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To keep the money coming in, track the numbers

... OR THE DOLLARS WILL SLIP AWAY UNNOTICED

To keep the firm profitable, “know the numbers.” Know the income, the outgo, the losses, the profitability. And in doing so, track the factors that affect them.

“Competition is fierce,” says **BRENDA BARNES, CPA**, managing principal of B2 Legal Management in Austin, TX. Not only are people cutting back on their legal expenses, but the number of attorneys is expanding. One statistic even shows one lawyer to every 300 people.

Thus, good financial performance today calls for good financial tracking so the money gets spent and saved in the right places.

THE ACCOUNTS RECEIVABLE NUMBERS

Start the tracking with the accounts receivable, and the overriding rule, Barnes says, is that 60 days past due warrants action.

For a law firm, the potential for full collection at 60 days is nil. Start discounting the bill right there. The longer it goes unpaid, the less the chance of collecting anything at all.

Tell the client “pay this by December 31, and we will cut your bill by 10%.” If the picture is really dim, cut it in half.

But cut it. As with retail business, “don’t fall in love with the inventory.” When something is a loser, “let it go.” Some money is better than none.

The only alternative is to sue the client, and that leaves the firm open to a malpractice claim.

THE BILLING REALIZATION NUMBERS

Watch the billing realization rate. It can slide without anybody’s realizing it.

The attorneys should be billing 90% of their work time, and the firm should be collecting 90% of what they bill. A rate any less than that indicates a problem,

most likely a problem with the billing communication.

One solution is to set up an agreement at the start of the work that the firm can charge overdue amounts to the client’s credit card after a certain number of days.

Another is to state in the agreement that the work will stop if the client doesn’t pay.

Yet another solution is to clarify the work descriptions on the bills so it’s clear what the attorney has done. Otherwise, “clients think they’re being taken advantage of or overbilled.” And they don’t pay.

THE CASH FLOW NUMBERS

Track the cash flow numbers.

The easiest way is to do monthly tracking with a spreadsheet showing the income and outgo. That tells

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the firm what to expect – that revenues will be down in July because of vacations or that a large insurance payment will be due in March.

Knowing how the cash flows, the firm knows how much to put aside month to month to cover the large expenses and when it's going to have to draw on the line of credit.

NUMBERS FOR PROCEDURES TOO

Know the work processes.

The way people do their jobs greatly affects the financial picture, Barnes says. Inefficient work not only slows the office down but leads to unnecessary overtime and even unnecessary hiring.

Her advice is to set up a procedures manual.

Wherever there's a good system in place, "write out how to do it from A to Z." Do that for everything from how files get opened to how conflicts are checked.

Another way to improve the work process is to ask each staffer "if you could have anything in the world to help you do your job better, what would it be?" It may be the computer equipment is antiquated. Or maybe the technology is underused.

Evaluating procedures identifies wasted work and duplications of work. It shows where tasks and even jobs can be combined. It shows what can be outsourced more cheaply than paying a salary for it.

Work process evaluation is especially necessary in larger firms, she says, because with many people doing many jobs, procedures tend to get covered in fluff and money gets lost in dribs and drabs.

A NEW TYPE OF ATTORNEY SALARY

Know too the attorney salaries, but look at them with a creative eye, Barnes says.

Many firms are staring at reduced work loads and an economy that doesn't support the risk of hiring new attorneys to replenish it. So they are bringing in new business by hiring attorneys not on salary but on a percentage of what they collect and originate.

The percentages might be 40% of the collections and 10% of the origination work. Or the firm might pay a relatively small salary and then at the end of the quarter or half year determine whether the attorney is owed more money.

It's a viable approach, because new attorneys, particularly those just out of school, are finding jobs tight "and need a place to land." Something is better than nothing, so they aren't averse to foregoing salary in exchange for a percentage based on performance.

And it's an affordable approach, because the firm

doesn't have to cover the attorney during a nonproductive month.

More still, it gives the new attorney a fast education in how to think like a partner as opposed to living on the comfort of a salaried job.

AND ALL THE NUMBERS IN THE BUDGET

Finally, Barnes says, keep ongoing track of the operational numbers with a budget.

Setting a budget and sticking to it prevents overspending and also shows when financial changes need to be made.

Track the budget numbers every month to see if reality is in line with projection.

With the frequent reviews, the firm can make accommodations for up or down changes in income and expenses. And at year 's end, the partners don't face an unexpected losses.

To set the budget, use the numbers over the past five years as rough estimates. Put in the little expenses as well as the big ones, from entertainment to rent. Then have the practice areas set out their individual expectations. The questions they need to answer are

- *Are we going to add (or get rid of) any lawyers?*
- *What are the projected billable hours for this practice area?*
- *What new business do we expect to bring in?*
- *Are we going to lose any clients?*
- *What are our projected collections?*
- *Do we have adequate staff support?*
- *Is our technology up to date or do we need to upgrade it?*

Along with that, have the attorneys project the number of their individual billed hours for the next year plus their collections and originations.

She cautions, however, to make sure their projections are realistic. If Attorney A estimates 1,900 billed hours for next year but in previous years has billed only 1,500, there has to be more than ambition to support the increase. There needs to be a new client or a new matter already in the works – not just a good prospect the attorney is talking with.

By tracking those numbers month to month, the firm knows immediately when revenues are dipping lower than expected and then can identify the contributing factors and come up with solutions.

For example, it could be the attorneys are giving too many discounts. Or it could be the realization rate is low because the hourly rate is too high.

What's more, the firm knows which attorneys are a drain – and need to be let go. A lot of those nonproductive lawyers, she says, "are sitting in larger firms" and ruining the numbers. ❖

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