



# AIA Best Practices:

## How to get paid

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Contributed by AXA XL's Design Professional Unit

### Summary

By reading this article, you will:

- Understand the value of assessing a prospective client's financial condition and acquire tactics to help you do so.
- Recognize the importance of developing a collection strategy and consistently following it.
- Learn simple techniques to improve your accounts receivable—before, during, and after the project.
- Explore how your contract can help you get paid and how you can prevent payment problems related to scope creep.

### Introduction

Your accounts receivable are probably the biggest asset of your business. The typical architecture firm has about half or more of its assets tied up in yet-to-be-paid—and yet-to-be-billed—fees.

Now, consider this: The average collection period for design firms is 65–70 days, and it is not unusual to hear of some as long as 120–180 days, especially for subconsultants. That is like giving clients a four-to- six-month interest-free loan!

So why is it so difficult to get paid, and in a timely manner? First, for many design firms, the billing process is not the first priority. Firms put off processing the paperwork. And, if the amount owed is small, they are tempted to wait another month.

Second, many firms do not have an effective billing and payment system in place or, if they do, they are disinclined to implement it consistently. They may be reluctant to enforce payment terms such as interest or penalties, or to suspend or terminate their services if asking for payment has not succeeded.

Staying on top of your accounts receivable is not merely a cash-flow issue. It is also a matter of liability.

The scenario goes something like this: You press a client for payment, and get your answer in the form of a threat or an actual lawsuit. A client who for whatever reason has no intention of making that last payment may claim there were errors in your plans and specifications. These countercharges may be inflated to make your collection efforts so costly that the idea of writing off that last invoice starts to look good. In fact, AXA

XL's claims supervisors report that countersuits resulting from a demand for fees are regularly in the 10:1 range: If you sue for \$100,000 in unpaid fees, you may be countersued for \$1 million.

Consider the structural engineer who, after letting a client's account fall behind to the tune of \$95,000, filed a lawsuit to collect the fees. The client countersued, alleging (falsely) that the engineer's delays cost the client \$130,000. After spending six years and more than \$50,000 in legal fees to pursue the claim, the engineer was awarded his \$95,000 and his client lost the counterclaim.

So the engineer won, right? Not exactly. Soon after losing the case, the client filed for bankruptcy and the engineer never collected a dime. Even if he had received the money, one would have to factor in the time lost to productive work for the principals involved over six years, the opportunity cost of the \$95,000 (plus the \$50,000 in legal fees), and the depreciation in buying power over six years' time. At an average inflation rate of 3%, the \$95,000 in fees would have been worth about \$79,000 after six years.

The sad truth is that most claims against you can cost you far more than the disputed fee. The hard costs of a lawsuit include your deductible payment (if you are insured) for legal fees and any internal expenses related to litigation— your travel, for example, or copying files.

Less obvious—but just as real—are the additional soft costs, such as lost billable hours or staff time. Add the emotional drain of a protracted legal battle; the loss of your client relationship; the damage to your reputation, employee morale, and productivity; and it rarely seems to make sense to file a claim against the client.

The good news is that there are a number of measures available to help you get what you are owed before it gets to the lawsuit stage. In this article, we take it step by step, including:

- assessing potential clients
- establishing an in-house collection strategy
- asking for retainers
- utilizing contractual billing and payment terms

In addition, there are measures you can take throughout the project cycle to help ensure that you get paid.

## Step one: Know your client

Did you know that working with the wrong client is a factor in a significant number of claims against design professionals? AXA XL's Risk Drivers research shows that 23% of claims can be traced to inadequate client selection practices.

By improving your client selection practices, your firm can significantly increase the likelihood of getting paid and reduce your chances of being sued. In other words: Know your client.

You can choose to provide services to a client who is financially unstable, or one who is financially viable. If the project starts to lose money, it is obvious which of the two clients is more likely to refuse to pay your fees and file a specious counterclaim in response to your collection efforts.

Begin by asking questions—questions about the prospective client’s experience with the type of project, level of sophistication, attitude about quality, reputation for honesty and integrity, willingness to institute dispute resolution techniques, and history of litigation.

Some of the most important questions to ask are related to money. For example:

- Does the client have a realistic budget in mind? Avoid clients whose budget and expectations are not in line with one another.
- Is sufficient funding available? What is the source of the funding? Many claims against design professionals can be traced to the fact that the owner did not allocate enough money or have sufficient funds available to do the necessary work. If it is a public project, has it been formally authorized, and has enough money been appropriated or otherwise set aside to complete the project?
- Has the client shopped around for a low fee? This may be a sign that dollars are tight.
- Is there an adequate contingency fund in the budget? A knowledgeable client understands that unexpected needs will arise and that he or she must maintain an adequate fund through the course of construction to meet these needs.

A key ingredient in client selection is assessing a prospect’s financial condition. Check every client’s financial capability and background before you agree to commit your services. After all, you are about to invest your payroll dollars up front in the expectation that you will be fully paid for these services within a reasonable time. You do not want to wait months to discover the client cannot or will not pay you.

Armed with the results of your research, you are in a better position to decide to accept or decline the project or take steps to protect yourself. If the client does not measure up on the important issues, run, do not walk, to the next project.

## Step two: Develop a billing and collection strategy

Institute a billing and collection strategy for your firm and follow it consistently.

Some consultants suggest billing twice a month, which offers certain benefits. First, you are not carrying large accounts receivable. Also, people want to get their first bill paid before they receive the second one. Finally, billing more frequently can reveal problems more quickly.

Your approach to billings can be flexible, however, and tailored to the client. Billing twice a month does no good if a client pays only once a month. If you know that the client cuts their checks on the 20th of the month, you can arrange your accounts receivable to send out that client’s invoices on the 15th. Design firms that bill only once a month sometimes miss one complete billing cycle and are 30 days behind from the start.

The solution is to ask about your client’s billing cycle when you are setting up the job number. Go backwards an appropriate number of days for processing and mandate that invoices for that client are processed then.

Decide as a matter of policy how—and when—you will follow up on invoices. Will you call the client within a week? Two weeks? Establish a protocol to address non-payment by the client. Will you enforce contractual interest and penalties clauses? Withhold deliverables? Ensure your procedures are consistent with your agreement (more on that later). Finally, decide how long you are willing to wait before you are forced to suspend or even terminate services on a project. Make sure your contract reflects these decisions.

## Step three: Ask for a retainer

Why should you finance the client's project for a month or two while you wait for payment? One option is to require a retainer upfront from the client. Consider asking every client—even existing ones—for a retainer to be credited to their final payment to you.

Some clients are often most reluctant to pay your final invoice. When a client's capital is tight, he or she may have far greater incentive to pay the contractor than to pay you. Then, too, some unscrupulous clients simply choose to not pay the final bill as a unilateral way of discounting your fees.

There are several other good reasons to try to get some (or perhaps all) of the fees paid in advance. If a client has a history of slow or late payment, and if you want to maintain a positive cash flow, explain to your client that you need to make certain you will be paid.

It is not unreasonable to ask for a partial payment before work commences and for regular payments as the project progresses. The retainer can easily be calculated as the labor involved in the first billing cycle, whether that is 60 days or 120 days. If the client balks at paying a retainer, explain that your staff needs to be paid during the first payment cycle; and if the client can figure out a way make the process more rapid, you are willing to listen. No client would go 90 days without getting paid!

Be sure to provide that the retainer be credited only against your final invoice. In this way, you will be working on the client's capital—not your own—throughout the project.

Design professionals are often reluctant to ask for a retainer. But consider this: With a retainer, you have leverage. If you are working on the client's money, and if he or she stops paying you, you can stop providing services. It is as simple as that. The retainer is your buffer, your assurance that you will be paid for your most recent services.

## Step four: Talk...then put it in writing

Sometimes a client is reluctant to pay because they do not understand the complexity and realities of the design-construction process, and why costs can escalate over early estimates. It is up to you to explain the process—as well as the roles and responsibilities of design professionals and contractors—regarding schedules, deliverables, and compensation methods.

Work with your client to define your scope of services, explaining the tradeoffs in terms of risk, quality, and schedule. Develop a precise list; a vague or imprecise scope can lead the client to expect you to provide broader services than you intended for the fee involved...which can lead to payment issues.

Your agreement can incorporate your agreed-upon scope. It can also clearly address when payment is due, the penalties for late payment, and your rights in the event of nonpayment. Establish clear terms about

payment mechanics, billing cycles, payment due dates, when interest and penalties apply, and your recourse in the event of nonpayment.

By using contract language that has “teeth,” and by following a consistent, well-designed billing and collection system, you can minimize the risks of write-offs and slow-to-pay accounts as well as threats of retaliatory liability claims.

## Step five: Start off on the right foot

At project inception, find out who on the client’s staff will be reviewing and approving your invoices, and meet with them in advance.

Some questions to ask include:

- How would the client like to see invoices prepared? Is a specific billing form required? If so, ask for a copy.
- Where and to whom should you send the bill?
- What backup information does the client require? For example, does the client require timesheets?
- When and how often does the client pay invoices? Time your invoices around their payment schedule.
- Who is the contact for questions if payment is not received promptly?

Use this meeting to go over your own billing and payment requirements, too. (Presumably, you have already spelled them out in your agreement.) Remind the client of any interest and penalties for late payment, and when those penalties kick in. Make sure the client’s representative knows the proper person in your firm to contact with any questions about your invoices.

## Step six: During the project

You can significantly aid the collection process (and reduce your risk of a claim) by actively working to maintain a good relationship with your client. We cannot stress this point enough.

Make sure there are frequent and regular communications with the client throughout the project. If the client never hears from you until receiving your invoice, he or she may find reasons to question or delay payment.

It just makes sense. If you have not met with the client for a few weeks, and they have not seen anything you have done, you need to call the client and update them. That way, when the bill for 200 hours arrives, the client will not be surprised, and the invoice approval process may be accelerated...or at least not delayed.

## Step seven: At billing time

- Bill promptly and in accordance with the terms of your contract.
- Provide all necessary information with the invoice and check it thoroughly for errors.
- Follow up quickly—within a week. Call the client to assure that the bill has been received and that he or she has no questions.

Keep an eye on your accounts receivable and try to reduce the collection time to the shortest feasible period. If your contract states “due in 15 days,” remind clients of their obligations under the contract.

## Step eight: If payment is late

A slow payment can be a danger signal and needs to be addressed as soon as possible. Call the client to find out if there is a problem. If there are concerns about quality or performance or errors in billing, act quickly to address any concerns. If payment is still not made, follow up promptly in writing.

Continue to follow up with slow-paying clients. A weekly call is not too frequent. Be persistent and firm, but maintain a positive demeanor. Let the client know you need payment to meet your own obligations.

If the client refuses to pay and cites dissatisfaction with your work, explain that holding back payment is not permitted in the agreement. Attempt to separate the two issues, and push for payment and the resolution of the problem as two separate matters.

Maintain a written record of everything that happens during your collection efforts, including notes of phone calls, statements made, messages left.

If the problem turns out to be the client’s “temporary” inability to pay—not an issue with your services—consider getting a promissory note or offering a relaxed payment schedule for the amount due to that date. (Document details of these discussions.) And be on the lookout for other financial problems on the project. Make sure you have a record of correspondence and other communications about the issue. Six months down the road, when you are still trying to collect your fee, the client will have trouble making a case for errors or omissions, since they never raised it in the first place—and you have the documentation to prove it.

If your contract allows, you might consider withholding deliverables until you get paid.

Do not threaten any action (e.g., suspension of services or legal action) you are not prepared to take. If you are forced to act, consult with your attorney to ensure you have the necessary protections. And call your professional liability broker or professional liability insurer. The best insurance companies might be able to intervene and help you improve the situation, or suggest strategies to deal with the problem.

Staying up to date on collecting your accounts is even more crucial when you have no construction administration duties. If you have no involvement in the actual construction and are still waiting to get paid, you can nip the problem in the bud much earlier than if you were still involved.

Finally, while no one relishes the idea of stopping services mid-project, it might make more sense than continuing to “throw good money after bad” and letting nonpayment distract you from other profitable projects and increasing the chances of a major liability claim.

## Step nine: Project closeout

Reaffirm the entire project with the client and solicit the client’s opinion of their level of satisfaction. Consider giving your client a project summary with total billings as a “snapshot” view of the project for the client’s file.

Submit your final bill promptly after substantial completion of your services, when a client’s satisfaction is usually at its peak. Some firms offer a prompt-payment discount at this point. This is also the best time to find out about new projects that may be coming up.

## And finally...

Stay in touch with your clients, even between projects. Good clients—those you enjoy working with and who pay their bills—are worth their weight in gold.

## Scope creep

Scope creep can cause collection problems, if the client is not prepared for increased costs. Part of the solution is to formalize any changes to your scope or services.

Begin by taking the time with the client to carefully define your scope of services during the contract formation process. Discuss options, what is included, what is not included, and what might come up. The final agreed-upon scope can be part of your contract.

Make sure all project team members are familiar with the agreed-upon scope. Stress the importance of identifying any potential changes to the scope and of getting authorization before proceeding.

If a change in scope is required, inform the client in writing and include a detailed description of the change in services, impact on the project schedule, project cost, and professional fees. Obtain written authorization from the client. Some architects bring a form to client meetings to be filled out on the spot when an additional service is requested. It includes what the client wants added, the estimated fee, any changes to your schedule, and the client’s signature.

The information contained herein should in no way be construed as legal advice and should be used in conjunction with specific guidance from competent legal counsel experienced in the design and construction industry and familiar with the laws in your state, province, or jurisdiction whose laws will govern your contract.

## About the contributor

AXA XL is the P&C and specialty risk division of AXA. Coverages underwritten by Greenwich Insurance Company, Indian Harbor Insurance Company, XL Specialty Insurance and Company.

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This article corresponds to:

*Architect's Handbook of Professional Practice, 15th edition* Unit 1 – The Profession  
Chapter 16 – Risk Management  
Section 01 – Risk Management Strategies