

The Next Best Thing After Cutting Expenses: Collections

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When the economy reached the depths of the recession only a few short years ago, the almost universal reaction among law firms was to cut expenses. Associates, income partners and staff were laid off. Offices were closed. Perks were eliminated. Summer associate classes were downsized and start dates were deferred. Even some partners were deequitized. The hope was that all or some of these measures would substantially offset the decline in revenue. Yet law firms continue to suffer the lingering effects of what some have called the “worst economic recovery ever.”

However, further expense cutting may no longer be the answer. A recent survey conducted by Wells Fargo Legal Specialty Group indicates that expenses are rising faster than revenue at the nation’s largest law firms, and management is running out of ways to manage the imbalance. So where does the solution lie? Maximizing the collection of revenues through the implementation of best practices in billing, credit and collections.

Where should you start? If your firm already has a professional collections staff, it’s time to retain an accounts receivable management consulting firm to see how the firm, its locations, practice groups and attorneys are performing from a billing and collection standpoint. CMS/Intelliteach (www.cms-group.com), one such firm, offers two products. The first is called a Baseline Assessment Review (BAR). The BAR analyzes the firm’s billing and collection realization performance over a three-year period. Among other things, it determines the current collection staff utilization and account coverage and provides insight into the effectiveness of the billing and collections process. The review enables CMS to proactively make recommendations for work in progress (WIP) and accounts receivable (A/R) improvement. One of the more eye-opening reports is the exposure or “at risk” report, which details the amount and percentage of A/R and WIP that will never be collected based on the firm’s historical performance.

The second product provides a more comprehensive evaluation. This cash flow review analyzes a firm’s entire cash flow cycle to identify those issues and provide specific solutions for improving the revenue function and increasing firm profitability. It covers critical problem areas from client intake and management through the final disposition of an invoice and write-off policies. Critical to your return on investment and success is studying the results of either review and taking the steps to implement any recommended action plan.

If your firm does not already have a collection manager, it is probably time that it hired one. You might think that based on how they delegate responsibility for them, collections aren’t that important to law

Law Practice TODAY

THE MONTHLY WEBZINE OF THE ABA LAW PRACTICE MANAGEMENT SECTION

firms without collection managers. In fact, you could get the impression that it is almost an afterthought. Instead of a collection professional, the firm's office administrator, its managing partner, the chief financial officer, the billing or accounting staff or a combination of all of these individuals have these duties and responsibilities, without any overall policy or strategy in place. Frequently, these individuals do not have the interest or time, yet alone the requisite training to capably take on this role. Many are just not comfortable with this role.

Every AmLaw 200 law firm, and even those firms with revenues as little as \$50 million annually and 100 timekeepers, have a need, sufficient work and the financial ability to justify the hiring of a professional collection manager. If you are not convinced, simply add up your write-offs for the past year alone attributable to your clients' financial inability or unwillingness to pay. If that number far exceeds the average salary and benefits of a collection manager, you probably need one. If you add credit review at client intake and managing the firm's year-end collection push to the mix of responsibilities, ample work exists for at least one collection manager and, depending on the size of the firm, probably enough work to keep a number of individuals busy.

Many firms combine the roles of billing and collections into one position designated as the billing & collection manager. Some of these firms seem to think that adding the word "collection" to billing manager enables that person to take on that role. That is often not the case.

Accounts receivable management is a highly specialized area. A number of professional organizations, including the National Association of Credit Management, American Collectors Association and the Commercial Law League of America, provide education, resources and certifications for its members.

While it probably shouldn't be the case, based on the idiosyncrasies of law firms, collection of receivables in a law firm environment is even more specialized. In most law firms, especially the largest ones with multiple offices and hundreds of timekeepers, there simply is not enough time to capably perform both roles. Combining the roles also limits the pool of qualified candidates when the position does become open. Typically, you can find an individual with the knowledge and expertise to excel in one of the positions, but rarely both. Those with collections experience may not have the necessary billing experience, and vice versa. Accordingly, these roles and the title should be split.

Law firms also can take a page from their brethren in the private sector by conducting a credit review at client intake. While firms have made strides in this area, this remains an area of opportunity for many firms. This is not to suggest that law firms should be asking their clients to complete credit applications or provide financial statements. It also does not mean turning away new business in what is one of the most challenging economies in decades.

What it does mean is conducting some minimal due diligence, making an informed decision on the clients that the firm decides to accept, and then putting some protections in place based on the firm's tolerance for risk. For business clients, this means, at a minimum, pulling a Dun & Bradstreet or a

comparable report. For individual clients, it means running a comprehensive report to determine possible employment, property ownership, suits, judgments, liens, prior bankruptcy filings and criminal records. It also requires attuning attorneys, when they meet with prospective clients, to understand their financial ability and willingness to pay the anticipated fees and costs for the work to be performed. To be able to use this information, you will need to know the estimated total fees for the matter and/or average expected monthly billings. From there, you can make some recommendations, depending on the firm's level of risk tolerance. These recommendations may include, among other things, obtaining an evergreen, advance payment or security retainer, obtaining a corporate or personal guaranty, increased hourly rates, reviewing the client's account periodically by placing them on a credit watch list, or putting the client on a "short leash" – all very effective mechanisms to manage risk.

Law firms can take another page from other industries by stopping work on past due accounts until the client's account is brought current. For years, businesses have been able to successfully leverage this collection tool by halting current shipments or future orders on goods until their customer's account was brought current.

Every firm should have a policy on when to consider stopping work. It doesn't have to be a number set in stone and may even consist of an aging range. It also will vary based on the firm's tolerance for risk. There will be exceptions as well. Whatever that trigger or the range is, every attorney in the firm should be aware of the firm's expectations in this regard. The client should be given a reasonable opportunity to bring their account current or make payment arrangements after they have been notified of the firm's intention to stop work, or the firm's inability to handle a new matter for them. You will need to be particularly careful in litigation and intellectual property matters to make sure you comply with all ethical rules and guidelines. The few law firms that do have this policy in place and have enforced it, have found it to be effective and, surprisingly enough, it has not led to the loss of firm clients.

Along with credit and stop work policies, the firm should have a written billing and collection policy. The firm should establish the expectations and the roles it expects the firm's attorneys to play with respect to billing and collections. Attorneys should know when a client's account is past due and "seriously" past due, when responsibility for collecting the account will be taken out of their hands, with or without notice, and when and if it will be placed with a collection agency or law firm. With this information, attorneys will be able to comprehend the importance and significance of the different aging periods on their account receivable reports. This information also will be necessary in order for them to convey the firm's expectations to their clients and assist with collection of their own receivables.

Once you have written policies in place, you will need a finance or billing and collections committee with the authority and power to enforce those policies. The key is to establish well-thought out policies that are consistent with the firm's culture. It may involve not only "sticks" but "carrots" as well.

Policies that are enforced work. Policies that are only enforced inconsistently, sporadically or rarely, do not work. Exceptions to the policies will occur but should be far and few between.

Such a committee brings numerous benefits. In order for the collection manager to effectively perform their job, they frequently rely on cooperation from attorneys for such things as client financial and contact information, the status of a pending matter or prior collection efforts. Even though the collection manager may sit on the committee as an ex officio member, the attorney will view it as the committee's decision when, for instance, the firm requires a sizeable retainer to open a new matter or withdraw from a client's case because the client's account is seriously past due. This allows the collection manager to continue to maintain the relationships he or she has formed with the firm's attorneys. It also allows the attorney to place the blame on the committee in the attorney's own efforts to follow up with the client to get paid.

Attorneys who do not want to contact their own clients regarding their past due accounts and will not allow their collection staff to contact them either is a recurring problem at many firms. Tying an attorney's performance review and ultimately their compensation to their fees outstanding and their billing and collection realization is one possible solution to this problem. Their duty to be good firm citizens and how well they fulfill that duty also should be part of this equation.

This can be problematic at the higher revenue generating and more prosperous law firms, because collection of another receivable may not personally matter to the partner if they already generated enough revenue for the year and expect to receive a substantial distribution at year end anyway. Collection policies and enforcement of those policies by the finance or billing and collections committee by removing the account from the hands of the partner when they have been ineffective in securing payment from their client should help resolve this issue.

Educating attorneys on how professional collection staff collects the firm's receivables should be strongly considered at most firms to obtain attorney buy-in. A fair number of attorneys seem to think that collections is synonymous with confrontation, when that is often not the case. In fact, that is one reason, and maybe the most prevalent reason, why attorneys are reluctant to contact their clients themselves. Yet telephone contact is probably the most effective, yet most underutilized tool to get paid.

Law Practice TODAY

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Other attorneys are fearful of anyone other than them speaking to their client. They are particularly fearful of whom the collector will contact and what they will say. One attorney I know, remarked that it would be a “disaster” for someone other than him to contact his client regarding their past due account. Attorneys with this same line of thinking would probably be surprised that a collector would initially contact the accounts payable department or the controller at the client, and the conversation (resulting in payment, by the way) would take place without even using the words “past due” or “collect”. Collection successes, even small ones, are also helpful in securing attorney buy-in.

Putting all of these pieces together and effectively managing credit and collections requires collection software developed specifically for law firms. Firms using Outlook to store contact information and diary future actions and Excel spreadsheets for past activities will be out of luck when that individual leaves the firm.

Many firms would be surprised that they already have collection software as part of their time and billing system, but have never used it. Those that don’t have it will find that it is surprisingly affordable considering the significant role that it plays and the efficiencies that it creates.

The two leading software vendors selling collection software specifically targeted for law firms are Select Associates (www.selectsa.com) and Minisoft Worldwide (www.minisoftworldwide.com). Both would allow a new collector to seamlessly transition where the prior person had left off.

Lastly, a word or two needs to be said about alternative fee agreements (AFAs). At most firms, AFAs still comprise only a small component of firm revenues compared to the billable hour. Truth be told, the billable hour still remains “king” at most law firms. This appears to be the predominant reason why law firms remain on the fence on what to do with respect to AFAs. However, there is no evidence that AFAs are going away anytime soon. In fact, the surveys suggest otherwise - client demand for their use is only increasing.

Law firms are faced with two options. They can bury their heads in the sand and pretend they don’t exist. These firms will continue to “dabble” in AFAs but most of those engagements will be unprofitable. Alternatively, they can get on the AFA bandwagon and embrace them. This means investing in education, project management and matter/budget planning software.

Consider, if you will, a suggested minimum investment of the amounts you wrote off in the last year or two alone on matters that exceeded the flat fee, fee cap or risk collar and your “losses” on your blended, discounted or contingent fee arrangements, among other things. The firms that invest in AFAs will learn how to properly manage these matters and eventually make them profitable.

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