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10 tips to jumpstart your collections

How to assess your
operating reserves

Thinking about adding
nonequity partners?

Pros and cons of adding another partner level

The legal industry is
resilient — but challenges remain

LAW FIRM MANAGEMENT

SPRING 2022



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10 tips to jumpstart your collections

Collections are a fundamental part of profitability and perhaps more important — and more challenging — than ever. By taking the following steps, you can boost your law firm's revenues while reducing your post-due date efforts.

1. PERFORM A FLOW ANALYSIS

Use flowcharts and timelines to illustrate your current billing processes. These will help you identify stumbling blocks or bottlenecks that delay the process, from timekeeping to invoicing.

The analysis shouldn't be a one-off. Do the analysis at least annually, depending on how your collections are going. This will allow you to implement improvements on a continuous basis.

2. ESTABLISH A FORMAL, FIRM-WIDE POLICY

Firms shouldn't handle collections in an ad hoc manner. You need standardized billing and collections procedures so everyone is on the same page, whether new to the firm or an old hand.

That said, be open to alternative approaches suggested by creditworthy clients. Billing clients in their preferred method may lead to fewer excuses for late or partial payments.



3. SET EXPECTATIONS EARLY

Discuss payment terms and your collections policy with new clients at the outset — for example, how often you bill and by what medium. What are the effects of delinquent payment? Will there be financial penalties? Will you seek to withdraw from representation?

If clients have their own billing guidelines, ask questions about their expectations and processes. Understanding their side of the equation can help you secure timely payment in full.

4. CONFIRM CREDITWORTHINESS

You don't necessarily need to run a formal credit check on every prospective client. You do, however, want some evidence that clients are able to pay before signing on.

You might want to charge an initial consultation fee. This can weed out clients who will struggle to pay. You can offer to apply the fee to a retainer if hired. (See "Reconsider retainers" on page 3.)

5. DON'T DRAG YOUR FEET

Bill according to a regular schedule, whether at the end of the month, semi-monthly or, for transactional matters, when the work is complete. Regular billing puts clients on notice and allows them to budget for their payments. Plus, clients are more likely to pay for work that's still fresh in their minds.

Never let more than a month go by between invoices. If nothing is due, at least send a status report.

6. PAY ATTENTION TO INVOICE FORMAT

Invoices should be easy for lay people to understand. First and foremost, clearly state the amount due, the due date and contact information for questions.

RECONSIDER RETAINERS

When properly administered, requiring clients to pay retainers can go a long way toward preempting collections problems. And they're not just for larger firms.

Retainers give attorneys some guarantee that at least part of a client's bills will immediately be paid, keeping that client's account balance at zero. If the applicable state rules permit, you can request an automatic replenishment arrangement (also known as an evergreen retainer). When the retainer balance drops below a certain threshold or work in progress begins to approach the retainer balance, the retainer is refreshed.

Retainers are an option even if you don't have clients with deep pockets and long-term or ongoing work. Smaller firms or solo practitioners can require an upfront payment of \$500 or \$1,000, with the client adding to the balance with monthly or semi-monthly payments. If clients can't make that initial payment, you may face collection issues down the road, so it also acts as a screening device.

Don't stop there, though. Consider breaking down the services so clients know what they're paying for, thereby reducing the odds of disputed charges. You may want to tailor the service descriptions based on a client's level of sophistication.

7. MAKE PAYMENT EASY

If you haven't already, widen the payment methods you accept beyond paper checks. Today's clients expect the option to use credit cards, automated clearing house and online payments (complying with the applicable state ethics rules).

For old-school clients who prefer to pay by check, you can make it easier by including a stamped, self-addressed envelope. For flat fee services, you might accept payment through peer-to-peer payment apps such as Zelle, Google or Apple Pay, PayPal, or Venmo.

8. CONSIDER CHARGING INTEREST

You needn't, of course, call it "interest." You can instead refer to a "discount" for early payment.

Any such charges should be included in the fee agreement and discussed upfront. This is, of

course, assuming the charges are permitted in your jurisdiction.

9. FOLLOW UP

There's no need to be shy when payments are past due, especially when you can automate follow-up. Reminders should go out immediately if invoices aren't paid after 30 days and regularly after that.

Only offer compromises like significant discounts as a last resort. Such measures disincentivize timely payment.

10. CONDUCT REGULAR REVIEWS

Develop the habit of reviewing work in progress and unfinished matters for potential billing opportunities. Prepare and circulate work-in-progress and accounts receivable reports so attorneys know where their clients are in terms of payment.

YOU CAN'T AFFORD NOT TO

Not every law firm has the resources for a dedicated billing and collections team, but the tips above are even more essential in such circumstances. They can help you spend more time on your core competency and less time running down receivables. •

How to assess your operating reserves

The COVID-19 pandemic has affected law firms in many ways, perhaps none so much as the importance of operating reserves. Having sufficient reserves to cover day-to-day operations is crucial. But the reserves amount needed varies by firm and may require additional partner capital contributions. If your firm is among those businesses with diminished reserves, here are some steps you can take to remedy the situation.

ADD UP EXPENSES

All firms face financial pressure. For example, your firm may have to provide client cost advances during lengthy litigation. And while the economy is holding steady for now, it's not unusual for clients to drag their feet when settling bills. Regardless, outside vendors expect prompt payment. Your firm might not have invoiced a client before vendors demand payment.

Once a law firm has settled the appropriate capital level, it's time to decide on the proper breakdown between partner contributions and lines of credit.

In addition, growing firms must take on new associates and lateral hires. Even lateral hires who bring clients with them usually receive several paychecks and incur overhead costs before those clients start generating — and paying — additional revenues. Partners also are expensive: As more Baby Boomers approach retirement age, some firms have more partners leaving to retire than young partners buying in.

Finally, today's attorneys expect to work with sophisticated hardware and software, and clients



expect their attorneys to leverage technology to provide efficient, cost-effective services. Keeping up with rapidly changing technology — and technologically up-to-date competitors — can be expensive.

CREATE A CAPITAL RESERVES PLAN

These issues can all be alleviated with adequate capital reserves. If revenues fall short, your firm can tap its capital to bridge the gaps. Having a capital plan can be helpful in these situations.

Your plan should address the firm's capital needs for the next three to five years. To quantify those needs, consider your average revenue cycle, any anticipated capital investments (for example, technology or physical space), operating expenses, estimated client disbursements, and perhaps partner draws (although it's usually best to defer draws rather than to pay them out of capital). If applicable, your firm should consider any payment obligations to retired partners.

CALCULATE YOUR CAPITAL LEVEL

Once you've calculated your capital needs, you have options for determining the specific amount of capital your firm will have to keep on hand.

You might base capital needs on one or more of the following four basic options:

1. Monthly expenses (not including partner draws). If your firm has a strong cash flow (meaning prompt collections), you might set capital at one to two months. If you have a slower turnaround, you should consider using three to six months as the measure.

2. Fixed percentage of gross fee collections. When setting the percentage, assess the timeliness of your collections and plans regarding hiring and space. Most firms set the percentage close to 10%.

3. Long-term debt. Putting aside capital equal to half of your firm's long-term debt provides lenders with some comfort. Since the 2008 recession, lenders have been less accommodating about extending credit to law firms than they were in the past.

4. Net fixed assets. This method assumes that your firm has secured outside loans to finance fixed assets, and that your partners will fund working capital in an equal amount.

When you've settled on the appropriate capital level, decide on the proper breakdown between partner contributions and lines of credit. This decision should consider your firm's — and individual partners' — tolerance for debt. The higher the debt tolerance, the greater you can rely on credit lines over contributions, and vice versa. Note that your partners should also consider potential personal liability associated with lines of credit. Credit lines typically are subject to joint and several liability, putting all of your firm's partners at risk of liability for the entire amount owed in the event of default.

MAKE ADJUSTMENTS

So, you've done the work and made a plan that meets your firm's strategic and financial needs. Now what? Review it annually to see whether you're meeting your goals. If not, start the process over and adjust as necessary. Having a capital plan will help with the uncertainty and provide partners and other stakeholders with a sense of stability. •

Thinking about adding nonequity partners?

PROS AND CONS OF ADDING ANOTHER PARTNER LEVEL

Smaller law firms that are reluctant to add more equity partners may consider creating nonequity partnerships to reward and retain high-performing associates and lure in laterals. This approach can come with both pluses and minuses, though, and requires significant forethought.

ALLURING ADVANTAGES

Most obviously, a nonequity partnership tier gives firms a way to retain strong attorneys who aren't necessarily effective rainmakers. It's

especially appealing when such attorneys practice in lucrative niche areas.

The title conveys prestige without increasing the number of partners entitled to earnings, complicating governance or requiring capital. And it lets the firm raise these attorneys' billing rates, so the earnings grow.

Talented nonequity partners can lead teams and manage portfolios independently. Clients benefit from their deep experience and expertise, and equity partners have more time to expand their practices and do community work.

POTENTIAL PITFALLS

Nonequity partnerships can prove a good idea in certain situations, but they're not without their downsides. For example, if a firm isn't careful, it can undermine profitability, because nonequity partners typically work fewer hours than equity partners and associates despite the increase in base pay that comes with the title. Firms generally can address this concern by providing less frequent pay increases and incorporating more performance-based variable pay.

Law firms that create a nonequity partnership tier also risk having the tier become an inefficient "boneyard" for good, but not particularly talented, attorneys. To avoid this outcome, firms need to incorporate some type of annual rating system (based on factors such as skills, productivity and experience).

Those who consistently rank lowest require some type of action, most likely an exit strategy. This should help keep a lid on the number of nonequity partners while simultaneously raising the group's performance levels as a whole.

IMPLEMENTATION ISSUES

If your firm decides to proceed with a nonequity partnership tier, you must consider several issues ahead of time to increase the odds of success. For

example, how can you make attaining the status meaningful to an attorney?

Start with some fanfare. Issue press releases and send announcements about the promotion to clients, other attorneys and the new partner's friends and family. List nonequity partners on the firm website, letterhead and other marketing materials. You also can give a new nonequity partner some additional fringe benefits, such as life insurance, a firm credit card or a club membership.

A nonequity partnership tier gives firms a way to retain strong attorneys who aren't necessarily effective rainmakers.

You'll need to determine the role nonequity partners will play in governance. Consider sharing at least some financial information. Let them attend some partnership meetings and allow input on management decisions as nonvoting partners. You also can assign them to firm committees and base part of their compensation on firm performance.

At the same time, though, an equity partnership must remain distinct and ultimately more

desirable. You want attorneys throughout the firm to continue to strive, rather than set their eyes lower, settling for nonequity partnership for the long term.

PROCEED WITH CAUTION

Creating a tier for nonequity partners is no small decision. It has substantial implications for a law firm, both cultural and financial, so exercise care. •



The legal industry is resilient — but challenges remain

After experiencing a surprisingly positive year in 2020, the U.S. law firm market ended 2021 on solid economic footing. That's according to the *2022 Report on the State of the Legal Market*, issued by the Center on Ethics and the Legal Profession at Georgetown University Law Center and the Thomson Reuters Institute. Here are some of the key findings from the most recent edition.

SOARING DEMAND AND RATES

While demand for legal services was weak in early 2021, it climbed over the rest of the year. The real estate and corporate practice areas were the primary drivers behind this demand; both recovered their losses from 2020 and exceeded pre-pandemic demand levels. Litigation again struggled, though, with demand mired below pre-pandemic levels.



The report also found that law firms continued to “aggressively” raise their billing rates in 2021. Combined with better realization, this contributed to another year of strong profits at many firms.

HIRING OBSTACLES

The heightened demand has created a growing hunger for legal talent. Firms, however, are running headfirst into attorneys’ evolving work

preferences — for example, better work-life balance and feeling appreciated and recognized at work — as they try to add to their numbers. In response, the report says, many firms have boosted compensation. Associate compensation rose at double-digit levels, in turn causing overall law firm costs to increase.

But greater compensation hasn’t been enough to combat attorney turnover. Based on analysis of turnover patterns, the report found that those firms with the lowest turnover don’t necessarily have the highest compensation growth. Surprisingly, the firms that tended to have the lowest compensation growth were those with lower turnover rates.

Notably, workloads also didn’t seem to correlate with turnover. Attorneys at the firms with the lowest turnover billed an average of 51 more hours per year than their colleagues at firms with the highest turnover.

LINGERING ISSUES

The favorable findings shouldn’t give law firms too great a sense of security, the report cautions. It identifies several additional issues firms need to address, including hybrid work models and operational efficiency.

The report notes a growing consensus among firm leaders that some combination of remote and on-site work is inevitable going forward. That will lead to questions involving, among other things, equitable assignment of work, mentoring, evaluations, advancement and firm culture.

AGILITY IS ESSENTIAL

Law firms, the report says, displayed “surprising agility” during the pandemic. Now, it adds, they must stay similarly agile in areas like managing support staff and improving financial practices including billing and collections (see “10 tips to jumpstart your collections” on page 2). •



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