

# Engagement Budgets

BY ED POLL

The Key that Unlocks Collections and Cash Flow



One of the most important prerequisites for any law firm to get paid is consistently establishing a budget before beginning an engagement. Budgets ensure greater productivity and cost effectiveness for both firm and client by demonstrating to clients that the firm is sensitive to their needs, and reinforcing that the firm provides value and not just a block of hourly time. Budgets significantly increase the chances of collecting fees because the client understands what to expect in terms of events, money and time, and agrees to the process outlined.

### **SAVING LAWYERS FROM THEMSELVES**

There are different kinds of budgets within any law firm: for the firm itself, for practice areas, for functions (marketing, technology) and for specific matters. In a firm of any size, administrators should be involved in budgeting for specific matters as well as in the broader categories. Administrators' jobs require accuracy, particularly in those functions that depend on their control and management of revenue. By contrast, when lawyers do the budgeting, they are not so detail oriented, both because they are not skilled in or oriented to financial details, and also because they are not convinced of the value of the process and prefer to adjust on the fly.

Ultimately, a budget is a valuable discipline that can save lawyers from themselves. Too many lawyers focus on the task at-hand and seeing the goal line but without planning the path to get there or getting the buy-in from the client before starting. Often lawyers start working without thought to whether the client has adequate capital to pay for what's ahead. Such lawyers take ad hoc steps rather than make a thoughtful strategic plan to achieve the desired outcome. Conversely, if the desired outcome is achieved, but the client doesn't understand what the firm accomplished, the bill may go unpaid. Creating and adhering to a budget is a practical exercise in business discipline and in communication.

#### ENGAGING BUDGETS AT THE START

Budgeting for a client matter where the anticipated expense is greater than a minimal amount (whether that is \$500 in a small firm or \$10,000 in a large one) should be founded on an engagement agreement that sets out the expectations of the client, the responsibilities of the lawyer and spells out the fee agreement. The process should begin by getting as much information as possible from the client about goals and expectations. Administrators can facilitate this information gathering process by developing a checklist form that lawyers can use in an initial consultation, with

or without an administrator present. Information should cover parties, claims, anticipated strategies and desired outcomes. Though this may be a form for internal use, it might be a good idea to request the client to review and initial it.

Understanding the client's objectives is the prerequisite of the budgeting process. "Winning" may not be what the client actually wants. A client may wish to delay the final outcome for political or financial reasons. The client may want to have a platform from which to tell his/her story, nothing deeper than that. To understand clients' wishes, involve them in the budget preparation and have them formally approve the final budget.

This communication process at the start allows for defining performance, and avoids misunderstanding later. During a budgeting discussion, for example, the client may be told that for "X" dollars, the firm will do this and for "Y" dollars the firm will do that less "ABC." While "ABC" may not be important, the client gets the message that the budget is being adjusted to fit the appropriate price level based on the service to be delivered. In effect, this allows each lawyer to change the value composition of what the client is buying.

Going through this process of detailing and negotiating to prepare the engagement letter better enables the firm to avoid a client with unrealistic expectations or demands and who

### CHECKLIST TO PREPARE ENGAGEMENT BUDGET

- **Identification of goals** to be achieved for the client to consider the matter successful, in terms of cost, result and time required.
- **Current status of the project or case**, including an estimate of its complexity, other parties and other counsel who may be involved, courts or regulatory agencies that have jurisdiction.
- **Documents to be generated**, depending on whether the matter is a transaction (negotiations, regulatory filings, contracts, financing documents) or a litigation (discovery, pleadings, motions, briefs)
- **Responsibility for document drafting**, particularly in terms of whether documents are to be shared in an extranet or other external database and who is to be responsible for overseeing document check-in/check-out.
- **Extent of anticipated and work** to be done by other professionals, including reimbursement rates and policies.
- **Staffing plan with billing rates**, specifying which partners, associates and/or paralegals are to be used and whether a blended rates of all lawyers is to be applied.



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believes that budget parameters, whether of time or outcome or costs, are guarantees instead of informed estimates. Discussing engagement terms will frequently uncover the client that will in the future express irritation with delay, who will chronically complain about everything, who will demand constant or instant attention, or who expects unrealistic or abnormal hand-holding. If the client says at this point, "This is too expensive," the response should be that other firm clients find that their expenditure for such services is more than justified by the results. Add, however, that if the client still feels the budget is too high, it would be best to seek other counsel because past experience indicates that the proposed budget is realistic. Often, the client will be impressed with such knowledge and preparation and will accept the terms of the budget. At worst, if the client walks away, going through the process of detailing and negotiating the budget weeds out clients who will cause payment or service problems later.

#### **MAKING COLLECTIONS A BUDGET ESSENTIAL**

Because the budget developed in the engagement agreement is the foundation for all future fee and collection considerations, never hesitate to be as detailed as possible in the terms spelled out. There are two ways to specify terms that prevent collection problems.

- **Set a written fee agreement.** Typically a written fee agreement is required for contingency work but not for hourly or transactional work, though states are moving in the direction of requiring writings. Many attorneys miss an opportunity by not having a written fee agreement. There are marketing benefits in terms of defining and managing client expectations and how these expectations will be met, and removing uncertainty about fees.

- **Specify the collection cycle.** Set specific dates of the month by which clients will be billed. For example, state in the agreement that invoices will be sent on or about the twenty-fifth of the month so that clients receive statements on or before the first day of the following month. Since businesses close their payable cycle on the first to the fifth of the month, and pay their bills on or about the tenth to the fifteenth of the month, this can speed payment.

The more lenient are the collection terms that the firm extends to clients, the more cash the firm will need while waiting payment. Conversely, tough credit terms (such as charging interest on unpaid balances) are likely counterproductive – clients who won't pay their bill won't pay the interest, either. Never give in to the temptation to extend credit in the hope that the client will give you more work. Strive to get paid quickly for the work as it is being done – and document that in terms that are part of the budget agreement.

#### **COMMUNICATING PROGRESS ON THE BUDGET**

It is important to emphasize budgeting is and should not be an adversarial process. Without client buy-in and approval, budgets and collection terms are meaningless. The budgeting process, including all subsequent communication, must be a collaborative effort. If the parties can't trust one another, if the client and the lawyer behave as adversaries, the representation will likely be unsuccessful and there will likely be difficulty in collecting the fee. Collaboration means communication. Because lawyer and client will each have unique information at any given time, both must advance the process together. Honesty, openness and candor right from the start will make the entire representation easier and more

successful. Budgets are the best way to initiate and maintain that communication.

Status reports on progress according to budget can be particularly valuable because they demonstrate that the firm is actively working to accomplish what the client wants. Such reports do not have to be a detailed administrative burden. A simple form can easily be saved as a word processing file, with appropriate boxes to be checked and blanks to be filled in for a few basic categories. The goal is to show clients what work is being done now (for example, litigation boxes might include case evaluation, research, pleadings, motions, and so on), how the matter is progressing compared to the budget, and what the next steps

will be. Particularly useful would be a section that shows clients the current status of their account in accord with budget terms. (Send a request to [edpoll@lawbiz.com](mailto:edpoll@lawbiz.com) if you'd like one example of a status report.)

#### **BUDGETING FOR CASH FLOW AND VALUE**

One important end product of a good budget and clear payment terms is one that benefits the firm and makes the administrator's life easier: an effective cash flow plan. The cash flow plan is a financial guide to plan for profits by prioritizing, anticipating and allotting the revenues and expenditure of funds. Cash flow analysis is the most important management tool at the firm's disposal for planning future activities and controlling financial affairs. When budgeting becomes an integrated part of cash flow planning, the firm has a much better handle on how much revenue will be coming in and when it will come in. Using budget estimates by matter to prepare a forward-looking estimate of expenditures planned and receipts anticipated for a rolling 12-month period is the foundation of sound financial planning.

The kind of budget, collection and cash flow analysis discussed here falls well within the purview of many firm administrator responsibilities. The degree of lawyer involvement needed doesn't require mastering management jargon or looking at things through the eyes of an MBA. Lawyers who understand budgeting/collection/cash flow process as an integrated part of their practice can better assess the value they provide to clients, and better reflect it in their bills. They begin to think in terms of anticipated travel, staffing plans, strategies for effective structuring of discovery within the context of the budget. They develop an appreciation of those areas where costs can be controlled and where costs are inherent. In short, they do a better job for their clients – and that's what budgeting is all about. ✱

#### *About the author*



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#### **WHAT TO SPECIFY IN A WRITTEN FEE AGREEMENT**

- The type of fee to be charged, whether a flat rate, contingency fee, blended hourly rate, straight hourly rate, or some form of alternative billing arrangement
- How the fee will be calculated, especially if it is not an hourly rate and will be based either on percentage recovered/saved or payment when specific benchmarks are met
- When and how often the fee will be billed, with specific dates of the month by which clients will be billed and by which payment is expected
- Methods of payment accepted, primarily whether by check or credit card (and if the latter is accepted, stipulate how the card will be used and have clients sign an authorization to charge their cards)
- The grace period for receiving payment and who the firm should contact for overdue payment if the grace period has passed
- The consequences of non-payment, including the lawyer's right to withdraw under Rule 1.16 if clients do not honor their payment obligations under the terms of the agreement
- Any policies regarding discounts, recognizing that the best policy is never to discount a fee that has been stipulated in the fee agreement
- Process for resolving fee disputes, which can range from the firm's right to use a collection service to use of state bar rules which provide for optional and mandatory procedures to settle fee disputes.