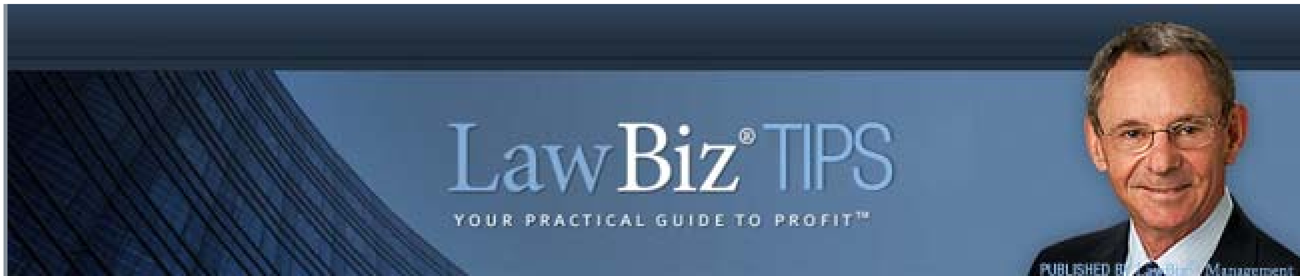

Week of **February 24, 2009**

Make Sure You Realize What You Bill

A coaching client called me recently and talked of billing out $150,000 in a recent month, but collecting only $90,000. The situation was a perfect example of the fact that too many lawyers fail to grasp the importance of collections. They feel a false sense of security as they pile up billable hours, but don't realize the danger in the uncollected cash that those hours represent. The gap between the two is defined as the realization rate, defined as the amount of a lawyer's time actually billed and collected.

The goal of any realization is to have a high billed to collected ratio. An overall ratio of less than 80% is a recipe for trouble. The lawyer just mentioned has a realization rate of 60%. In any business, if you collect 60 cents on the dollar, you are going to face problems in short order. If you realize only 60% of what you bill, in order to survive you will need to treat that 60% as 100% of your income. In other words, all your financial decisions will need to be based on the money actually collected, not on the billings sent out. If you can run your business on the 60%, that would be fine, but few lawyers can.

It is possible to estimate the progress of realization by using the accounting measure of turnover ratio: accounts receivable balance divided by the result of billings per days in the billing period (either monthly or annually). The turnover ratio tells a lawyer to expect payment for billings X number of days after a client receives a statement. The national average for law firms, according to past surveys, is often as much as 150 days. Of course, it's vital to do everything possible so that turnover is high; the longer a billing is outstanding, the less likely it is to be realized.

The turnover ratio illustrates one of the paradoxes of law firm finance: the greater your billings, the greater the need will be for cash in the firm. That's because greater billings mean more client work; this means more staff and other resources are required to do that work. These resources, staff, vendors, landlords and utilities, etc. expect immediate payment. Given the gap between when you send out a bill and when you receive payment, the more client invoices you have outstanding, the more cash you'll need while waiting for the money. The average 150 day turnover means a typical small firm should have funds sufficient to operate for at least five months on the expectation that the money will take that long to come in.

The lesson is obvious: lawyers must vigilantly focus their energy on collecting what they bill. Failure to do so will cause economic disaster.

Ed's Tweeting! twitter

Personal Commentary

For more information on collecting, visit our YouTube Channel for our latest Legal Pad vid-cast: *Collecting Your Fee*.

Best wishes,

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