



the Law

Spring 2016

Armstrong Watson's specialist publication for the legal profession

How to sell your
law firm

Planning for a
positive cash flow in
2016

Purchasing property via
pensions

A taxing divorce

An interview with...
Jim Thomas, Managing
Director at PDW Group

ArmstrongWatson®

Accountants, Business & Financial Advisers

A track record of providing solutions to the legal profession



In this edition...

How to sell your law firm

Rosy Rourke, Legal Sector Manager

A taxing divorce

Helen Thornley, Senior Tax Consultant

Planning for a positive cash flow in 2016

Andy Poole, Legal Sector Partner

Purchasing property via pensions

Justin Rourke, Financial Planning Consultant

Fit for Work Scheme

Karen Thomson, Director of Payroll

An interview with...

Jim Thomas, Managing Director at PDW Group



Andy Poole

Andy Poole
Legal Sector Partner

Welcome to the Spring 2016 edition of *The LAW*, the specialist publication for the legal profession from the legal sector team at Armstrong Watson.

In the last edition I noted that "merger activity certainly seems to be hotting up in the legal sector". I continued to say that "right now we're engaged in nine separate active mergers of law firms. That's in addition to the long list of firms looking for a merger". I suggested that "given the legal aid and personal injury changes, it's only going to increase". My prediction has come true and since then our number of instructions from law firms in active mergers has increased to 16.

If you are looking to buy or sell a law firm, contact me as we have the experience to help in ways that generalists cannot.

Specialists are available from all of our 15 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.

Please contact me if you would like to discuss how we can help you, or if you would like any further information on anything referred to in this publication.

The Law Society has exclusively endorsed Armstrong Watson for the provision of the following services to law firms throughout the North of England:



- Strategy Planning Workshops
- Business Plans
- Benchmarking
- Trading Structure Reviews
- Mergers & Acquisitions of Law Firms
- Law Firm Valuations
- Forecasts
- Raising Finance
- Lock-up Reviews
- Pro-active Tax Planning
- Tax Compliance
- Audits
- Accounts Rules Reporting
- Accounts Preparation

Call 0808 144 5575 to be connected to your local office, or visit www.armstrongwatson.co.uk/legalsector

Armstrong Watson Accountants, Business and Financial Advisers is a trading style

Armstrong Watson is a partnership under English law. A list of partners is available at the principal place of business, 15 Victoria Place, Carlisle, CA1 1EW

Armstrong Watson is regulated by the Institute of Chartered Accountants in England and Wales for a range of investment business activities

Armstrong Watson Audit Limited is registered to carry on audit work in the UK and Ireland by the Institute of Chartered Accountants in England and Wales. Registered as a limited company in England and Wales No. 8800970. Registered office: 15 Victoria Place, Carlisle, CA1 1EW

This newsletter is a general guide to issues facing the legal sector. It is not a substitute for professional advice which takes account of your specific circumstances. Subjects covered change constantly and develop. No responsibility can be accepted by the firm or the authors for any loss occasioned by any person acting or refraining from acting on the basis of this publication.



How to sell your law firm

Rosy Rourke, Legal Sector Manager

Contact Rosy at rosy.rourke@armstrongwatson.co.uk

There are an unprecedented number of issues impacting the legal sector at the current time, including personal injury and legal aid reform as well as general trading conditions. The issues are pushing the market towards consolidation and activity in this area is buoyant.

Armstrong Watson is recognised as one of the leading firms in the mergers and acquisitions arena, with a proven track record of assisting law firms. To demonstrate our record, we are currently engaged in 16 different live law firm mergers.

Looking to exit the legal sector market?

Here are our top tips to consider:

- **Preparation and time**

Ideally the preparation to sell your practice will begin a number of years prior to your target date. This will allow the time to ensure your practice is operating as profitably and efficiently as possible, and to fully consider the other tips below in order to maximise its value.

Whatever the timescale of the sale, you will need to be as prepared as possible. Entering into the sales process without the information and required understanding of your own business is only likely to damage the outcome for yourself.

- **Understand your objectives**

Why are you selling your practice? Is it simply to maximise price and exit the legal services market? Are there other factors to consider?

These may include consolidation through expansion, security for your staff or a good future service for your clients.

- **Be realistic about the value of your practice**

A formal valuation of the practice should be undertaken. The value of a practice in reality is often very different to what the owners perceive it to be. A formal valuation will help to focus and understand what the realistic outcome of the process will be.

- **What are the practice's strengths and weaknesses?**

You need to know what is attractive about your practice to a potential buyer. This may be the loyal experienced staff, efficient working practices, or the potential for future growth within your client base. This will be crucial in identifying weaknesses which could negatively impact any deal and allow consideration for how those potential faults can either be addressed before the sale or negated by the buyer in the future.

- **Research your potential market to maximise value**

Identify a small number of firms that will be a good fit with your practice through market research, and based on areas such as work types, geography and strategic objectives. Reverse due diligence should be undertaken to ensure any buyer is in an appropriate financial position.

'Arguably the most important factor to consider is culture'

- **Accurate data**

WIP value will be one of the most essential areas in selling your practice, and will be closely examined by any buyer.

Ensure your data is accurate and that you understand its realisable value.

Close any completed cases, write off any irrecoverable WIP and identify cases where WIP may be under-valued.

A formal WIP audit by a specialist may be appropriate. Consider what other data may be required and ensure that is both available and accurate.

- **Up to date financials**

Your financial information needs to be up to date and readily available. Any buyer is likely to want to see both historic accounts and future financial information, in the form of forecasts.

Explanations for any anomalies or variances, both positive and negative should be pre-empted, and the basis of any forecasting should be both understood and documented fully.

- **Consider your future tax position**

Understand what you are selling. To some extent this will be dependent on your firm's structure and the motivation behind the sale, and may be shares in a company, or the assets of the practice.

Tax advice should be taken early on in negotiations to ensure that any tax implications of the proposed structure of the deal are fully understood, and that the deal is as tax efficient as possible for you.

- **Involve your external advisors early**

Any external advisors should be involved in the process as early as possible. This will include an external lawyer and a lead advisor as a minimum.

They will assist in removing the emotion from the process and be able to advise on the process from an objective point of view.



Finally, although not covered in the list of the points above, arguably the most important factor to consider is culture.

If the culture of the two practices doesn't match or can't be aligned, then post merger integration rapidly becomes impossible and if not addressed at an early stage, can also lead to the merger falling down late on in the process.



A taxing divorce

Helen Thornley, Senior Tax Consultant

Contact Helen at helen.thornley@armstrongwatson.co.uk

Spring into Divorce



I wonder how many times family solicitors get asked whether or not it is true that the number of divorce enquiries peak post January? The media certainly make a play on it, and it can be an opportunity for profile-raising for family teams. But regardless of whether the festive season is the final straw, for tax purposes the crucial date is in spring with the 5 April tax year end.

Capital Gains Tax

The main tax to consider in a divorce is frequently Capital Gains Tax. This will be relevant if the couple have assets including property, shares or a business they want to transfer between them or sell to realise cash.

We should note that tax issues are essentially the same whether ending a marriage or civil partnership and have used marriage as a short hand in the following. Unmarried couples who separate will have different tax issues which are not covered in this article.

Married couples are allowed to transfer assets between them without gains or losses. They can continue to do this until the end of the tax year (5 April) in which they have separated. After that, any assets transferred are deemed to occur at market value until the divorce completes.

If a separation commences early in 2016, there is very little time before the end of the tax year on 5 April 2016 to agree the split of assets and make transfers. Capital Gains Tax could then be an issue in the following tax year when transfers are finally made. So if a couple separate early in the tax year they can have much longer to plan.

If transfers need to be done after the initial tax year of separation clients may need advice on tax costs. It is also necessary to identify if various reliefs such as Private Residence Relief for their home or Entrepreneurs Relief or Gift Relief for business assets are relevant.

Tax credits

Clients must report a change in circumstances - such as one party moving out - to HMRC within 30 days and start separate claims. This includes separations under a court order or separations which are likely to become permanent.

Marriage Allowance

For couples eligible for the Marriage Allowance - which allows a transfer of some of the personal allowance of the higher earner to the lower earner - the 5 April cut off is again relevant. It is possible to elect to stop the transfer either at the start or end of the tax year of divorce. The timing will depend on whether the lower earner is likely to have to go out and work and use all their personal allowance.

Inheritance tax

After divorce or dissolution no doubt all clients are advised to review their will. It's worth checking the Inheritance Tax (IHT) position too as a single person will have only one nil rate band and will pay IHT if their assets exceed £325,000. From April 2017 the residential nil rate band starts to be phased in and that should also be considered.



Planning for positive cash flow in 2016

Andy Poole, Legal Sector Partner

Contact Andy at andy.poole@armstrongwatson.co.uk

Profitability levels may have improved for many law firms, but cash flow remains stubbornly difficult to pick up. This is likely to continue into 2016, particularly for those firms that are fortunate enough to be part of an expanding market.

As activity levels increase, staffing and other expense requirements grow. Those expense payments are required to be paid as work is performed, yet the law firm will typically not receive payment until it has performed the work, raised the bill and then waited for clients to stump up the cash.

The period between performing the work and raising a bill is known as WIP days; the period between raising the bill and getting paid is known as debtor days. Collectively WIP days and debtor days comprise the lock-up period – the amount of time that cash is locked in the system. It also reflects the working capital requirements of the business, which will grow as activity increases given that increasing expenses need to be paid the whole lock-up period before the firm will benefit from the increased receipts.

So, how can firms manage the cash flow challenge?

One way is to ensure that the business is appropriately funded. Firms do require a certain amount of working capital funding which tends to be raised as a mixture of bank funding, specialist lender funding and partner capital injection; the latter of which may also be borrowed.

Funders will want to see partners having some skin in the game, but more importantly that they have a well-managed business with realistic forecasts demonstrating an ability to repay the funding under a range of circumstances.

The starting point for planning for positive cash flow therefore needs to be the preparation of detailed financial forecasts that demonstrate the anticipated cash flow, together with the potential impacts of various potential outcomes.

Those forecasts should be fully integrated with a balance sheet, profit and loss account and a funds flow statement. They should include detailed assumptions and thoughts behind the numbers and they should be used to manage the business on an ongoing basis.

The forecasts should allow law firm leaders to identify the points at which cash flow may be tight and permit appropriate decisions to be made in advance.

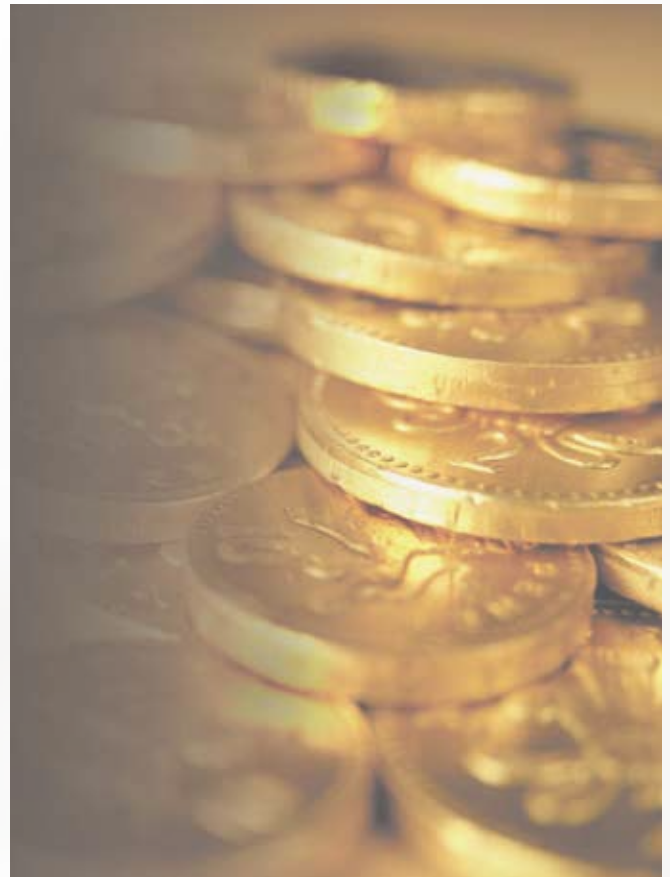
Debtor days and WIP days by fee earner should be analysed to allow accurate forecasts to be prepared. Both should also be monitored on at least a monthly basis as part of the ongoing management of law firms. Those periods will vary widely by work type, but in general if average debtor days for the firm exceed 60 and/or average WIP days for the firm exceed 90, then the working capital requirements for the firm will be higher than the averages for a firm with a well balanced mix of work types.

Realistic lock-up targets should be set by fee earner, taking into account their role and work type. Those fee earners not only need to be aware of those targets, but also how they can regularly access the information for self-management; why they are being monitored and targeted; and the implications of their day-to-day activities on the lock-up period – i.e. how they can improve matters. Financial education is therefore an imperative, but crucially education designed to allow fee earners to become more comfortable in having difficult financial conversations with clients that not only maximise cash flow but also maximise client relationships. Our in-house training courses for law firms outline how it is possible to do both.

My top 10 pointers for maximising cash flow in 2016

- Preparing realistic forecasts
- Obtaining a suitable funding mix
- Analysing, targeting and monitoring debtor days and WIP days by fee earner
- Providing in-house training courses for all partners and staff on understanding finance in law firms
- Resisting the temptation to recruit too many staff too early – sweat your assets appropriately
- Clearly agreeing the fee basis - or better still the exact fees - and the timing of work and payments at the outset of all new instructions
- Agreeing with clients that interim bills will be raised on at least a monthly basis – then reviewing WIP prints on a monthly basis for all potential bills, however small
- Raising the final bill promptly on completion
- Raising monthly bills no later than the 22nd of each month so that they are received by clients before the end of the month and may therefore hit their payment runs a whole month earlier
- Empowering the credit control function and preventing fee earners from unnecessarily blocking the credit control process

The same principles apply whether your law firm is expanding and seeking to maximise cash flow to restrict the growth of working capital requirements or whether your firm is not so fortunate to be growing and needs to maximise cash flow to stabilise the business. Either way, law firm leaders will need to take hold of cash flow management in 2016 or risk going the same way as the firms that have sadly run out of cash and perished in 2015.



This article was first published by Solicitors Journal on 02/02/16, and is reproduced by kind permission. www.solicitorsjournal.com



Purchasing property via pensions

Justin Rourke, Financial Planning Consultant

Contact Justin at justin.rourke@armstrongwatson.co.uk

Can your business premises save you tax?

Traditionally, most law firms have been established as a partnership or LLP, but an increasing number have decided to incorporate and the number of firms operating as limited companies probably now outstrips other modus operandi. As is the case with all forms of business, proprietors are generally keen to retain as much of the revenue they generate as possible and minimising tax liabilities often ranks highly in this regard.

The Government has taken considerable steps to increase its tax take recently, with pensions being placed firmly in the firing line, especially for higher earners and those with substantial accumulated benefits, but what many directors often overlook is the potential tax advantages of using commercial property within a pension; including their own business premises.

Many businesses own the premises from which they trade, or they are owned collectively by the directors, which generates income for the company or the individuals involved, but the problem here is that tax is payable on this income (either Corporation Tax on the business or Income Tax on the individuals) and if the premises are sold at a later date, tax may become payable again on any capital gain generated on disposal.

Whilst there may be some initial costs involved and possible tax implications in the short term, transferring ownership of the property to a pension scheme has a number of potential benefits.

- As the premises are now owned by the pension scheme trustees, all future growth in the capital value is sheltered from tax.

- If the business continues to trade from these premises it must pay rent to the pension scheme. This rent (on commercial terms) is classed as a business expense, thereby increasing legitimate business expenditure and reducing the annual Corporation Tax bill.
- Depending upon the type of pension scheme used, the pension could, in certain circumstances, provide loan backs to the business to help fund legitimate business projects in future.
- Transfer of the premises into the pension scheme may be regarded by HMRC as a pension contribution and could, in certain circumstances, attract tax relief.

These arrangements can be particularly attractive when considering exit strategies for the directors and succession planning thereafter.

There are downsides of course. Property can be illiquid and if a quick sale is desired this may not always be feasible if market conditions dictate otherwise. Furthermore, to arrange property purchase with a pension scheme is not without cost, as in addition to fees being payable for advice, other costs such as Stamp Duty, conveyance and (possibly) environmental surveys need to be factored into the equation.

Funding of the purchase of the property by the pension scheme also needs to be considered, so those without some form of accumulated pension benefits may not be able to go down this route.

Due to the numerous options available, the possible tax implications and the strict governance of pensions, advice is essential to ensure that all the bases are covered, but provided care is taken the advantages and the tax savings in particular can be highly advantageous, especially over the long term.



Fit for work scheme

Karen Thomson, Director of Armstrong Watson Payroll and Employee Services

Contact Karen at karen.thomson@armstrongwatson.co.uk

Do you know about the Fit for Work scheme?

With sick pay compensation withdrawn for small businesses, the Fit for Work initiative is designed to help employers manage absence. So how does it all work? Karen Thomson, of Armstrong Watson Payroll and Employee Services investigates.

Many moons ago the Department for Work and Pensions (DWP) announced another blow for SMEs: an end to small businesses being able to claim sick pay compensation. There was little, if any, consultation on this change and, as the Telegraph reported in January 2015, "the government quietly withdrew the scheme."

Many payroll professionals were aware of this in plenty of time, but it came as quite a shock to many small employers and may still be a shock to some legal firms, if they haven't paid Statutory Sick Pay out for a year or so. The payroll services, here at Armstrong Watson still receive enquiries now from small employers who haven't realised the compensation scheme has gone.

So what did the government decide to do to replace this scheme? Nothing financial, I am afraid! Say hello to the Fit for Work service, as it is now called. The scheme saw many delays before finally rolling out in September 2015.

So what is it?

The aim of the scheme is to help employers manage sickness absence, especially for the smaller employer who doesn't have the advantage of an occupational sickness/health scheme.

It provides free health and work advice via the website and by telephone to try and prevent the absence in the first place, along with a free referral system for an occupational health assessment.

Unfortunately, this isn't available to employers where the employee either hasn't reached, or isn't expected to reach, four consecutive weeks of sickness absence. So for those employers who have an employee taking one day a week on a regular basis, the referral cannot be used.

How does it work?

In addition to being able to access help and advice, if your employee is referred for an assessment, it is possible the employer will receive (normally via email) a return-to-work plan.

As well as the GP being able to refer an employee, the employer can also request a referral. The employee must be eligible by meeting the following criteria:

- Be employed
- Absent from work for four weeks or more
- Have a reasonable likelihood of making at the very least a phased return to work
- Not been referred for an assessment in the last 12 months and not have received a return-to-work plan, including being referred by the GP
- Provided their consent to be referred

Now the last bullet is what I personally find irritating. I accept it is always better to have employee buy-in, but what if the employee just doesn't want to play ball and is quite happy having the security of a job, but perhaps receiving a healthy sickness payment; very possible in the legal sector?



An interview with...

Jim Thomas

Managing Director at PDW Group, specialists in all aspects of business performance improvement

1. What are the typical challenges you see facing legal firms right now?

The challenges are numerous, and include continued economic pressures impacting on trainee recruitment numbers and various firm wide cost cutting measures, as well as many clients being more fee sensitive and looking for cheaper alternatives. An increasing number of law firms are merging or looking at doing so which is clearly changing the competitive dynamic in the marketplace. The SRA has been conducting its fair share of changes to regulations trying to reduce bureaucracy and improve access to the profession but these changes offer their own challenges. People continue to be a key challenge to law firms, including how well they are led, managed and developed, their reward mechanisms and the diversity and mobility of the workforce.

2. So how can law firms improve business performance?

The two main underdeveloped and highly 'influenceable' opportunities that can transform performance in law firms in our experience are People engagement – the most successful firms put their people at the heart of their business, with the senior leadership of the business setting the tone by ensuring that values and behaviours are a high priority for all and not just some words on their website; and all line managers are confident and capable to engage in all aspects of people and performance management with their teams. 2) Client advocacy – the most successful firms are truly client centric, so rather than just delivering their services as best they can, they also focus on properly measuring and developing client advocacy and 'make this cultural', that is to say that during the process of service delivery, external efforts are also pointed at gaining a deep understanding of their clients, with key client messages informing the firm's strategic choices, and any 'gaps' in client specific service quality perception acted upon. The vast majority of law firms that we know are either woefully or partially lacking in one or both of these regards.

3. All firms say they're different, what genuine differences do you see in the market?

Most law firms claim to be 'different', but the

perception of most clients, private or business is that there is not much difference on the surface. It's highly unlikely that there is much competitive edge to be gained through the products and services themselves, and these days clients just assume technical capability, so there's little to be gained there either, although so many lawyers still seem to believe that's the case. In our experience true competitive differentiation comes from the people, the way people behave and the way the business is run. So the 'right people on the bus sitting in the right seats' is an absolute foundation, and there are then a further ten or so fundamental principles of great businesses that are irrefutable, and the more of these the law firm is able to develop and 'demonstrate' the more profitable it will be. These components cover a broad spectrum including the quality of leadership, financial management, job and team role clarity, values, and regular open and high quality one to one conversations within the business and with clients.....and the 'F' word in business...FEEDBACK!

4. What could a typical law firm learn or adopt from successful businesses in other sectors?

All of the above. There are a handful of great businesses in the UK, and a larger handful who are working hard to 'be great', and most law firms could adopt many of the principles and approaches of these great firms, a taster of which is in the previous answer.

5. What are the key questions that equity partners should be asking themselves about the future?

Let's start with these for now. How great is the business in which I have a stake.....and more importantly, what do our clients think, and what do our people think? Are we really the very best law firm to do business with? And are we really the very best law firm to work for? Depending on the answer to those questions, ask yourself, how much do I want my business to be great or am I just happy the way it is? If the former, then there is more than likely some work to do, some comfort zones to step out of, and some step changes that have to be made....but in our experience, it will be well worth it in the not so distant future.

www.armstrongwatson.co.uk/legalsector

ArmstrongWatson[®]

Accountants, Business & Financial Advisers

A track record of providing solutions to the legal profession