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MINIMIZE CLIENT CREDIT RISKS

By George A. Abodeely

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TO SURVIVE IN TODAY'S economy, law firms have devoted their attention and financial resources to strengthening the administrative side of the business. Among other things, this may include a significant investment in new or enhanced management information systems and the hiring of trained financial managers and staff. To maximize the return on their investment, law firms should improve their internal collections process without alienating clients.

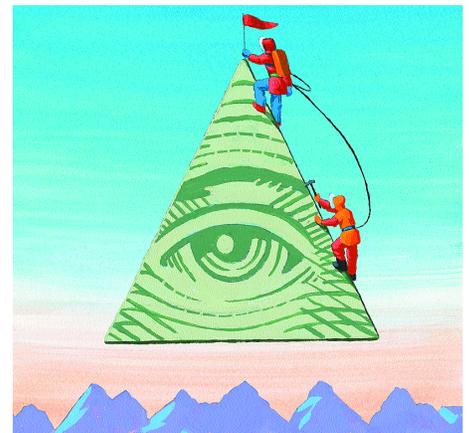
Many of the "problems" assigned to collections specialists might have been avoided in the first place (or minimized) had there been a better internal approach to client/matter intake, billing and collections management. This article will focus on client intake, an often overlooked or hurried process in many firms. (While many of these ideas may prove useful to firms of all sizes, they are best suited to full-service law firms with 50 or more lawyers. And these ideas may not always apply to specialized practice areas that require a formal applications process as a means of obtaining the work and securing payment.)

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Risk from the get-go

Unless your firm is able to obtain a full advance or retainer from every new client, one has to be willing to assume a certain degree of credit risk in order to survive and grow. The key is to control this credit risk by establishing an internal review process that allows the attorneys to make informed decisions before entering a relationship with a new client. To do so, your firm will need specific information that not only is used to clear the conflicts committee, but also can be used to help you perform financial due diligence on the potential new client. A determination must also be made as to which decision makers in the firm will be responsible for accepting or rejecting potential new clients. The decision-making process should typically be centralized.

Most firms have a strategic plan or business plan (even if the plan is just "understood") that includes the firm's goals for growth. Law firms should develop standards or guidelines for new client intake that reflect these goals for growth while defining what the firm considers to be acceptable risk. When developing intake standards, try to avoid a blanket policy that states "all new clients are required to submit an advance or retainer of 50% of the estimated billings." In a full-service law firm, blanket policies often don't work. Instead, consider establishing minimum financial-capacity requirements for each new client type that, if met, will waive the need for an advance or retainer. (Of



course, if an advance or retainer is available, take it.)

Consider the guidelines in the accompanying chart. Which category does the new client fall into? They include private entity, federal or state entity, insurance company and so on. Then determine its financial reliability.

The quality of the information obtained by the submitting attorney will determine the success of the entire process, and utilizing a well-designed intake form is the best way to present the information needed to screen new clients effectively and identify potential conflicts of interest. A new client form should include the following information fields:

- The type of potential new client or financially responsible party (e.g., publicly traded company, privately held company, insurance company, individual or sole proprietorship). The ability to obtain reliable, independent financial information

New Client Credit Screening Requirements

Financially Responsible Client Type	Minimum Financial Capacity Requirements in Order To Waive 50% Advance or Retainer
Federal and state government entities	No advance or retainer required.
Insurance companies	Standard and Poor's Insurance Industry rating of [insert rating code] or an A.M. Best Secure rating of [insert rating code].
Publicly held corporations	Most recent 10-K or 10-Q indicates a Quick Ratio of at least [insert ratio, i.e., cash and short-term investments divided by total current liabilities] and a positive stockholder's equity position.
Privately held corporations, including privately funded schools or universities	D&B rating of [insert rating code] or a financial statement indicating a Quick Ratio of at least [insert ratio, i.e., cash and short-term investments divided by total current liabilities] and a minimum net worth of [insert dollar amount].
Partnerships	Financial statement of each partner must show liquid assets (cash and short-term investments) equal to [insert figure] times the estimated billings for each new matter.
Individuals or sole proprietorships, litigation and nonlitigation matters	Unless insurance coverage has been confirmed, a 50% "evergreen" retainer of the total estimated billings is required.
Start-ups	Fees up to [insert amount] will be deferred until the first round of financing or for one year, whichever comes first. Client will advance all estimated costs.

will often be based upon the legal structure or formation of the potential new client. This information is readily available for the publicly traded or large privately held entities, while the opposite often applies to the smaller, privately held entities (where the risk often lies).

■ A realistic estimate of the total fees and costs to be billed for the initial matter.

■ Comments regarding a referral source's experience in getting paid.

■ The amount of the advance or retainer requested.

If none was requested, one would hope that financial pre-screening had been performed which indicated that the new client met or exceeded firm standards. If not, the submitting attorney should obtain from the client reliable financial information, such as current-year financial statements and prior-year tax returns.

■ Special billing requirements. Don't commit the firm to a billing procedure that requires a significant degree of manual intervention.

■ A statement of whether "this client [does] [does not] meet the firm's minimum financial capacity guidelines," completed by a person in a position of responsibility.

Establish an appeals process for submitting attorneys who believe there are compelling reasons for accepting a new

client that does not meet the firm standard. Firms should also establish an internal tracking mechanism to ensure that all new clients who were provided with a fee or retainer agreement actually sign and return them to the firm. Even if signed fee or retainer agreements are not required in a particular jurisdiction for all client

types, obtaining them will greatly enhance the firm's collected realization rate in the event of a dispute.

Well-designed new client intake standards will reduce excessive credit risk, focus the firm's marketing efforts and level the playing field for the submitting attorneys.

Old client, new matters

Here's where the old adage of "throwing good money after bad" applies. When reviewing a new matter from an existing client that has cleared the conflicts committee, an analysis of the client's existing receivable and work-in-process balance should be performed. The firm may then compare the results of this analysis against an established standard that is considered "unacceptable" in terms of exposure from any particular client. When developing the standard, try to avoid rigid or blanket criteria. Instead, consider one used in the lending community known as "cross aging," in which "advanced approval will be

required to open a new matter for any existing client with a total receivable or work-in-process balance of which greater than 33% is aged beyond 60 days."

When a new matter does not meet the firm standard, the decision maker(s) should have the authority to instruct the submitting attorney to first obtain payment of an existing delinquency (or a full advance or retainer) before work may begin on the new matter. These screening measures are crucial if the firm expects to control the level of credit risk for any particular client.

Once again, a good form is needed to enhance this process. A firm's new matter should include a section on the client's billing and payment history with the firm, since inception. This may include information fields such as total dollars billed, paid and written off since inception, and the collected realization rate of total dollars billed. If rejected, an appeals process should be established so that the submitting attorneys may present their views as to why an exception should be made for a particular client.

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Consider the client's history.