

Collections Without Counterclaims

The impact of not getting paid is significant. Depending on your firm's profit margin, writing off a \$100,000 receivable is the equivalent of giving up \$1 million to \$1.5 million in gross fees—not something many firms can afford.

In good economic times and bad, some design firms are able to get paid more quickly than others and have fewer disputes over clients' refusing to pay. What's their secret? It's a combination of effective management of the process from beginning to end, good communication and documentation, and appropriate accountability for project managers.

In preparation for this article we interviewed design firms with favorable track records in managing collections and professional liability insurers. We offer our own expertise along with a summary of their best practices for collecting payments and dealing with counterclaims filed in response to pursuing payment.

Billing and Collection Practices

Avoiding problems with collections starts with client selection. Trust your gut, and always remember: You don't lose money on projects you don't take. But even a good client's financial circumstances can change quickly. For clients with large upcoming receivables and for all new clients, many design firms perform periodic credit checks. One approach is to subscribe to a credit service, such as Dun & Bradstreet or Experian. The cost of getting a credit report—between \$25 and \$100 for a single report—is small compared to the cost of a client that cannot pay. Another approach, especially for new clients, is to ask for references from their banks and from firms with which they've done business in the past. Successful firms develop metrics for monitoring and assessing clients' payment performance.

Particularly with larger clients, there is another question: "Is the person with whom you are dealing empowered to authorize your services?" It is important to ask questions and understand organizational hierarchy up front in order to avoid problems down the road.

And be cautious about accepting more work from clients that have been slow-pay or no-pay in the

past. If your firm does accept the work, consider requiring a retainer. Hold the retainer to apply against the final bill. If the client is not the owner of the project, you might be able to arrange being paid directly by the owner.

Everyone in your firm should be tuned in to how much exposure there is with all clients, not just the slow payers. If one or two clients represent a significant portion of your accounts receivable, they should receive a proportionate amount of attention and monitoring.

Once you decide to accept a project, the most critical component to effective receivables management is having a **written, signed** contract. An oral contract isn't any less binding than a written one, but it is sure more difficult to prove.

A well-drafted contract will clearly set forth the legal name of the client and the identity of the people authorized to bind the client, the time when you will submit your invoices, the time the client has to raise questions about them, the time when payment is due, the additional consequences to the client for failure to make timely payments (such as interest accruing, reimbursement of your collection costs, and your right to stop working), and the process and forum for resolving disputes.

Note: If your firm is doing business in a foreign country, any or all of the rules may change. Determining your options for collecting from foreign clients should be part of your project due diligence.

Billing Promptly

Assuming a client has good credit and you move ahead, establish a billing and invoice follow-up schedule, and stick to it—a basic, but often-neglected process. Some project managers (PMs) and some firms can be slow to get the invoice out the door. After all, what would you rather do: meet with a client, design a project, or submit hours to be billed?

Firms need to be tough on enforcing internal procedures. Failure to keep up with submitting hours slows the entire process and often results in invoices being sent months after the work was completed.

A client's staff and financial condition can change quickly. If a slow-moving invoicing process results in your firm's billing in September for work done in July, you may be facing a different and likely more difficult environment for collection. And with everyone's memories dimmed by time, resolving billing disputes becomes much more difficult.

Managing the Billing Process

The following guidelines are an example of one firm's approach to managing the billing process.

1. PMs submit billable hours, and the initial invoice is sent with a cover letter or e-mail and appropriate backup material in accordance with the billing schedule. Then, the PM is required to call the client in a week to 10 days to be certain the invoice has been received.
2. If the terms are 30 days and the client has not paid, PMs are required to start calling the client on day 31 or 32 to determine the issue.
3. For the next 60 days, the PM is responsible for the receivable and makes periodic calls to check on the status of the bill. PMs are required to be polite, but persistent. Each call is summarized and confirmed in an e-mail.
4. PMs are advised to pay attention to their clients' payment habits. For example, if a client that previously paid on time and in full now pays later or only sends partial payments, the PM must meet with the client and try to discover if there is an underlying problem. The key risk tip is to meet and communicate with the client at the first hint of a problem. If there is a problem, it needs to be addressed and fixed. If there is no problem other than slow pay and the client is happy, it needs to be documented.
5. PMs are encouraged to be flexible about the time frame—not about extending it, but about reducing it. If something doesn't "feel" right, they don't need to wait until day 91 to escalate. They can take more forceful action sooner if appropriate.
6. After 90 days, the invoice is written off for the PM (so the project profit isn't artificially inflated and the PM "feels the pain") and turned over to accounting. Of course, the revenue is re-recognized if received.
7. After 120 or more days, take one or more of the following final options: negotiate a settlement; sue for payment; file a lien; for subconsultants, go straight to the owner; turn to professional collection; or accept that payment will never be received and (really) write it off—all discussed later under "Final Options."

Sticking to the Plan

As outlined above, setting the tone for effective collections starts with PMs' understanding of the importance of their role in the process. Firms that have the most success managing collections typically make it a part of the PMs' bonus calculations. Some firms focus on behaviors—did the PM follow the plan?—while others focus only on a target for days to collect. Some focus on both. We spoke with several CFOs who directly attributed improved collections to their firms' implementation of a plan to tie collections to bonuses.

Handling Additional Services

The consensus among those we contacted is that disputes over payment frequently arise out of additional services—change orders. The most common complaint from clients is that the architect or engineer performed services not ordered. Here are three key steps to avoiding the potential for such problems:

1. One important practice is not to negotiate requests with just anyone. Any request must come from an individual or individuals the client has designated as being authorized to amend the scope of services.
2. As with the initial contract, accept only written requests.
3. Perhaps the most critical aspect is to make sure your employee is up to the task. Not everyone is equipped to match scope and fees.

Some of your people may feel ill at ease with this more formal structure. To help them over the hump, let them blame management or the accounting department or legal counsel or whatever individual or group—either within or outside of your organization—is a good “fall guy.”

Communicating With Clients

As soon as your client’s payments slow down or stop, communication becomes paramount. Call the client; or bring up the issue at the next meeting, and tackle it politely, but head-on. Let the client know you are aware that payment is not being received in a timely manner and you need to talk about it. Ask questions to try to understand the root cause.

If the client is unhappy over service issues and his/her way of telling you is by not paying, find out what the issues are, and address them. Strangely enough, this is actually a marketing opportunity. If the client has an issue and you resolve it, your relationship will be stronger than if you never had an issue because your relationship was tested and you performed. Always document any resolution in writing.

If your client acknowledges receipt of the invoice and agrees that payment is due, but tells you that the only issue is that his/her firm is financially unable to pay, document the following:

1. The service provided is what was requested.
2. The client is satisfied with the service.
3. The invoice was received, and the amount due is correct.
4. The client’s only issue is inability to pay due to financial concerns.

If possible, have the client sign off by sending the above to the client in writing and asking for an affirmative response to all four issues.

Final Options

If your firm has done everything right and the client still hasn’t paid, what do you do? Before taking any action, have a person within your firm who is not emotionally invested in the issue investigate.

The first step is to check the file. If the client did not pay and the PM followed the process, then there will be documents explaining what happened.

The second step is for the investigator to talk to the client. There may, in fact, be a problem your PM did not discover, or the client may have changed his/her story. If it’s the latter, remind the client that you have documents confirming he/she was happy with your firm’s service and nonpayment was due to a financial issue and nothing else.

If after researching the problem and taking all possible steps, your firm is still not getting paid, you have the following options:

- ▲ Negotiate a settlement.
- ▲ Sue for payment.
- ▲ File a lien.
- ▲ Go straight to the owner (if applicable).
- ▲ Hire a professional collector.
- ▲ Accept that payment will never be received, and write it off.

Negotiating a Settlement

Depending on the circumstances, you may decide to accept a discounted lump sum or perhaps to allow a payment plan or deferred payment.

If you choose a payment plan or a deferred payment, you should insist on a promissory note and possibly a release from issues known to date. Consider tying the promissory note to an event—the client will pay when 20 percent of the units are sold, when the baseball (or football or opera or ballet) season starts, or when some other event relevant to the project occurs. If the client truly cannot pay now, this might be your best option, at least in the short term. After all, you cannot get blood out of a stone.

But, as noted earlier, do get some written commitment from the client that the money is due and some promise to pay the bill, perhaps in installments over a specified period of time.

Suing for Payment

If it seems pretty clear your client is not going to pay you, you can file a lawsuit seeking payment. A well-drafted contract will include your state as the jurisdiction and your home county as the choice of venue as well as contain the right to recover your attorney's fees.

Filing a Lien

You may be able to place a lien on the project. Sometimes, just the threat is enough to trigger payment. The time for filing a lien is usually tied to the last date you provided service and, depending on the state, can be short. Investigate your deadlines as soon as you know you have a payment problem. A lien may secure preferred rights if the client declares bankruptcy.

Going Straight to the Owner

If your firm is working for an architect or general contractor (GC), but not the owner, you can threaten to go to the owner about the payment problem. If the owner has paid the architect or GC, but your firm has not been paid, this might change the dynamics of the discussion. As with any threat, you must follow through to maintain your credibility.

Turning to Professional Collection

Some firms transfer their collections to a professional collector—either an employee in a corporate credit function or a collection agency. This may have a considerable upside:

1. Collection becomes the responsibility of someone for whom the primary—and, in fact, only—job function is collecting money.
2. This option puts some distance between your project personnel and the enforcers. It may help to preserve project relationships because none of your project personnel is the person on the phone insistently asking for a check.

The downside is that your firm must incur additional overhead or give up a portion of any funds ultimately collected. This solution is not necessarily the right one for every firm, but if your firm is having trouble with collections, you may want to consider this option.

Writing Off the Receivable

You should always, as objectively and unemotionally as possible, determine at the outset of any formal procedure whether your expected costs to pursue payment exceed your maximum probable recovery. In this situation, the best course may well be to cut your losses and move on.

Counterclaims

If your firm takes formal legal action to collect fees, how concerned should you be about a counterclaim? Will it be expensive to defend? Is the client likely to prevail?

Counterclaims are always a possibility when you take a more aggressive approach to collections. When they occur, the allegations are often vague and intended only to dissuade you from the collection process.

Whether you will face a counterclaim depends in part on your firm's preparation. If you follow these recommended steps, you are likely to have your "i"s dotted and your "t"s crossed. As a result, counterclaims will be less likely and possibly less expensive to defend. At least one firm noted that when it is well-positioned and has well-documented files, it has been able to respond

effectively to counterclaims for less than \$5,000 in legal fees.

The Insurer's Role

If you do receive a counterclaim, how much of a role will your insurer play? The answer will depend on the allegations, but professional negligence is normally at least part of the claim. As soon as you get wind of a counterclaim, you should contact your insurance broker and/or insurer and bring one

or both of them into the picture. If your insurer provides pre-claims assistance, you should consider contacting it before you initiate formal legal action.

With the insurer in the picture, you may have a better shot at a successful mediation's resulting in collection of your fees. If you already have a collections attorney when the counterclaim arrives, be sure to connect him/her to the insurer's attorney to assure a unified approach.