# The Law

Autumn 2013

*Armstrong Watson's specialist publication for the legal profession*

## Outcomes Focused Regulation

Its impact upon running your law firm as a business.

## Cash flow and funding for law firms

We share some tips for improving cash flow in your law firm.

## Long Term Care Costs

Can anything be done to ease the burden?

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Welcome to the Autumn 2013 edition of The LAW, the specialist publication for the legal profession from the legal sector team at Armstrong Watson.

Specialists are available from all of our 14 offices to provide pro-active support and advice to lawyers in compliance and business improvement matters. This publication is designed to allow us to share our collective experience in acting for lawyers throughout the UK.

I also keep our law firm clients up to date with more immediate developments in the legal profession via Twitter. If you would like to follow me, I'm @AW_AndyPoole

Recent developments include the Law Society releasing what they view as risk indicators in the financial stability of law firms. There have been a number of high profile casualties recently and it has been well documented that a large number of firms are currently struggling.

Please contact me if you would like an initial confidential conversation on how we might be able to help to improve your profitability and cash flow, or if you would like any further information on anything referred to in this publication.

Andy Poole

Andy Poole
Legal Sector Director

# In this edition:

## Long term care costs - can anything be done?

Peter Bouweraerts discusses this increasingly important issue affecting many in the UK.

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## Cash flow and funding for law firms

Richard and Mark share some tips that will help to solve your cash flow problems.

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## Outcomes focused regulation and its impact on running your law firm as a business

Andy Poole reviews the business impact of the new regulations upon law firms.

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## Leeds Law Society and Armstrong Watson

Joanna Dixon of Leeds Law Society updates us on developments at the Society and working with Armstrong Waston.

# How We Help Law Firms

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# Long term care costs – can anything be done?

Peter Bouweraerts
Financial Planning Consultant

With the ever increasing elderly population in the UK, it comes as no surprise that the demand for care is increasing at a rapid rate.

This is an emotive issue for many, as family members are often saddened to see that assets diminish due to care costs and in many cases the family home has to be sold to fund care.
The Government are plainly aware of the issue and are planning to implement a cap on the costs of care at around £70,000. However, this is not as attractive as it sounds initially, as many areas associated with care are excluded from the cap. For example, accommodation and food costs are not included within this amount and over the years it is possible that these costs could amount to a significant figure for most people, perhaps even the most significant costs of all.

Having seen the Government's proposals, people who believe that they will no longer need to sell their house, or only have to fund up to the cost cap for their care, may be in for an unpleasant surprise. In which case is there anything they can do?

Thankfully, with sensible planning it is possible to protect assets to some extent for the next generation and the first thing to do should usually be to make sure that the local authority assessment has been conducted properly and that all entitlements in relation to care costs are claimed.

Importantly, when the Local Authority assesses someone's assets and their ability to pay, are they assessing the correct assets?

In the Charging for Residential Accommodation Guide (CRAG), it is made clear that the value of life insurance bonds should be disregarded in the assessment of care costs. In some cases people may have amassed substantial sums within such bonds and local authorities may try to take the value of these into account.

However, the CRAG report is clear that as these types of plans have an element of life cover attached to them, they should not be viewed as investments and should, therefore, be disregarded. It may be that care costs are better funded from other areas so that the value of the bonds remains intact for future generations.

So, aside from making sure that the initial assessments have been conducted properly, is there anything else that can be done?

One area to explore is the option of a long term care annuity. This involves giving up capital to an insurance company who in return pay an income for life. Given the age and health of most people going into care, it is often the case that the rate of income paid will be at a relatively high level in comparison to lifetime annuities for those in good health. Extra value can also obtained if the amount is paid directly to the care home, as this is free of tax.

A long term care annuity can therefore be a good tool to bridge the gap between someone's income and their care costs. It will provide certainty of income for the rest of their life and although it may mean that capital from savings and investments (not life insurance bonds) may have to be used, this could be a preferable alternative if it means protecting the family home.


# Cash flow and funding for law firms

Richard Andrew, Legal Sector Manager
Mark Baines, Professionals Executive

The recent announcements calling administrators at a number of prominent law firms may have been a surprise for some, particularly as positive public statements had been made about their finances and growth not long before. However, growth in a practice often results in an increased cash requirement in order to finance work in progress and debtors at least in the short term. A shortfall in working capital coupled with a historically high level of gearing can become too much for the lenders to law firms.

Understanding your working capital requirement and the cash cycle is key to foreseeing shortfalls in funds and improving your overall cash position and self-sustainability. Increasing pressure on overdrafts caused by a number of issues in the legal sector means that law firms need to put their working capital cycle to the top of their agenda. Indeed, we have received a growing number of enquiries from law firms and their bankers in connection with cash flow difficulties. Solving these cash flow problems normally involves three key steps:

## 1. Understand the maximum short term requirement

This requires a robust financial model to accurately predict the maximum shortfall in funds. Once the financial model has been completed it is important to compare the on-going performance with the predicted performance in the financial model. Variances between actual performance and predicted performance should be investigated and the financial model updated so that it evolves and becomes more accurate. Lenders will normally request that financial models are prepared or reviewed by an external, independent accountant. Using an accountancy practice like Armstrong Watson, with specialist experience in refinancing law firms, will add greater credibility to your financial model.

## 2. Explore the options for financing the short term requirement

The cheapest form of finance will always be personal or family funds, and therefore businesses which experience cash flow difficulties will often exploit these options first. Partners often provide additional cash flow funding to their law firm without considering step 1 above and step 3 below. It is important to note that these steps are just as important whether the funds are personally or externally raised. Depending upon the exact circumstances, a bank may be willing to extend finance facilities to allow law firms to "trade out" of cash flow difficulties. However, this will depend greatly upon their confidence in your financial model and how closely actual performance mirrors predicted performance. In some cases a change in bank may provide a cash flow opportunity. Our connections in the banking sector and our reputation as experts in the legal sector mean that we are well placed to explore all of the available finance options for you.

## 3. Improve the working capital cycle

This is the most important step of all. If no changes are made then the whole exercise may have to be repeated in six months time and banks are likely to take a dim view of repeating the process. A law firm can only "trade out" of cash flow difficulties by making positive changes to the way in which they operate. Here are a few areas where law firms can make small changes which can result in significant positive cash flows:

- Request payments on account from clients for disbursements.
- Regular reviews of work in progress and debtors with individual fee earners.
- Ensure client funds are transferred to the office account at the earliest permitted opportunity.
- Accurate time recording to ensure maximum bills of costs.
- Issuing regular statements to clients.
- Formal credit control procedures.
- A policy of interim billing.
- Appropriate use of costs draftsmen to maximise fees.
- Clear payment terms on bills of costs.
- Scrutinise and reduce overheads.
- Reduce the level of drawings.
- Consolidate debt and extend debt terms to achieve better interest rates or reduced repayments.

As an external accountancy firm with expertise in the legal sector, we perform independent reviews covering the areas above and all of a firm's lock up processes. We provide reports specific to your law firm with a detailed set of recommendations ranked according to their impact on cash flows. We also perform follow up reviews to ensure that our recommendations are being implemented and best practice is adhered to. Until these new processes become habitual, it is natural for fee earners to return to the old way of doing things. It is only with on-going monitoring that a lasting improvement can be made to the working capital cycle.

If any of the above sounds familiar then please contact us for a confidential, no obligation discussion.

# Outcomes focused regulation and its impact on running your law firm as a business

Andy Poole, Legal Sector Director

Outcomes focused regulation ('OFR') was introduced on 6 October 2011 and despite much publicity within the profession, many law firms have not made significant changes as a result.

I'm not going to concentrate on the technical compliance issues here. I want to cover the much more interesting impact of OFR on how law firms are run as businesses. It could be argued that the commercial business aspects of OFR should force lawyers to do what perhaps they should have been doing anyway, which is to run their businesses as businesses.

According to Principle 8 of the SRA Handbook "you must run your business or carry out your role in the business effectively and in accordance with sound financial and risk management principles".

Will turning sound business sense into a compliance requirement force lawyers to change the way they run their businesses? Or, should the wider issues in the market be doing that anyway?

Outcome 7.4 of OFR contains the requirement to "maintain systems and controls for monitoring the financial stability of your firm". Indicative Behaviours of meeting this outcome include:

- IB 7.2 – controlling budgets, expenditure and cashflow
- IB 7.3 – Identifying and monitoring financial, operational and business continuity risks

Is relying on your external accountant preparing your annual accounts months after the period to which they relate sufficient to comply with this compliance requirement?  Is that sufficient for you to respond to the almost daily changing factors in the legal services market?

I believe that all law firms should have this at the top of their priority list of action points. Prudent financial management is key to client service continuity by a sustainable law firm that can deal with changes including The Legal Services Act; banning referral fees, removing work from the scope of legal aid and the Jackson reforms tied up in LASPO; reducing recoverable costs in the personal injury fast track portal; and potentially extending the portal.

Have you prepared a detailed bespoke business plan covering all of these impacts on your business?  Does it include cash flow, profit and loss and balance sheet forecasts?  Have you undertaken steps to maximise performance, utilisation and recovery?  Have you undertaken a review to identify ways to reduce the length of time taken between performing work for clients and getting paid for it?

Armstrong Watson can help you.  Our specialist legal sector team can prepare cost effective business plans and forecasts and we can work with you to boost your profitability and cash management.

Call your local office for an initial no obligation discussion:

Call 0808 144 5575
Email: andy.poole@armstongwatson.co.uk

# Leeds Law Society and ArmstrongWatson - measures of success!

By Joanna Dixon, Leeds Law Society

Leeds Law Society has a new President, Heidi Sandy. She specialises in relation to all aspects of commercial contract disputes, breach of confidentiality and restrictive covenants, banking and finance litigation and professional negligence. Sandy is also the immediate past chair of the National Junior Lawyers Division (JLD) and a former chair of the Leeds Junior Law Division.

The Society's objective locally and nationally is to promote the interests of its members whilst remaining conscious of the opportunities and threats that face the profession as a whole.

Leeds Law Society has been working with Armstrong Watson over the last couple of years on various projects both legal and social "our on-going relationship with Armstrong Watson is exactly the type of value added relationship that delivers real benefit to our members" said Heidi Sandy.

Members benefit from social events and networking events that give members the much needed opportunity to network informally between professions and build networks across disciplines. Examples of our work with Armstrong Watson include a hugely successful seminar with Andy Poole, Stephen Mayson and Stuart Bushell and also a follow up seminar on the changing legal landscape and The Legal Services Act, preparing legal firms for what these changes mean to the profession with Andy Poole, Michael Napier and Jon Busby.

The recent Society wine tasting events is another good example of our partnership with Armstrong Watson. They were extremely well received by the group of sixteen lawyers that took part. The same group attended each session for six consecutive months which provided a forum for relationships to build over a period of time. Each session concentrated on wines from a different region of the world, allowing the group to learn more about how the wines were created.

We're working with Armstrong Watson again this Autumn with the launch of a spirits tasting course for a group to take part in similar tasting sessions!