QLD LEGAL FINANCE

BRIEFING · PROFITABILITY

Law firm cash flow *and lock-up.*

What principals need to watch before a profitable practice becomes a cash-constrained one — where the money is sitting, and what a day of lock-up is worth.

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Profit does not pay payroll. Cash does.

A law practice can be profitable on paper and still experience cash pressure because the timing of work, billing and collection is out of alignment with the timing of wages, rent, tax and other operating commitments.

That is why lock-up deserves the attention of principals. It measures the period for which the practice is effectively financing work before the corresponding cash arrives.

The issue is not simply whether debtors are high. It is whether the practice understands where cash is trapped, how quickly it is moving, and what management action will release it.

> **QLF PERSPECTIVE**
> Cash pressure in a profitable practice is often not a revenue problem. It is a working-capital problem.

1. Understand the cash conversion cycle of legal work

For most law practices, cash moves through a sequence:

Work performed → WIP accumulated → bill raised → debtor created → cash collected

Each stage introduces time. That time is funded by the practice.

The useful management question is therefore not only 'How much WIP and debtors do we have?' but:

- how old is it;
- where is it concentrated;
- why has it not moved;
- who owns the next action;
- whether the trend is improving or deteriorating.

> **DIRECTOR QUESTION**
> How many days does it currently take, on average, for one dollar of legal work to become one dollar of cash?

2. Lock-up combines WIP days and debtor days

Lock-up is usually understood as the combined period represented by unbilled work in progress and unpaid debtors.

A simple management view is:

WIP days + debtor days = total lock-up days

The exact calculation methodology matters less than consistency. A firm should adopt one method, use it every month and track the trend.

GOOD CONTROL

A lock-up number calculated differently each month is not a trend. It is a series of unrelated estimates.

3. WIP is not automatically an asset of equal quality

A dollar of WIP recorded yesterday is not commercially equivalent to a dollar that has remained unbilled for 180 days.

Older WIP may indicate:

- a matter has stalled;
- billing milestones are unclear;
- the responsible lawyer is deferring a difficult billing decision;
- the client has not been updated about scope growth;
- the recorded value is unlikely to be recovered in full;
- the work is complete but the billing process has failed.

The principal should therefore see WIP by age and, where useful, by fee earner or responsible principal.

RED FLAG

A practice reporting total WIP without an age profile. The total can remain stable while its quality deteriorates materially.

4. Debtors should be managed by age, owner and next action

The debtor ledger should not be managed as one aggregate number.

A useful monthly view separates current, 30, 60, 90 and 120-plus day balances and identifies the material accounts in the older categories.

Every significant overdue balance should have:

- a named owner;
- the date of the last action;
- the next action;
- an expected resolution date;
- a note where there is a dispute, payment arrangement or other impediment.

QLF PERSPECTIVE

An ageing report without ownership is descriptive. An ageing report with owners and next actions becomes a control.

5. Billing timing is a cash-flow control

Many firms focus on collections while allowing billing delays to remain embedded upstream.

But a debtor cannot be collected before it exists.

Review:

- how frequently matters are billed;
- whether billing events are triggered by time, stage, milestone or matter completion;
- how quickly draft bills are reviewed;
- whether responsible principals sit on billing decisions;
- whether small balances are allowed to accumulate unnecessarily.

> **DIRECTOR QUESTION**
> How much completed or billable work is currently waiting for a billing decision?

6. Fixed fees change the shape of the problem, not the need to manage it

Fixed-fee work can improve predictability, but it can also disguise WIP pressure if delivery effort and billing milestones are not monitored.

For fixed-fee matters, the firm should understand:

- how much of the work has been performed;
- how much of the fee has been billed;
- how much cash has been collected;
- whether the original scope assumptions remain valid;
- whether the matter is consuming more resource than priced.

> **RED FLAG**
> A fixed-fee matter appears commercially healthy because the fee is agreed, while the unbilled effort required to complete it continues to rise.

7. Trust money can improve collection timing — but it is not office cash

Where trust money is held for costs and the practice has the appropriate authority to transfer those costs, the timing of the trust-to-office process can affect office cash flow.

That does not make trust money part of the practice's liquidity.

The management discipline is to ensure that:

- trust and office cash remain reported separately;
- eligible trust-to-office transfers are processed promptly and correctly;
- the supporting authority and records are complete;
- the practice does not mentally count client trust money as available working capital.

> **RED FLAG**
> A healthy trust balance creating false confidence about the practice's actual office liquidity.

8. A 13-week cash forecast converts lock-up into action

Lock-up explains where working capital is tied up. A cash forecast shows when that becomes a problem.

A 13-week forecast should show, by week:

- opening office cash;
- expected client receipts;
- payroll and superannuation;
- rent and major recurring expenditure;
- activity statement and tax payments;
- other material commitments;
- closing cash;
- the projected low point.

The forecast should also distinguish between high-confidence receipts and receipts that depend on uncertain billing or collection assumptions.

> **DIRECTOR QUESTION**
> What is the lowest projected cash point in the next 13 weeks, and which receipt assumptions does that result depend on?

9. Stress-test receipts rather than trusting the base case

The base forecast is useful. The stressed forecast is often more informative.

Simple scenarios may include:

- the three largest expected receipts arriving 30 days late;
- a major matter not billing in the expected month;
- an unexpected payroll or recruitment cost;
- a large tax payment falling earlier than anticipated;

- a planned partner draw proceeding despite weaker collections.

> **QLF PERSPECTIVE**
> A cash forecast should reveal the margin for error, not merely reproduce the most optimistic version of the next quarter.

10. Partner drawings should follow cash generation, not accounting profit

A profitable month does not necessarily mean the practice has generated distributable cash.

Before drawings or distributions are considered, management should understand:

- current office cash;
- near-term liabilities;
- tax and superannuation obligations;
- the 13-week cash low point;
- the level and age of lock-up;
- any planned capital expenditure or recruitment.

> **RED FLAG**
> Partner drawings based on reported profit while the practice is simultaneously increasing its overdraft or stretching creditors.

11. Growth usually consumes cash before it produces cash

Growth can increase working-capital pressure even where margins are healthy.

New fee earners create wages immediately. New matters create WIP before they create bills. Bills then create debtors before they create cash.

This can produce a counter-intuitive result: a growing and profitable practice becomes more cash constrained.

> **DIRECTOR QUESTION**
> If revenue grows by 20% over the next six months, how much additional working capital does the practice need to fund that growth?

12. Use targets, but manage the movements

A target lock-up number is useful, but the movement behind it matters more.

Each month, principals should understand:

- whether WIP days improved or worsened;
- whether debtor days improved or worsened;
- which component caused the movement;
- which principal, team or matter type is driving it;
- what action is expected before next month.

> **GOOD CONTROL**
> A target only becomes useful when someone owns the gap between the current result and the target.

A practical monthly working-capital dashboard

MEASURE	CURRENT MONTH	TREND	MANAGEMENT QUESTION
WIP days	Current result	12-month	Why has unbilled work moved?
Debtor days	Current result	12-month	What is slowing collection?
Total lock-up	Current result	12-month	Is working capital improving?
90+ debtors	$ and %	3-month	Who owns the material balances?
120+ debtors	$ and %	3-month	What requires escalation or provisioning?
Old WIP	$ and %	3-month	What is genuinely billable?
13-week cash low point	$ and week	vs prior forecast	What assumptions create the low point?
Available facility	$	monthly	What headroom remains?

Worked example: profitable but cash constrained

Consider a practice producing strong accounting profit but carrying:

- $600,000 of WIP;
- $450,000 of debtors;
- combined lock-up of 115 days;
- $220,000 of office cash;
- a payroll and superannuation cycle of $180,000;
- a $140,000 activity statement payment due within six weeks.

The practice may look profitable while having very limited room for delay in collections.

If several large receipts slip by one month, the problem is not that the P&L suddenly became wrong. The problem is that too much capital was tied up between work performed and cash received.

> **QLF PERSPECTIVE**
> The right response may involve billing timing, collections, WIP discipline, partner drawings, working-capital facilities or some combination of these — not simply 'win more work'.

What principals should ask every month

1. What is total lock-up, and which component moved?
2. Where is the oldest material WIP?
3. Which 90-plus debtors changed since last month?
4. What completed work is still waiting to be billed?
5. What is the 13-week cash low point?
6. Which expected receipts create the greatest forecast risk?
7. Are drawings or discretionary spending appropriate given the forecast?
8. Is growth consuming more working capital than the practice has planned for?

Where QLD Legal Finance fits

Cash flow and lock-up sit at the point where bookkeeping becomes management.

QLD Legal Finance can support Queensland law practices with:

- WIP and debtor analysis;
- lock-up reporting and trend monitoring;
- billing and collection-cycle review;

- 13-week cash-flow forecasting;
- working-capital scenario modelling;
- management reporting and exception tracking;
- commercial discussion with principals around drawings, growth and cash requirements.

The objective is not to make the practice obsess over cash every day.

It is to make sure cash pressure is visible while management still has choices.

Important information

This guide is general information only and does not take account of the circumstances of any particular law practice. It is not legal, income tax or financial product advice.

Lock-up and cash-flow methodologies are management tools. Firms may calculate WIP days, debtor days and working-capital measures differently. The methodology adopted should be applied consistently so trends remain meaningful.

The worked example is illustrative only and does not represent a benchmark or recommended level of cash, lock-up or working capital for any law practice.

Trust money must remain clearly distinguished from the practice's own funds and must not be treated as available office liquidity.

QLD Legal Finance supports Queensland law practices with trust accounting, financial control and advisory services. It is not affiliated with or endorsed by Queensland Law Society.

Source basis

This draft has been developed from the QLD Legal Finance management-reporting and matter-profitability frameworks prepared for the resource project, with a specific focus on working capital, lock-up and cash-flow control for law practices.

WHERE THIS CAME FROM

This guide is part of the QLD Legal Finance resource library — practical material written for the people who run Queensland law practices, not for other accountants. If something here raises a question about your own firm, write to **enquiries@qldlf.com.au** or call **07 3261 2833**. A director will answer personally.

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