

The Lawyer's Office

Want profitability? Run your practice by 'RULES'

By Paul Sullivan

I'm frequently asked what type of financial management tools larger firms use to track their profitability, the financial effectiveness of their lawyers, and overall financial health of the firm.

There are five essential components to effective law office financial management: Realization, Utilization, Leverage, Ex-pense Control, and Speed of Billing and Collection.

Commonly known by the acronym of "RULES," these components, if properly managed, will make the firm profitable, provide the highest level of personal income to the owners, and maximize cash flow.

Realization is the amount of dollars that are actually collected as a percentage of the dollar value of the time billed. Low realization is primarily the result of billable time being written off, or bills being written off, because the client didn't pay.

Realization should be analyzed from a variety of perspectives. Reports showing realization by client, by individual matter, by each individual attorney, and by billing or responsible attorney, if the firm has such a structure, are valuable.

Having a billing system that can provide realization information by these categories will give management the ability to compare individual items within each category and identify any problem areas. Good management will then deal with the problem.

Utilization is simply the productivity of each timekeeper relative to the amount of hours each can bill in a particular period. Good timekeeping habits and a timely recording of billable activities is key. Those who don't enter their time regularly are fooling themselves if they think they are capturing all the tasks they have performed. Most firms set billing goals and monitor and enforce prompt time entry. The goals are based on realistic expectations, and a timekeeper's future promotion and compensation are based on the ability to achieve the goals.

Leverage is the ratio of non-owner timekeepers to owner timekeepers. The higher the ratio, the more likely the owners will personally benefit. All timekeepers should be making contributions to overhead in excess of their direct costs.

Direct cost is composed of salary, bonus, and benefits for a particular timekeeper. The collective contribution of all timekeepers, after covering expenses common to the firm (indirect costs), becomes the distribution or profit pool. The greater the number of contributors to the distribution pool, relative to a lesser number of those to share in the pool, results in bigger shares for the owners.

In many firms, leverage is becoming more difficult to achieve, and as a result, the productivity of individual owners is becoming a significant management issue.

Expense Control is the exercise of monitoring expenses and then taking necessary action. A budget can be a very effective management tool to monitor expenses throughout the year. It is created based on historical data as well as anticipated needs for the year.

When expenses exceed the budget, it's important to analyze the cause and then take corrective action. Corrective action could be reduction of expenses in other areas, or some effort to increase revenue to deal with the increased costs.

It requires careful analysis, because whatever decision is made will have an impact - not necessarily positive. It could even cost more in the long run if the wrong decision is made.

Speed of Billing and Collection of accounts receivable is critical to good management. Most clients prefer to receive bills on a regular basis, so every matter in a law office should have a "next billing date" attached.

Missing dates not only impact cash flow, but also might make a client unhappy. Many clients have strict billing guidelines. It will require good billing and accounting systems, and a knowledgeable person in the office, to adhere to them.

Bills sent out without meeting the requirements probably won't get paid. Electronic billing is becoming more prevalent, so having that capability will become an increasing necessity for firms.

In addition to having good reporting procedures to identify delinquent accounts, having a willingness to contact those clients and ask them to pay is good management. A personal contact is always better than writing a letter or just sending a notice.

I've heard more than once from attorneys that they didn't want to offend good clients by asking for payment, yet they continue to pile up time on the file with no payment. This impacts realization as well as cash flow.

Do you really think a non-paying client is a good client? A good client is a happy client who pays bills. Often the bill is unpaid because of a misunderstanding or an issue the client wants to discuss first. Make contact anytime a bill goes beyond 60 days.

Large firms live by the RULES, but for even a small law office, knowing and using the RULES will go a long way towards financial success.

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