

Selected Collection Techniques and Tips

(Extracted from an Abo & Company presentation to the National Employment Lawyers Association-NJ Meeting)

“Words pay no debts”
(William Shakespeare)

“Collecting Fees And
Costs From Clients:
Where Ethics Meet Practice”
(Hanan Isaacs, Esq.)



“Why leave your money
in someone else’s pocket?”
(Martin Abo, CPA)

“Thanks for the information,
Captain Obvious”
(Benjamin Abo)

Of the four quotes from above, the last one from Marty Abo’s son Benjamin, may be the most appropriate for those reading the thoughts that follow about managing a firm’s accounts receivable. We all feel we know what to do — we just need to so remind ourselves and, as per the Nike ad we need to...“JUST DO IT.” That said and, while we use “client” or “customer” interchangeably, consider these ideas (in no particular order of priority).

◆ As most business people know, the more past due your receivables become, the less likely that you’ll collect what is owed. For manufacturers, retailers, lawyers, doctors, distributors, and accountants — you name the business or profession — here is the data on the collectability of past due accounts as they age:

Amount of Time Past Due	Average Recovery Rate
30 days	97%
90 days	90%
120 days	80%
180 days	67%
1 year	45%
2 years	23%
3 years	12%

The figures clearly reveal the decline in value with the age of past due accounts and they certainly support the need for firm and aggressive collection efforts in any organization. If your collections are deteriorating, you might want to discuss the situation with your accountant (hopefully us), an attorney seasoned in this arena and a collection consultant in order to examine your practices and recommend modifications.

◆ Bill responsively from the outset. Issue invoices as soon as feasible, preferably coincident to the providing of the service or sale of product. Delaying can lengthen the payment period. In addition, frequently the more credit you extend, the more you must borrow. Shortening the billing cycle while speeding up your collection process can have a profound impact on distributable income to the firm’s owners. While every business is unique, the average service firm, for example, may have 80 days of unbilled work while it typically takes another 60 days to collect those fees even after they’ve been invoiced. You add it up — 140 days from the time the services are performed until the

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payment is deposited and fully available to the firm. That's almost 5 months and if you can cut that "delay" by even just a third, you could free up enough cash for an owner distribution of one and a half months worth of fees!

- ◆ So much for averages and trends. I noted that the annual *Juris Law Firm Economic Survey* of mid-sized law firms revealed it took the average firm 72 days to mail the bill and another 76 days went by before that bill was paid — a total of 148 days (you can contact Juris at 800-377-3740 to purchase its survey). The more recent *LexisNexis Law Firm Economic Survey* showed that figure increasing to 170 days from providing a service to getting paid on it. A troublesome piece of data.
- ◆ I've seen some pro-active firms having a pleasant-voiced administrative person call the client after 10 to 15 days of closing a matter and so billing. The call, effectively a well disguised "customer service" or "public relations" follow-up, is an excellent time to so remind the client of their payment responsibilities (diplomatically, of course).
- ◆ Speeding up billing has a ripple effect in reducing related problems and ultimate write-offs or adjustments (i.e. payment for services performed almost 5 months after when actual payroll was incurred; monies could have been available earlier but were used for other "squeaky wheel vendors"; concessions are often made when time has passed; client/customer appreciation has already waned with the passage of time, etc.).
- ◆ On a similar note, pay attention to inadvertent delays by the people involved in completion of the matter. Since often you may not be able to final bill before the client receives some final document/notification/follow-up, do not let such files sit on your desk, your associate's desk or even your secretary's desk.
- ◆ The engagement letter may be the service firm's first line of defense if clients later allege that they were not aware of, or did not agree to, the specific fee structure for the services or the consequences of not meeting their payment obligations. If clients then do not live up to expectations, you will have already communicated the potential ramifications of this. For example, if clients do not pay in accordance with the policies so outlined, you may have stop-work provisions and/or disengagement provisions in the engagement letter that can be enforced.
- ◆ Provide priority processing for large billings and consider requesting progress payments on such large amounts. If your type of firm allows, consider requesting payment in advance or at time of service. Speeding up just a few days in receivables can make major differences in cash flow.
- ◆ Where permissible, consider requiring:
 - a. Advance Payment
 - b. Evergreen security/trust deposit
 - c. Payment by credit card
 - d. Installment payment agreement
 - e. Automatic debit memo on bank account
 - f. A standby letter of credit guaranteeing the payment
 - g. Personal guarantees from the client (or even a third party)
 - h. Obtaining a pledge of assets from the client
 - i. Having the client at least pay current invoices on a current basis.
 - j. The application of any excess payments against past due invoices.
 - k. A C.O.D. or advance payment with respect to new services.
 - l. Payment of outstanding invoices before starting new matters.
- ◆ Consider elaborating in your engagement letter or other communications how the client will be billed and how the firm expects to be paid.
 - State how the fee is to be charged, how it will be calculated, when the fee is to be paid and the consequences of non-payment, including your right to withdraw (ethically permitted). Importantly, spell out the consequences for non-payment within the agreed upon terms.
 - State frequency of billing — monthly or even bi-monthly
 - Request deposit to trust accounts or a minimum security deposit requirement (see my evergreen suggestion earlier).
 - Understand whom the firm should contact regarding receipt of invoice and payment. See if a "cc" to or an "information only" party should also be designated. (If the client requires that the invoice be sent to his/her attention, discern the name, number, and e-mail of his/her assistant).



almost 5 months can pass between the time services are performed and receipt of payment

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- Suggest email of bills in addition to or in lieu of mailed paper bills.
- Remind client THAT payment does not waive their right to dispute charges later.
- ◆ Try stating on each invoice sent out the discount for prompt payment **in dollars**, not merely as a percentage such as “2/10 net 30.” Also focus on the actual design of your invoice. If the invoice is confusing and doesn’t clearly identify the services rendered, the costs incurred, or the terms of payment, it is quite possible that the recipients may delay payment until the appropriate operating personnel can verify what was performed and that payment can be made. Similarly, if the address and other details as to where the payment is to be directed and what documentation is to be enclosed are unclear, delays can occur at either end of the transaction before payment is made or can be deposited.
- ◆ The cost of extending credit is a good example of the hidden costs that “eat up” working capital. Just ask us, as accountants, to show you the math. Consider the cost in direct bad debt losses as well as in payroll dollars for the time, effort and attention that slow paying accounts cost your firm. These are the truly hidden costs for these efforts and the least enjoyable part of any job (Abo and Sharkey consider it akin to “combat pay”). Then add the cost of capital tied up in receivables to the interest you pay to carry such receivables.
- ◆ Discounts work for many of our manufacturing or distribution clients and even for some professional service firms. If you do offer payment discounts and would like to accelerate collections and improve both public relations and cash flow, consider *writing clients* who don’t take discounts in order to delay their payment. Point out to them that, by taking the discounts and paying sooner, they can enhance their own financial performance. Assuming you provide typical terms of “2/10, net 30”, your letter might make the following points:
 1. By not utilizing the discount, the customer is borrowing from your firm;
 2. Based upon your terms, by delaying payment for the additional 20 days, the cost to the customer is increased \$2 for every \$100 owed;
 3. On an annualized basis, the cost of not taking this discount is equivalent to an interest charge of **37.23%**
 4. There are undoubtedly considerably less costly ways to borrow;
 5. The amount of discounts lost, based on the total amount of annual fees could have enabled the client to obtain a specific dollar amount of additional legal services without cost.Your clients will appreciate this information and you may encourage increased cash flow from your accounts receivable. Incidentally, these facts equally apply to your own accounts payable if you’re not taking advantage of discounts from vendors.
- ◆ Your offering such cash discounts may actually bring collections in at less cost. For example, if offering the “2/10, net 30” cash discount provides prompt payment incentives for a client to pay

within 10 days rather than his or her normal 60 days, the financing costs to your firm would be 14.4% (i.e. 360 days divided by 50 days times 2%). Of course, if most of your clients were prompt payers, establishing a cash discount policy to provide an incentive for the remaining few wouldn’t be cost effective. The firm may prefer to just stop doing business with the slow paying clients. We should state here that an alternative approach for dealing with slow paying clients is to add an interest surcharge for payments received after the 30th day.



Wow! We gave them a discount and they paid already!?

- ◆ Accept credit cards to make it as easy as possible for clients to pay for the firm’s services. Today clients, as well as the business owners themselves, live on plastic and therefore paying bills with credit cards is easy for them. The use of credit cards can be a tool to reduce your receivables and increase your cash flow. Suffice it to say that all credit card companies are not alike. Firms should confer with their accountants and credit card processing consultant to investigate how a particular bank or company charges them.

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- ◆ Consider putting a “payment button” on the firm’s web site. Many people like paying their bills online at any hour of the day. By enabling the client to pay through their website, firms can take advantage of this. Payment can be made by either ACH from the checking account or by credit card. Many credit card companies have this service. Some have no monthly fees or additional transaction fees, as do other payment gateways, such as Authorize.net and Paypal. It is not necessary to have a “Shopping Cart” to have this capability, nor is it expensive.

- ◆ During tough economic times like we are now seeing, client screening becomes a vital process. You may want to avoid working with clients who appear to have a history of, or are currently experiencing, financial problems; or you may establish different collection methods for these individuals (e.g., requesting retainers, etc.). In any event, some considerations before accepting a new client are:

- a. Make sure the customer is *able* to pay your price.
- b. Check references (banker, attorney, accountant, insurance agent, etc.).
- c. Contact the predecessor and learn as much as you can about why the client defected or why they withdrew from the engagement. Remember that past behavior is often the best indicator of future performance
- d. Review a Dunn & Bradstreet (or other agency) report on the client’s business and ascertain if it is consistent with the financial information you’ve received.
- e. Consider the use of background checks
- f. We’ll say it again: Get a retainer up front, before you begin any services.
- g. Remember: *Think real hard and long if you’re even considering a discount on your billing rate or fee to obtain a client.*

- ◆ Monitor cash flow carefully. One of the first negative effects of a recession is usually found in the slowdown in the payment of an enterprise’s accounts receivable. This is the result of your clients using their personal or trade payables as a financing vehicle instead of borrowing from a bank. Making sure that appropriate credit checks are made of all clients and requiring current financial information on all large clients is only prudent in times of tight cash flow. Accounts receivable should be monitored very carefully to ensure that pre-arranged credit terms are being adhered to before new services are provided.



**Your firm is in business
to earn cash from clients...**

- ◆ Management should make it clear to all relevant staff that **THE FIRM IS IN BUSINESS TO EARN CASH FROM CLIENTS** and that **AN ENGAGEMENT IS NOT COMPLETE UNTIL IT IS PAID FOR**. All personnel have a part to play. Management should be candid with all employees about existing difficulties and about their role and stake in getting the firm through these tough economic times. For example, account queries are not just low-level clerical matters. They may be complaints from unhappy clients who may feel let down. They should be resolved ASAP as prime client service priorities.
- ◆ Who says billing has to take place right after the end of the month? Establish the billing period to end one to five days prior to the billing frequency you’ve established. For example, if you were billing for the calendar month September, consider billing from August 25th through September 24th. Receipt of these bills from the firm may better match when businesses and even individuals pay their bills.
- ◆ Many business clients and even individuals pay their bills on a specific day of the month. Payment of invoices that arrive after that date, say the 10th, are put off until their next contemplated payment date. Find out what those cut-off dates are for your large clients and make every effort to meet them.
- ◆ For service firms, consider practice management software that migrates time and expense entries from emails, appointment calendar, phone calls, expense outlays, etc. directly into invoicing software.
- ◆ Cycle bill by designating specific clients or billing partners to perhaps a 4-week or so billing cycle. Such will spread out the work as well as smooth out the cash flow.
- ◆ Suggest emailing of bills in addition to or in lieu of mailed paper bills. Make sure the firm tests e-mail addresses and E-bill formats early on.
- ◆ Use window envelopes and include return envelopes with ALL requests for payment (i.e. actual invoices as well as statements).
- ◆ Send the invoice to a “named individual” using first class postage. For very large amounts, consider using courier services.

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- ◆ Large receivables should be pursued more aggressively before telephoning or pursuing smaller accounts. Do not fall prey to merely working in alphabetical or file number order. (*And that's not because ABO doesn't want to be your first billing effort.*)
- ◆ Increase the urgency of second payment requests by use of large lettering, red ink, underscoring, labels, etc.
- ◆ Firms should encourage drifting from the “conventional billing model” to speed up the billing and collection cycle (i.e. agreed upon fixed fees with established progress payments or even payments in advance; monthly or quarterly budgeted advance on an interim basis, etc.). While caution is needed to so monitor profitability, fixed fee arrangements may speed up collection for work performed but may enable the firm to benefit from internal efficiencies it gained from technology, similar past projects, leverage of less expensive personnel, etc.
- ◆ Not to downplay the role of the firm's CPA but, honestly, appreciate that most service firms maintain their books on the “cash basis of accounting” (at least for tax-reporting purposes and often even in the financial statements they submit to their partners or the bank). Thus, accounts receivable (fees billed but uncollected) or work-in-process (unbilled and uncollected fees) may not be the focus of attention or even revealed to the reader of the financials, often the largest asset of the firm. Such can often mask a receivable problem. One more item which typically is raised during discussions with your accountant — cash basis taxpayers cannot deduct bad debts (i.e. uncollectable receivables).
- ◆ Make a photocopy of the check from the client if there is a good possibility that the check may bounce and it will likely be retained by the customer's bank. Having made a copy before depositing the check gives you much vital information such as **a)** the name of the debtor's bank; **b)** the debtor's bank account number; **c)** the full name of the debtor; and **d)** the address appearing on the check, which may differ from the address in your files. All of this information is invaluable if you need to turn the account over for collection or take legal action to collect.
- ◆ Utilize lien rights, bad check laws and other legislative protection to the fullest extent to induce payment. While we, as accountants, may be of help in implementing suggested procedures and systems, it is incumbent on the “legal beagles” to make sure your firm comports within the legal and ethical parameters.
- ◆ Here are three methods to use for an up-to-the-minute assessment of your accounts receivable. Sort of an Abo “fiscal check-up”:

Comparison to your own past experience. Comparing any given month's receivables with your prior month-to-month figures can tell you when you need to monitor your collection efforts more closely. Try this:

$$\frac{\text{Cash collected during month}}{\text{Accounts Receivable on 1st of Month}} = \frac{\$90,000}{\$100,000} = 90\%$$



That “perfect” receivable turnover period is the shortest period consistent with satisfactory revenue volume and satisfied clients.

If this 90% effectiveness of collections is below the “norm” (average) for prior months, it's time to analyze why.

Comparison to your daily fees. In between too high-pressure collection tactics that alienate clients and too lenient policies that jeopardize your cash flow, there's an optimum turnover of your investment in services provided on credit. That “perfect” receivable turnover period is the shortest period consistent with satisfactory revenue volume and satisfied clients. Want to compute “days” fees outstanding? Try this.

$$\frac{\text{Accounts Receivables}}{\text{Average Daily Fees}} = \frac{\$120,000}{\$2,000} = 60 \text{ Days Fees Outstanding}$$

If your terms for service are net 60 days, you may be in fine shape. But if they are net 30, you may have a problem. The above 60 days' fees outstanding calculation is double your current payment terms of 30 days.

Comparison to credit sales. Your annual credit sales in relation to your average monthly receivables can be another important calculation.

$$\frac{\text{Net Annual Credit Services}}{\text{Average Monthly Receivables}} = \frac{\$710,000}{\$110,000} = 6.5$$

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Your turnover is 6.5 times a year, which is pretty good for many businesses. Compare this to your current turnover with your own firm's historical position as well as standards for your industry (note that, as business appraisers, Abo and Company has access to numerous databases which may be helpful).

- ◆ A business may wish to consider outsourcing the credit and collection function partially or entirely, especially if you have inadequate or inexperienced staff and are unable to proceed with collection efforts on a timely basis. Such collection enterprises typically offer firms a comprehensive collection service for managing and collecting the firm's commercial accounts receivables, including client accounts receivable up to pre-litigation and small claims court service. They may even function as an undisclosed support service in the name of the firm, allowing the firm and its management to concentrate on their business and not on the running of a collection department or operation. The firm retains this outside agency to handle its accounts collections process, functioning as an extension of the firm, collecting accounts in the name of the firm, effectively operating as the collections back-office of the business/firm.
- ◆ Watch out for the "end of the fiscal year squeeze." Especially prevalent in the larger firms, billing partners typically are pressured into putting on the "full court press" in the final days of the firm's year-end. Service professionals will often offer their clients significant discounts as many are compensated based on their actual annual collections. Many such clients will not only defer payment awaiting such an offer but also and even worse, begin to expect such discounting throughout the year and on all matters.
- ◆ Consider utilizing a bank lockbox to accelerate collections and cash flow. This is particularly effective when a number of clients are concentrated at locations quite distant from your office.
- ◆ Firms should be aggressive in collecting overdue accounts but don't spend more money chasing small accounts than you can receive by collecting them. Make direct telephone contact quickly with clients who don't respond satisfactorily to your first dunning letter.

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