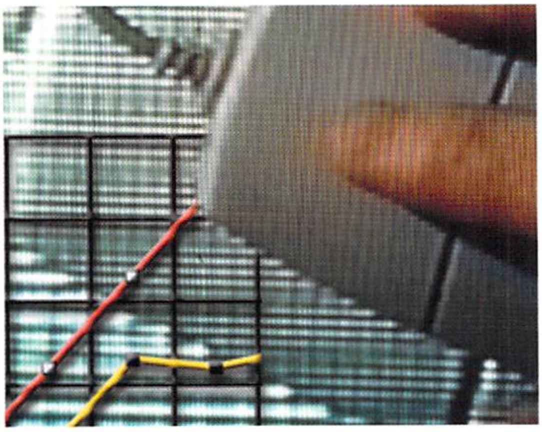
Jump-Start Your Cash Flow

By Paul Sullivan

Every law firm experiences fluctuations in receipts and expenses. Maintaining a positive cash flow can be difficult because of factors beyond your control. In this column, I'll outline some strategies for evening out those ups and downs.



Do you know where your money goes, and where and when it comes in? Here are tips to help you get control of your receipts and expenses.

Budgeting

The starting point is to make a budget, which needn't be more sophisticated than a list of income and expenses. Start by listing all the expenses you expect for a 12-month period. Although you may think you know what you're spending, you'll be surprised when you commit it to writing. Add a "fudge factor" of at least 10-15 percent to cover things you probably forgot.

Forecasting receipts is more difficult, but if you develop a system of timely billing and collection, you'll find that receipts flow more evenly. Needless to say, if your budgeted expenses are greater than your receipts you'll need to reduce expenses, increase revenues, or add more capital to your business.

Billing and receipts

A good billing system will help ensure that you not only charge what is due but also collect it. Too often people complain that a lawyer did work for them and a year later still hasn't sent a bill.

When you first meet with a client, discuss your fees, billing frequency, and expectations for payment, memorializing the discussion where appropriate through an agreement or engagement letter. Clients really do want to know what your services cost. When you outline expectations at the beginning you usually have fewer problems later.

Once the client agrees, the responsibility shifts to you both to deliver the actual legal work and to generate bills according to the agreed-upon schedule. Review your existing files for billing agreements. If none are in place, work with the client to begin billing on a mutually agreeable schedule. Even though some of your clients may have thus far received bills from you only once per year (or worse, at the end of the file), you might persuade them to accept bills on a schedule more conducive to good cash flow. After all, regular billings will level out their expenses, too.

Develop a system for recording your time regularly – at least daily, not weekly or monthly. If you're not recording your time daily, you're not recording all of your billable hours. Recovering lost billable hours is the same as reducing expenses or finding new clients. Be sure your bills get out on the dates you've agreed to send them. With the software available today, there's no reason not to bill on a timely basis.

Once you mail the bill, be sure to follow up if payment isn't returned on schedule. Many bills aren't paid because they went to a wrong address, or maybe withholding payment is your client's way of getting you to discuss a problem. A simple phone inquiry can generate a check or flush out a problem you can and should fix.

Expenses and disbursements

Although budgeting for expenses is easier than budgeting for income, problems can still arise. Annual payments for insurance premiums and taxes, extraordinary cash advances on client files, and unforeseen expenses like repairs and maintenance pose challenges. The following tips can help you to level out expenditures.

1. Many insurance carriers will bill monthly or quarterly, often at little or no additional charge beyond annual billing.

2. Although employees may grumble, moving pay dates to monthly or semi-monthly converts each month into an equal period with level payroll expenses. Biweekly or weekly payrolls result in an extra pay period in some months.

3. If you must advance expenses on files, get clients to agree they will directly pay any expenses over a certain amount. If you advance expenses for your client, you'll usually wait one to three months before you recover your costs – and that's if you bill monthly. If you handle numerous active files and constantly advance expenses, you may find that your money is tied up in advances – i.e., interest-free loans – to clients.

4. Establish a line of credit with your banker. Although you may dislike borrowing money, a line of credit can help you level your cash flow. You can draw on the line for as little as a day or use it to spread out expenditures over a few months. Lines of credit are usually structured so payback is irregular and at the borrower's convenience but always complete within a 12-month period.

The perils of late payment

To keep cash flowing smoothly, some business owners choose to shift expenditures into a different accounting period – in other words, they become late payers. Clients probably do that to you on occasion, and if you have corporate clients you may find that some deliberately delay payment beyond the normal 30 days. Delaying payment is not recommended – the line-of-credit approach is preferred – but if you elect to delay, consider these words of caution.

As you should be wary of chronic late payers, other businesses will become wary of you. Your overall credit rating may suffer, making it difficult to purchase on account, which only aggravates a tight cash flow.

Most importantly, *do not* delay payments to the Internal Revenue Service for taxes, particularly payroll taxes. It imposes severe penalties (10 percent for underpayment) plus interest, and if your business fails and the IRS is an unpaid creditor, the agency will invoke the 100-percent penalty against anyone who had authority over payment of taxes. This could include those who sign the checks, as well as those who approve them.

The IRS then assesses the total penalty against all of these individuals until the taxes are paid. In other words, you could become liable for taxes that someone else in your firm should have paid. Thus, if your firm is having financial difficulties, make sure that payroll taxes are being paid on time.

Getting control

Uneven cash flow does not necessarily indicate a serious problem with your practice. Instead, it is usually a result of growth and associated expenses getting ahead of the revenue stream. Implementing good procedures to ensure that bills go out regularly and are paid on time, then managing the expenditures with good budgeting, are essentials of sound financial management and will help keep you and your firm in the black. ■

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