

PETER SCOTT CONSULTING

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Year – end billing - turn your WIP into cash and profit - fast

In financial management terms, few, if any, actions at a year - end should take greater priority than billing all of a firm's work in progress that should properly be billed.

The likelihood is however that in some firms that will not be the priority on the part of everyone, or if it is, then the billing in the last few weeks of the financial year will account for perhaps 25% or more of annual turnover. Even then, for no justifiable reason, there is likely to be WIP remaining unbilled at the year - end which should and could have been billed to clients weeks or months earlier. That is financial madness.

Moreover, unreasonable pressure is put on accounts staff who have to process the bills. I have even heard stories of firms banning all holidays and even weekends for accounts staff in order to process the enormous volume of bills, which in addition can involve the payment of large amounts of overtime.

Where an excessive volume of billing at a year - end occurs it is also likely that much of the WIP billed in those last few days or weeks could have been billed many months earlier. WIP management needs to be managed consistently and effectively throughout the year and not left to the last few days of the year. However, such management disciplines are not universally accepted or implemented in many firms and panic sets in just about now, as partners and management realise that the firm's budgeted profit for the year will not be achieved because billable WIP is sitting there unbilled. This is often very old WIP and unfortunately the older the WIP the less likely it is to be billed. Being hit where it hurts most ('the pocket') can get some, but not all, partners to take action.

What can firms do now in the run – up to their year ends to reduce their WIP to its absolute minimum?

As a starting point, if they do not do it already, they could adopt the method some firms successfully use, which is to give each partner / fee earner a pro forma bill on each of their matters with the instruction to

*“Please bill this matter now. Otherwise provide me with **a good reason** why the matter cannot be immediately billed”*

Those who are managing the billing exercise should not take “no” for an answer in relation to the matters which partners and fee earners say cannot be billed before the year – end. They always have their reasons why they would prefer that matters are not billed. Instead, each partner / fee earner should be seen and questioned as to why they say those matters should not be billed. Experience tends to show that this second ‘trawl’ generates further bills.

Some firms at this stage adopt the ‘*star chamber*’ approach whereby partners who are clearly not doing what is required are ‘grilled’ by the firm’s ‘*star chamber*’ (e.g. the managing partner, FD and other appropriate ‘heavies’) with a view to generating the required billing. That as an approach can work extremely well, and not just at year – ends but throughout the year, to get partners into shape in relation to their cash management.

Other firms set each partner / fee earner / group, maximum amounts of WIP permitted to be carried at the year end, calculated by reference to what is the maximum realistic amount of WIP that should be carried in a particular practice area given the nature of its work. The carrying of ‘excess’ WIP either at the year - end or throughout the year can be dealt with, for example, by an appropriate penalty being applied to a partner’s profit share for that year. Firms also use WIP targets as a way to progressively over a period of time reduce WIP to a level consistent with what should be achievable best practice for that type of work. Again, payments to partners (both drawings and distributions of profit) are in some firms linked to the achievement of WIP targets.

Whether or not a firm has operated that type of method of managing its WIP throughout the year, it should in any event now give each partner / fee earner / group a maximum level of WIP to be achieved at the year – end. Previous ‘promises’ made as to billing should then be compared to such WIP targets and further billing extracted. And in the next financial year the firm should continue giving WIP targets to each partner / fee earner / group on a monthly basis to reduce WIP to permitted levels.

At the same time, firms need to monitor and control the realisation (recovery) rate on year – end billing because heavy discounting (on top of failure by partners and fee earners to fully capture all matter related time) will significantly reduce both profitability for the year, and the cash receivable in the coming weeks and months. A write – off policy requiring all write – offs of WIP to be first approved by a managing partner / FD / HoD (but not by individual partners) should be put in place and effectively operated to prevent heavy leakage of profit (and cash).

Even if all the possible billing is processed, the bills will still need to be promptly sent out to clients if cash flow is to be maximised. A problem which firms have recognised is that when bills are processed to achieve billing targets, they are often not sent out to clients promptly, or at all. This can cause not only cash flow problems but can also damage client relationships when credit controllers chase for payment of bills which have not been delivered. To help to deal with this, immediately following the year end partners and fee earners should be asked to confirm that all bills processed have been delivered to clients. Another solution is to have an accounts department send out the bills once processed, thereby taking the matter out of the hands of the partners and fee earners.

The next step should be to implement cash collection targets based on the year- end billing to ensure that the large volume of bills are turned into cash as quickly as possible. In firms which operate a system of cash collection targets it is often the case that payments to partners of both monthly drawings and profit distributions will depend on the consistent achievement of those targets.

The use of sanctions?

Should there be sanctions on partners for failing to reduce WIP to reasonable and realistic target levels or to collect achievable amounts of cash? Out of necessity some firms are moving in this direction, using the threat of sanctions which will 'hit the pocket' of partners, and these tend to have the required effect. Firms have learnt from hard experience that some of their partners will just not do what is required of them unless they realise they have to.

Managing WIP and debtors is just another aspect of managing performance in a law firm, as more and more firms understand that they must now be managed as businesses and that the partners who own the businesses must become businessmen and businesswomen. If not, firms will risk falling by the wayside in tomorrow's much harsher business environment.

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