure revenue projections on a monthly basis, and be realistic about whether the firm is underachieving in its collection goals. If it is, in fact, underachieving, figure out why: Is the work dropping off, are the clients having difficulty paying their bills, is the firm just not doing an effective job with its collections?

*(4) Have the right leadership and collection committees in place.*

Effective management of accounts receivable starts from the top. The firm needs to put the right people in leadership positions on the collection committee and hold them accountable for progress on collection efforts. These leaders must have the ability to tell the attorneys to address their collections and, in turn, hold the attorneys accountable for their actions (or lack thereof).

Many firms are losing revenue by giving attorneys too much autonomy regarding collections. Attorneys are given excessive leeway in dealing with their clients during the first 11 months of the year, only to have their feet held to the fire during the year-end stretch. With many firms having millions well over 90 days past due, the traditional culture of forgiveness needs to be replaced with a culture of high expectations for better collection throughout the year.

We also wonder when such firms will stop tolerating "good clients" who just don't pay their bills. When are they going to stop permitting clients to pay slowly without asking why? When will they start dictating the terms of payment rather than allowing the clients to do so?

*(5) Identify attorneys who have difficulty collecting their receivables—and take action.*

You know who they are. They are probably the same attorneys who have problems turning in their time sheets and getting their bills done.

Someone from the collection committee should meet with these attorneys on a regular basis and ask them to say specifically when bills can be expected to be paid. If they do not meet those dates or don't have a good explanation, the firm should make sure that others are available to help them with their collection efforts.

*(6) Evaluate whether the firm has the right administrative staff in place and determine if they are doing the right work in the right way.*

Are staff members reporting weekly on the accounts for which they are responsible, the age of the accounts, how much they have collected, and what they have in line for payment?

Do you know how much the collection staff are working on actual collections, as compared to other duties less important to their primary purpose (such as generating reports, sending out

reminder statements, providing information that the lawyers request)? Are they knowledgeable enough to provide the right reports and management information that will explain the progress of the collection efforts?

Staff must be held accountable, but due allowance has to be made for other demands on their time. If the firm decides to have staff contact clients directly about the bills, the staff must not have too many other responsibilities that keep them from this mission.

Beware of staff who prefer doing clerical work to managing receivables on a more proactive basis. Other work can sometimes feel more pleasant, but that often isn't getting money collected.

*(7) Be realistic about collecting older, more difficult receivables.*

Be aware that receivables more than 120 days overdue have only a 50 percent chance of being collected, and the rate continues to drop as receivables age.

The reasons why can vary. Perhaps the client is dissatisfied with the service; perhaps the transaction the firm billed for has failed; perhaps the attorneys are more focused on their current work. If you have any hope of getting paid, these accounts must be pursued diligently.

Some of these accounts may be difficult to collect only because no one has made the efforts to contact the clients. Firms should work with the attorneys and staff to figure out if the clients need to be pursued, and, if so, how.

And if an account cannot be collected, why continue to carry it on your books?

*(8) Be proactive.*

Make sure that the attorneys and staff involved in collection are meeting monthly and assessing progress. More often than not, little attention is focused on collection efforts until the last two months of the year. The effort must be year-round, especially this year. Even if you are unlikely to change old clients' habits of paying at year-end, teach new clients that they are expected to pay timely.

*(9) Use professionals.*

Law firms lose clients by doing poor work or by failing to deliver client service, not by asking clients to pay their bills. Managing receivables will not hurt the client relationship as long as it is handled professionally.

Firms can employ trained professionals in-house. Those who specialize in accounts receivables have the necessary experience and training, and can be accepted by the lawyers as professionals performing a vital function for the firm.

Alternatively, a growing number of law firms are retaining an outside receivables consulting firm (including those such as my own), with which the law firm works closely.

Either way, make sure you have professional staff working to collect your money. The current state of the economy has brought the issue to greater prominence, but regardless of the economy, each law firm must be able to manage its receivables based on the specific needs of its own practice areas, client base, and management style.

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