Slow Death from Exposure

When you run a law office, you have to manage your cash flow.

The irreducible reality is that you have to lay money out for overhead and disbursements before you can bill your clients. You may then have to wait until you client decides to pay you.

Your **cash flow exposure** is the value of your work in progress (WIP), unbilled disbursements and accounts receivable (A/R's). It represents the work you have done and not yet been paid for, plus the amount you have advanced to third parties on your clients' cases.

To find your **exposure factor** for a month, divide the cash flow exposure at the end of the month by the amount of fees and disbursements collected in the month.

Knowing the exposure factor for one month isn't particularly useful, but the trend in this number over a period of time is important information about the speed of the cash flow cycle in your practice. Down is good, up is bad.

To find your **average exposure**, determine your exposure numbers for the last day of several months, then average them. To find the **average exposure factor**, which tells you the number of months of average collections you have outstanding in WIP, unbilled disbursements and A/R's, divide your average exposure by the average of your collections over the same period.

Different kinds of practice produce different exposure profiles.

- ☐ A contingency practice has a very high WIP exposure because you can't bill fees until the matter settles; the disbursements exposure depends on whether you bill disbursements as the case proceeds; there should be no accounts receivable exposure because your bills are immediately paid from settlement proceeds.
- ☐ A transactional practice--real estate or commercial--normally has a volatile short-term WIP and unbilled disbursements exposure, but should have low A/R's exposure because the files should be billed and collected when the transaction closes.
- ☐ An insurance defense practice that interim bills on a monthly basis should be able to keep its WIP and unbilled disbursements exposure to a minimum; its A/R's exposure will depend on how quickly its clients pay.
- ☐ General practices and family law practices often have high exposure factors, particularly if the lawyer has a weak retainer policy, incurs disbursements with little thought to their impact on cash flow, fails to bill regularly and has weak A/R's followup procedures.

As a general rule, you should try to keep your exposure factor as low as possible. There are several ways to do this:

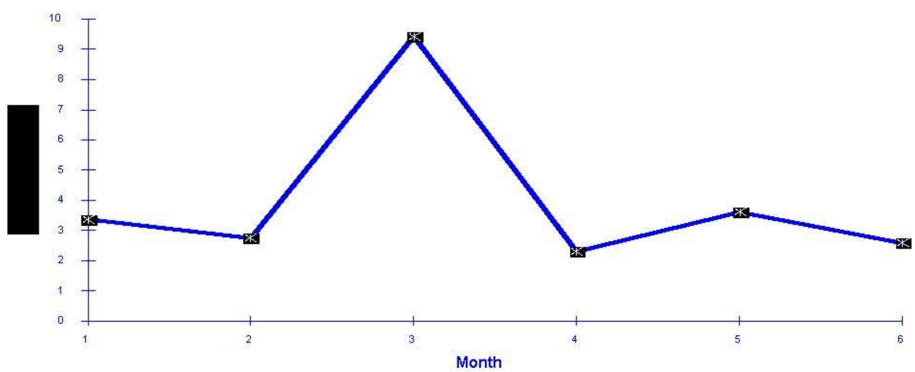
- ☐ Avoid unremunerative work unless you consciously decide to take it pro bono.
- ☐ Don't start files until you have an adequate retainer in trust.
- ☐ Keep your WIP low by billing it out as soon as possible.
- ☐ Keep your unbilled disbursements low by paying them out of trust or billing them out to clients as soon as possible.

Return to Top

- Keep your A/R's low by getting paid as soon as possible, preferably out of funds in trust, and by pursuing your receivables aggressively.

Today's computerized accounting programs make it easy for any firm to produce monthly or even more frequent bills and aged WIP, unbilled disbursements and A/R reports, which you use as the basis for your billing and collections activities.

Month	WIP	Unbilled Disbursements	A/R	Exposure	Collections	Exp. Factor
1	20,000	5,466.33	15,750.00	41,216.33	12,232.34	3.37
2	25,350.00	6,544.98	16,344.00	22,878.98	8,343.22	2.74
3	32,025.00	9,343.23	19,323.23	60,691.46	6,434.00	9.43
4	16,400.00	4,534.32	28,343.23	49,277.55	21,434.34	2.30
5	17,335.00	4,893.12	19,030.83	41,258.95	12,434.33	3.32
6	12,232.00	2,434.93	14,343.83	29,010.76	10,043.43	2.89
Avg	20,557.00	5,536.15	18,854.19	40,722.34	11,820.28	4.01



This spreadsheet and chart are for a hypothetical solo firm. The firm has an average exposure factor of 4.01. Its exposure factor peaked at 9.43 in month 3 due to a significant increase in all three exposure categories and a drop in collections, then bottomed out at 2.30 the next month when the collections recovered. On average, it takes 4 months from the time money is spent onoverhead and disbursements until it is recovered from clients.

Return to Top