

# The Distance Between Generating and Collecting Income

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What's the big fuss about billing and collecting fees? Why is so much made of this seemingly simple process? After all, isn't it a very basic function in the financial management of every service business? Is it because that to do it successfully one needs an Ivy League education or has to master some complex formula for positive results? Of course it isn't. Then why is such a "big deal" made of it? Ask yourself these questions. How would you like to work hard for over a month and never get paid for it? How would you feel about working today and not get paid for it until over four months from now? In the meantime you must continue to pay all of your bills and expenses. If these situations applied to you wouldn't you think it was a big deal? This is what occurs in the typical law firm.

According to Altman Weil's 1999 Survey of Law Firm Economics, the per-attorney average of "write downs" and "write offs" exceeds \$32,000 per year. Since the average billing rate is \$185 per hour this equates to over 176 hours, which equates to over one month's work. Additionally, the average amount of unbilled Work In Process (billable work recorded not yet billed) per lawyer at year-end is in excess of \$60,000, which represents over two months work performed not yet billed. Add to that the average amount per attorney in Accounts Receivable (work billed not yet collected) at year-end of nearly \$53,000 representing nearly another two months of billed hours worked. In summary, the average firm has a per attorney balance of over four months of work performed which has either not been billed or not paid for. During this same time the firm has been paying the expenses related to performing this work (labor, fees, administrative, etc). This same firm has also either "written down" or "written off" a total in excess of one month's billable hours per attorney. Simply put, if a firm had ten attorneys it would have in excess of \$1,000,000 combined in Work In Process and Accounts Receivable and it would have "written down/off" over \$300,000 in billable work done. Now you have the picture – you know why billing and collecting are such a "big deal."

Now that we've established why it's so important to have a billing and collection process that works efficiently and effectively, we have to ask the question- what makes the process succeed in one office and fail in another? In other words-where is the magic? What "voodoo" makes the process work? The answer is –there is no magic and there is no "voodoo." Those firms which bill and collect fees most successfully almost always take a very simplistic and basic approach to the process yet always give the process the highest level of importance in the administration of the business of their firm. The process of generating, billing and collecting fees should always get the highest of priorities, as it is the most significant element involved in producing higher earnings. There are four- phases to the process: Client Acceptance, Capturing Time, Billing, and Collection. In reviewing what distinguishes the successful firm from the firm that struggles with the process it becomes apparent that five "ingredients" appear consistently in all phases of the process.

**Clarity** - clear, meaningful communication with both client, regarding services to be provided, billing policies and payment expectations and staff regarding internal policies and procedures applicable to the billing and collecting process.

**Systems** - medium used to collect, record and manage data necessary to the process. This is the configuration of technology, both hardware and software, which performs the task of gathering and storing the data necessary to the process and is able to provide the data in a form which is viable for evaluation and billing.

**Procedures** - methods used to record, bill and collect. These methods are the “how to” steps to be used in each phase no matter who is performing the task. A successful firm usually documents these methods so that the “how to” stays the same even if the personnel performing the task do not. The documentation is written in a clear unambiguous form so as to leave little for interpretation.

**Policy** - “rules” used regarding the recording of time, dates for review of Work In Process, preparation of the bills, “write downs,” “write offs,” collection and collection follow up.

**Evaluation** - regular review and assessment of financial management data from the system regarding the timeliness of billing, collection, billing rates charged, realization, aging of Accounts Receivable, etc.

Of the five ingredients mentioned above, Evaluation is the most important and it is also the area where many firms “drop the ball.” Without it, firm management doesn’t know if: 1) the procedures in place are being followed and if so are they effective; 2) the office system is adequate to provide information needed to properly manage the finances of the firm; 3) the policies are being adhered to in order to maximize the collection of the fees the firm worked so hard to generate. Proper financial management of both firm and client matters dictate that firm management should know certain key financial statistics of the firm such as the average billing rate, the average rate actually billed, the average rate actually collected, the firm realization rate, the firm expense per hour costs, how long a billable hour stays in Work In Process before it is billed to the client, and, on average, how long a billed hour stays in Accounts Receivable before it is collected. Without an awareness of this type of information the successful management of a firm’s finances is left to chance.

This brings us to the four phases of the process mentioned above, and what should and should not be done to achieve success. For the billing and collection process to have a fair chance of success it must begin with clear communication to the client regarding all aspects of the engagement in the Client Acceptance phase. A concise discussion should be held concerning services to be covered, fees to be charged, how expenses will be handled, billing frequency, due dates for payment and all other expectations of both client and firm. This understanding should then be put in writing in a definitive engagement letter. This limits misunderstandings and formally defines the service and fee arrangement. It is also critical at this time to establish the business nature of the relationship even though the matter being handled may be of a very personal nature. Capturing Time is a discipline that is crucial to the process and should be cultivated into a habit, therefore requiring both formal training and an understanding of the ramifications to the firm of not maintaining accurate time records. All time, billable or not should be recorded by all personnel on a daily basis. Statistical data supports the fact that real billable time is lost if not recorded on a contemporaneous basis. It’s easy to “lose” a half an hour’s worth of phone calls, brief meetings, etc. daily if time isn’t recorded contemporaneously. At the average rate per hour of \$185 this translates to over \$20,000 of lost billing-not because the work wasn’t done but because a procedure or policy was violated. Even when using alternative fees (not hourly billing), all time should be recorded to better manage these engagements. This brings us to the Billing phase of the process.

Remember this axiom “ the more timely the bill, the more timely the payment and the fewer questions about the bill from the client”. It is suggested that bills be sent out no later than the 10<sup>th</sup> of the month following the month the service was rendered. Statistical surveys have shown that timely billing can increase a firm’s realization anywhere from 2% to 5%. On a \$500,000 gross billing that can mean \$10,000 to \$25,000 in increased collections. When WIP is reviewed timely the attorney is less apt to “write down” the hours as the value of the services is more clearly

perceived due to the close proximity in time of the actual service being provided to the bill for that service. Bills should be easy to read with just enough information to allow the client to understand what he is being charged for. The bill should not contain any surprises, either charges for services not agreed to on acceptance or charges well in excess of those approximated in discussion with the client. If charges are running well in excess of those estimated the billing attorney should meet with the client to discuss this as they occur. Once a fee is billed we enter the last phase of the process, *Collection*. Once a fee is billed it becomes an asset of the firm called an Account Receivable. Unlike cash the problem with this asset is that the longer it stays on the books the less valuable it becomes.

This is due to the diminishing chance of collection and the costs of “financing “ the receivable, which can easily equate to thousands of dollars. It is easy to see, therefore why it is extremely important to have procedures in place to follow up on billing that is not paid timely. These procedures must be utilized uniformly to be effective as this is critical to the successful financial management of any firm. Suggested action steps and a timetable would be as follows: at 30 days send a “friendly” reminder, at 45 days a telephone call from the collection “department,” at 60 days a telephone call from the billing attorney, at 75 days a collection letter, and at 90 days a certified letter that the account is being turned over for collection and that the firm is evaluating whether it can continue representation (at this point, even if billed timely, it has been at least 3 + months since the service was performed).

There are a few additional tips that may enhance the collection phase of the process. Use “flat” or “fixed “ fees when possible (remember accurate time recording is critical to “flat” fee pricing); offer alternative methods for payment (credit card, direct check, etc.); reserve part of the retainer and apply it against the final bill (this should be discussed at acceptance).

In summary, as a process, this isn’t “rocket science.” However to be successful at the process it needs to be given the highest level of priority. Finally, the process requires consistent vigilance and discipline to effectively shorten the distance from generating a fee to collecting it.

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