

Legal Sector Breakfast Briefing

Tuesday 7 July 2015

Financial Stability

This briefing qualifies for 1 hour CPD – Authorisation Ref: EKQ/ARWA

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The Law Society



Legal Sector Breakfast Briefing

Tuesday 7 July 2015

Welcome

Brian Lake

Head of Centre, Business and Private
Bank North East



Yorkshire Bank

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Legal Sector Breakfast Briefing

Tuesday 7 July 2015

- | | |
|---------|----------------------------------|
| 8.00am | - Arrival and breakfast |
| 8.30am | - Welcome |
| 8.35am | - Briefing – Financial Stability |
| 9.30am | - Q & A |
| 10.00am | - Close |

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The Law Society Financial Stability Toolkit



Authors

Andy Poole, Legal Sector Partner, Armstrong Watson

- Understanding finance in law firms
- Management information, KPIs and early warning indicators

Richard Andrew, Partner, Armstrong Watson

- Financial forecasting

Peter Scott, Peter Scott Consulting

- Boosting cash flow
- Boosting profitability

Mark Ranson, Restructuring Partner, Armstrong Watson

- Restructuring the law firm

Elaine Wilcox, Insolvency Practitioner and Consultant, Armstrong Watson

- Insolvency in law firms

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Andy Poole
Legal Sector Partner

Understanding finance in law firms and
what to measure

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Understanding finance in law firms and what to measure

Agenda

- The need to understand finance
- The need for management information
- Key performance indicators
- Benchmarks
- Financial analysis, reporting and forecasting

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The need to understand finance

- Law firms need to be run as businesses
- Who has the greatest impact on the financial performance of law firms?
- Education is the key



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The need to understand finance

Samantha Barrass, former SRA Executive Director:

"Unlike the banks, failing law firms won't be bailed out by the tax payer. Instead, any costly interventions necessary to safeguard clients will be met by all of you here today; firms run responsibly, diligently and effectively picking up the tab for those that aren't"

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Profit and loss account	2014	2013
	£'000	£'000
Income		
Fee income	2,560	2,534
Bank deposit interest	10	8
Other income	4	4
	2,574	2,546
Expenditure		
Employee costs	1,024	1,270
Premises costs	248	245
Admin costs	70	77
Advertising	21	13
Legal and professional	10	8
Pll	280	270
Referral fees	95	25
Bad debts	74	62
Depreciation	19	19
Bank charges and interest	103	93
	1,944	2,082
Profit	630	464

Balance Sheet	2014	2013
	£'000	£'000
Fixed assets	174	190
Current assets		
Debtors	447	419
WIP	530	500
Prepayments	42	39
	1,019	958
Current liabilities		
Bank loans and overdrafts	400	465
Accruals	30	32
Purchase ledger	28	30
OTSS	102	133
	560	660
Net current assets	459	298
Net assets	633	488

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Balance Sheet

2014

2013

£'000

£'000

Represented by:

Current accounts

233

88

Capital accounts

400

400

633

488

Contingent items removed from WIP
for UITF40

510

480

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KPIs

	2014	2013
Debtor Days	64 days	60 days
WIP days	148 days	141 days
Lock-up days	212 days	201 days

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Drivers of profitability

Gearing	2.5
Hours	1,068
Recovered rate/hour	136
Profit margin	30%
Profit per equity partner	

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Drivers of cash flow

	Target	AW
Fee income	£1,000,000	£1,000,000
Overdraft	£(200,000)	£(200,000)
WIP days	54	99
Debtor days	50	68

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Impact

Case study: how to increase your bank balances

What would bank balance be if the WIP days and debtor days reduced to target?

WIP days	99 – 54	=	45 days improvement
Debtor days	68 – 50	=	18 days improvement
			63

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The need for management information

- What information do you produce?
- Why?



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Targeted management information

Reporting

- Base on KPIs
- Easy to understand
- Relevant to the firm and decisions to be made by the firm
- Relevant to the individuals
 - what they can control
- Assess and reward people based on
 - what they can control
 - what they can measure

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Targeted management information

Forecasting

- Base on KPIs
- By department
- Three year forecast updated annually
 - Integrated profit and loss, balance sheet and cash flow
 - Cash flow is the result of the interaction between the profit and loss account and the balance sheet
- Three month rolling cash flow

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Summary

Key points

- Understanding is vital
- Four factors to concentrate on:
 - Utilisation
 - Recovery
 - WIP days
 - Debtor days
- Targeted management information

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Richard Andrew
Partner

Financial Forecasting

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Topics

- Why are financial forecasts important?
- The benefits of forecasting
- Different types of forecasts
- Example and sense-checks
- Questions

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Why are financial forecasts important?



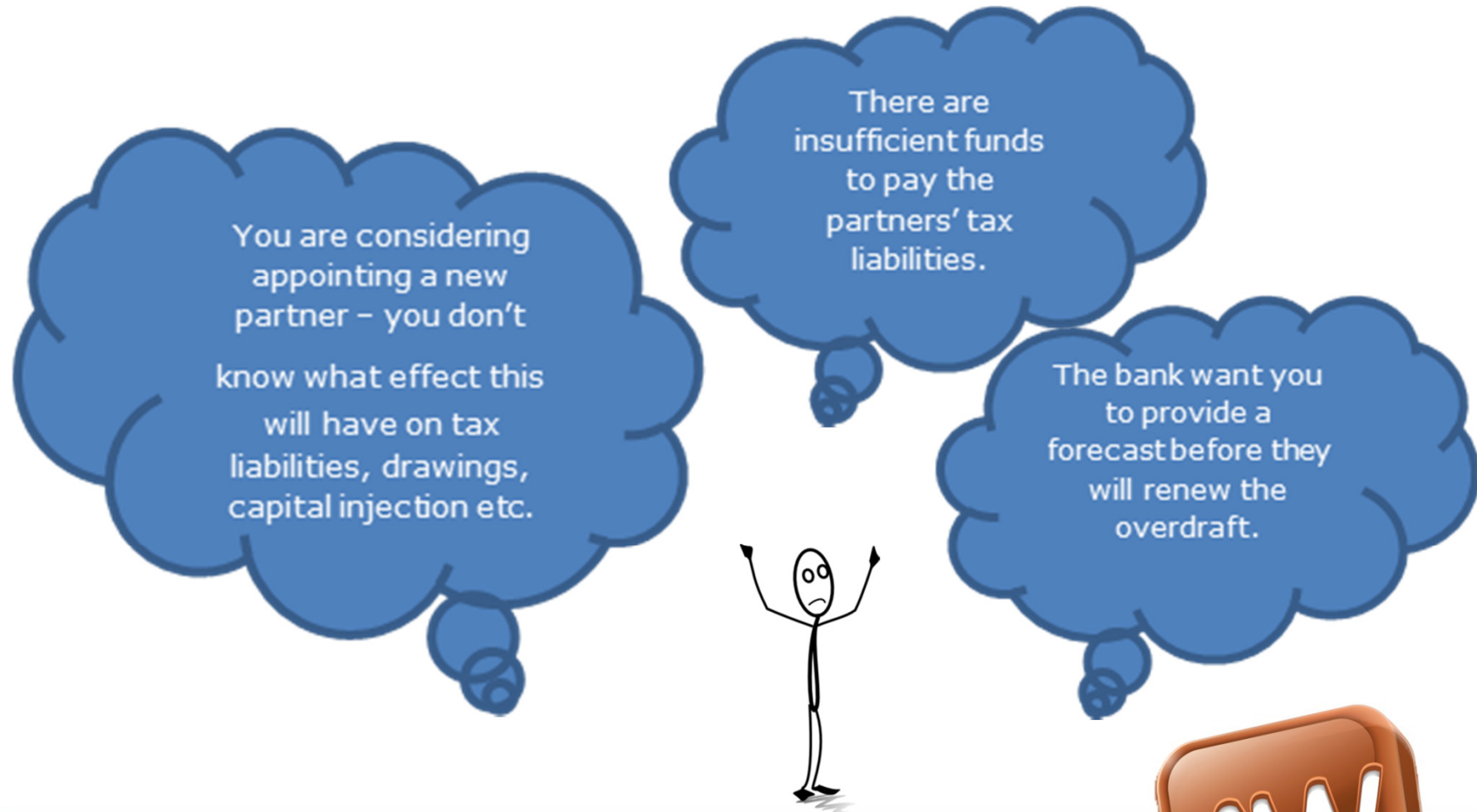
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The benefits of forecasting



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The benefits of forecasting

One of the partners is retiring and requires repayment of his capital account. There is scope to spread this over a period of time, but you don't know what the firm can afford.

The overdraft is increasing, but the management accounts show that profits are the same as last year.

The partners have been asked to reduce their drawings.



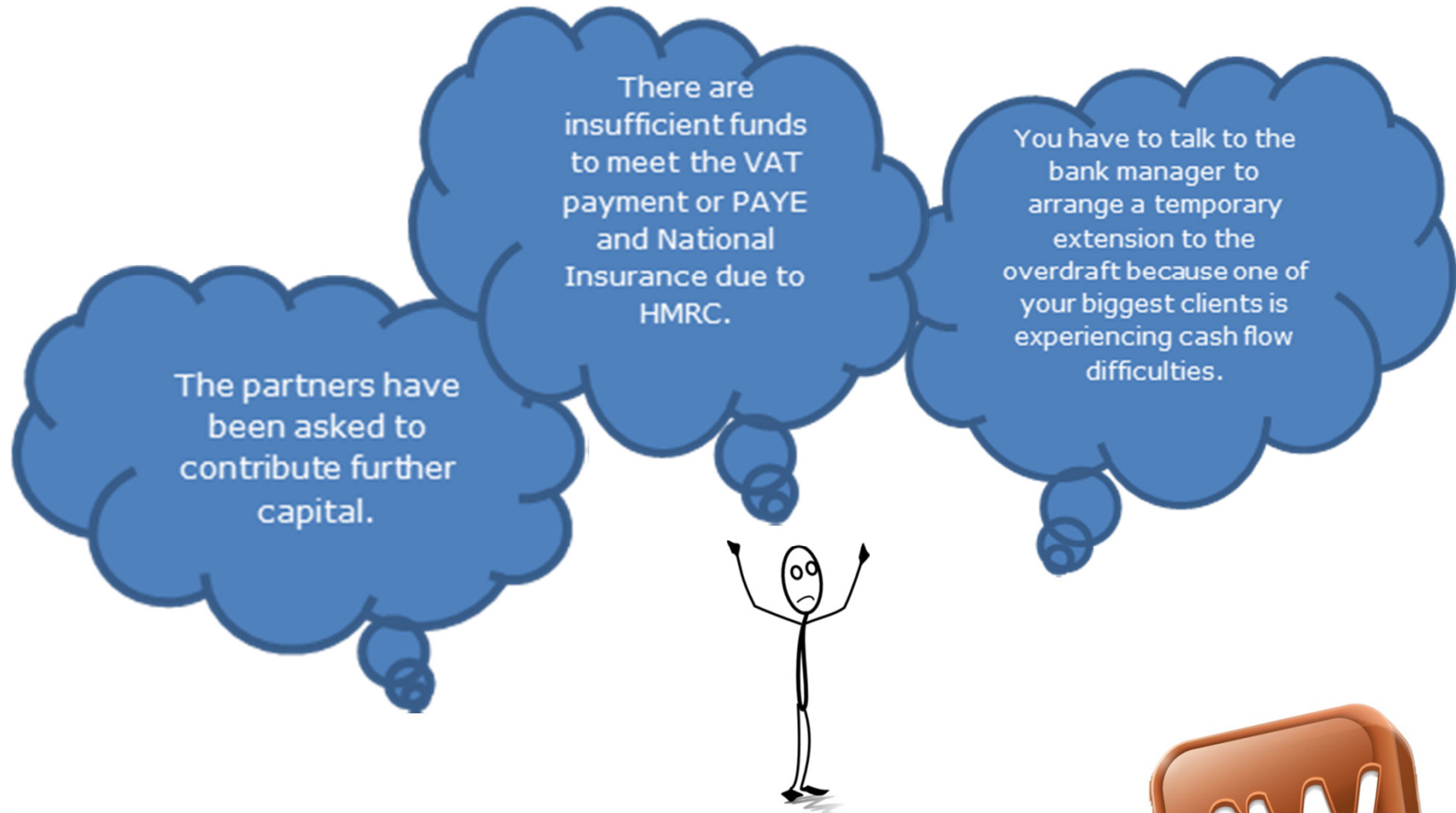
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The benefits of forecasting



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The benefits of forecasting

One of your fee earners wants to take on an additional employee – you don't know what effect this will have on the profits, cash or the pay back period for this investment.

Profits are lower than last year, but you don't know why.



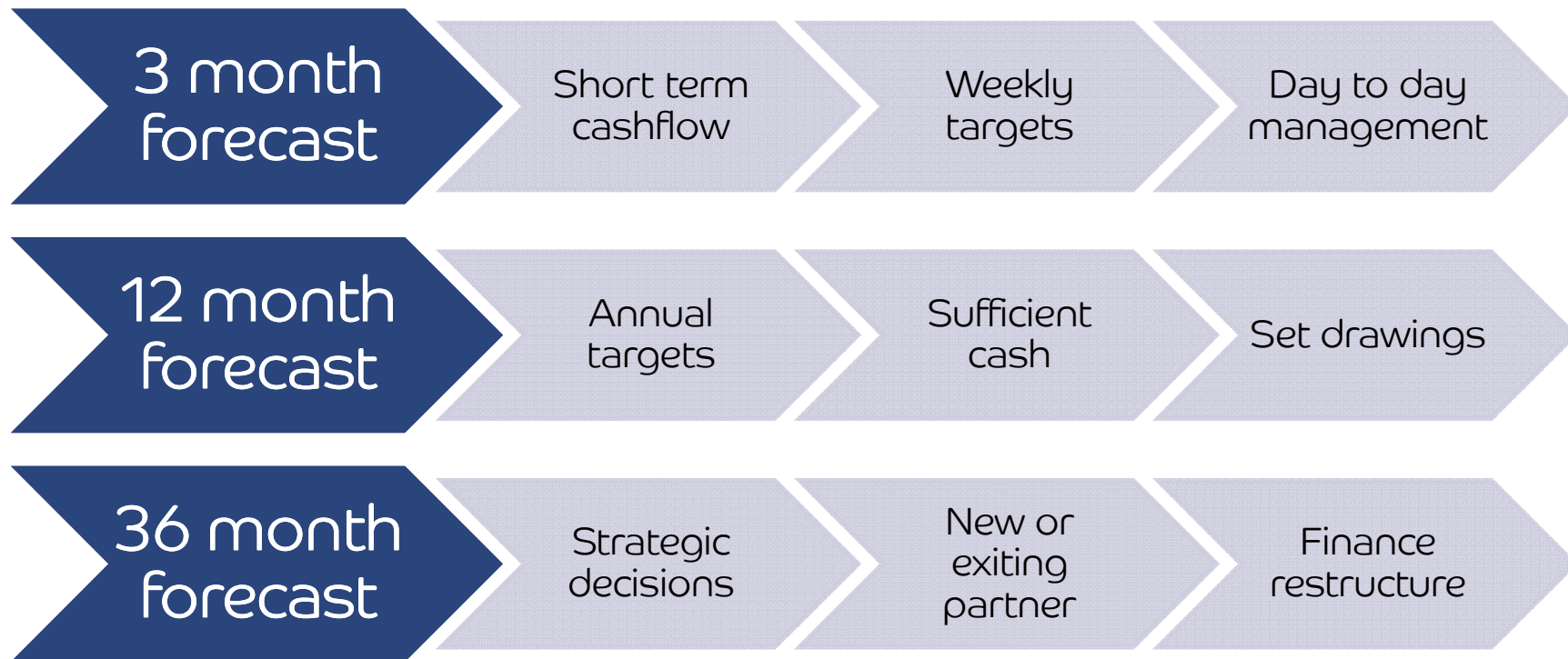
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Different types of forecasts



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Example

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Sense-checks

- Balance sheet “balances”
- Accurate opening balance sheet
- Profit and loss account
- Tax payments
- Work in progress
- Debtors

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Summary

- Why are financial forecasts important?
- The benefits of forecasting
- Different types of forecasts
- Example and sense-checks

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Elaine Wilcox
Insolvency Consultant

Insolvency

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Matters to be covered

- What do we mean by insolvency?
- Choosing the best insolvency process
- Other matters to be considered along the way

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What do we mean by insolvency?

If a practice is:

- unable to pay its debts as they fall due;
or
- its assets, when realised, would be insufficient to pay off its debts and other liabilities

then it is insolvent for the purpose of UK law

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Choosing the best insolvency process

- Legal framework
- Constitutional document
- Assets that can be realised
- Pressing creditors
- Personal guarantees and possible liabilities
- Effect of practicing certificate

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Sole practitioner

- Personally liable for all business debts
- Non-business assets will have to be realised on insolvency of practice

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Worst case scenario - Bankruptcy

- Unsatisfied Statutory Demand
- Intervention by SRA
- Practising Certificate automatically suspended
- Assets vest in the OR
- High costs
- Reduction in any return to creditors

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A better solution – Individual Voluntary Arrangement (IVA)

- Contract with creditors to pay an amount in full and final settlement of debt
- If approved binding on all creditors
- Interim order – protection against pressing creditors
- No vesting of assets
- Lower costs
- Does not automatically trigger intervention
- Discretion as to whether practising certificate suspended

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Example

	Bankruptcy £	IVA £
Business Assets	Nil	25,000
Personal Assets	70,000	50,000
	70,000	75,000
<u>Costs</u>		
Legals	7,000	5,000
OR Admin fee	1,850	-
Secretary of state fees	12,545	-
Trustees fees	25,000	-
Nominees/supervisor fee	-	20,000
	46,395	25,000
Available for creditors	23,605	50,000

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LLP/Limited Company

- Body corporate in their own right
- Protects members from personal liability
- Exposure usually capped at level of capital contribution
- Can borrow money with debenture over practice assets

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Worst case scenario – Compulsory winding up

- Statutory demand
- Freezing of bank account
- Intervention – possible personal liability
- Minimal asset realisations
- Personal liabilities

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A better solution – A prepack Administration

- Sale of the WIP
- Notice of Intention to appoint
- Sale contract drawn up pre-administration
- No need for solicitor IP
- Better return for all creditors
- Reduced exposure of members

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Other considerations

- Pre-insolvency transactions potentially increasing personal liability
 - Preferences
 - Transactions at an undervalue
- Wrongful trading leading to personal liability
- LLP – possible personal liability for withdrawals from capital account

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Summary

- Important to obtain specialist advice
- Solutions that give a better result for all
- Protect yourself by obtaining best advice on pre-insolvency transactions

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Mark Ranson
Partner

Restructuring the law firm

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When do I need to consider it?

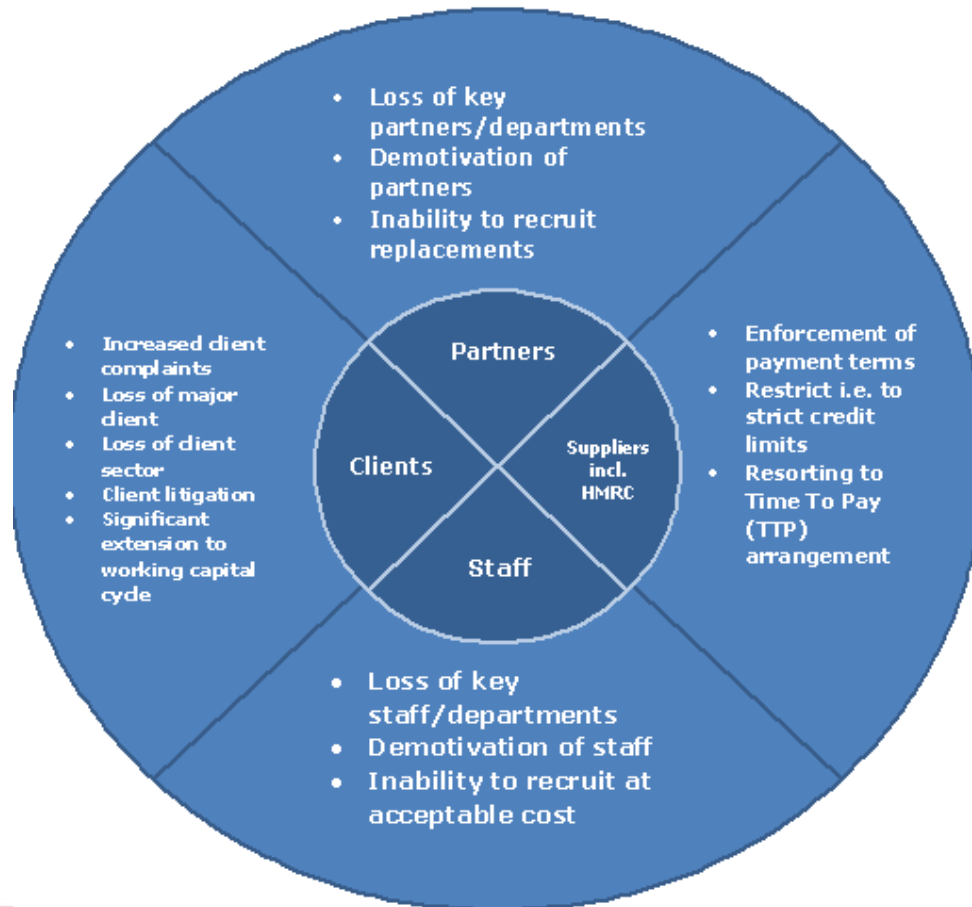
- Insufficient profits for partner lifestyles
- Overdraft always at limit
- Request for increase in partner capital
- Inability to pay key staff market rates
- Poor productivity from demotivated staff
- Poor performance by comparison to benchmark KPIs

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When do I need to think about restructuring my practice?



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Cash is king

- Businesses do not survive without cash
- Use 13 week models to manage cash and predict pinch points
- Take remedial action to collect cash from internal resources



Longer term forecasting

- For partners
- For funder(s)
- Key that partners buy strategy first
- Sanity checks



Understanding the strategic position

- Identify success and reinforce it
- Isolate under-performing areas and kill/cure
- Analyse results by reference to scarce resources
- Define what you want success to look like



Getting on with it!

- Make decisions and acting on them
- Communicate with relevant stakeholders
- Use experienced advisers
- Tough decisions may be required

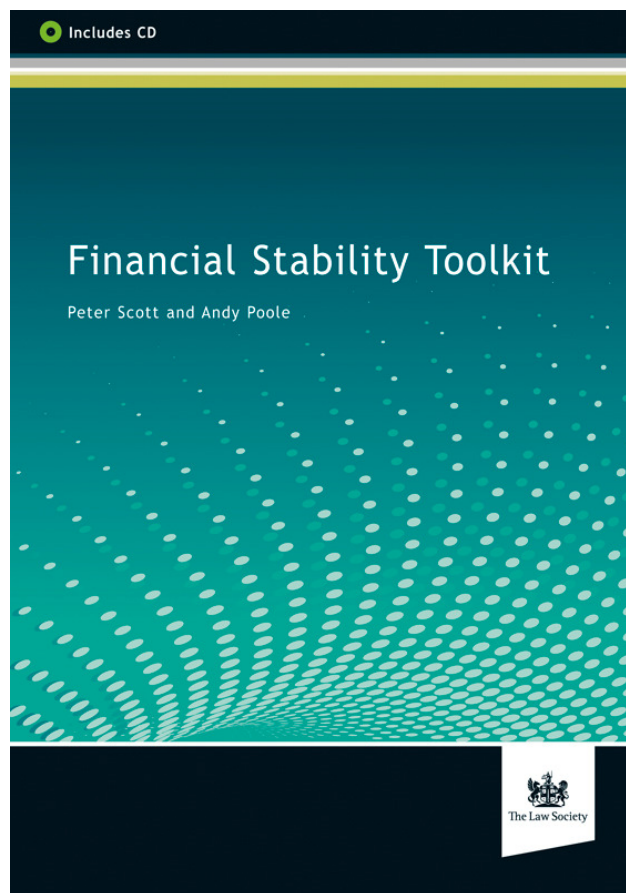


Failure ≠ Insolvency

- Scarce resources may make turnaround impractical
- May need to merge/close to achieve a satisfactory outcome
- Most turnarounds are successful!



Financial Stability Toolkit



Order at:

bookshop.lawsociety.org.uk

Price: £69.95

Available from 21 May 2015

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Andy Poole
Legal Sector Partner
Armstrong Watson

Milburn House, Hexham Business Park, Burn Lane, Hexham NE46 3RU

T: 01434 375550

F: 01434 375555

M: 07828 857830

Twitter: @AW_AndyPoole

E: andy.poole@armstrongwatson.co.uk

www.armstrongwatson.co.uk/legalsector

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Questions and Conclusion

Brian Lake

Head of Centre, Business and Private
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