



Legal Sector Breakfast Briefing

Thursday 5 September 2013

Financial Stability





Legal Sector Breakfast Briefing

Welcome

Andy Poole
Legal Sector Director
Armstrong Watson





Legal Sector Breakfast Briefing

Introduction

Andrew Argyle
Chief Executive
Zenith Chambers



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

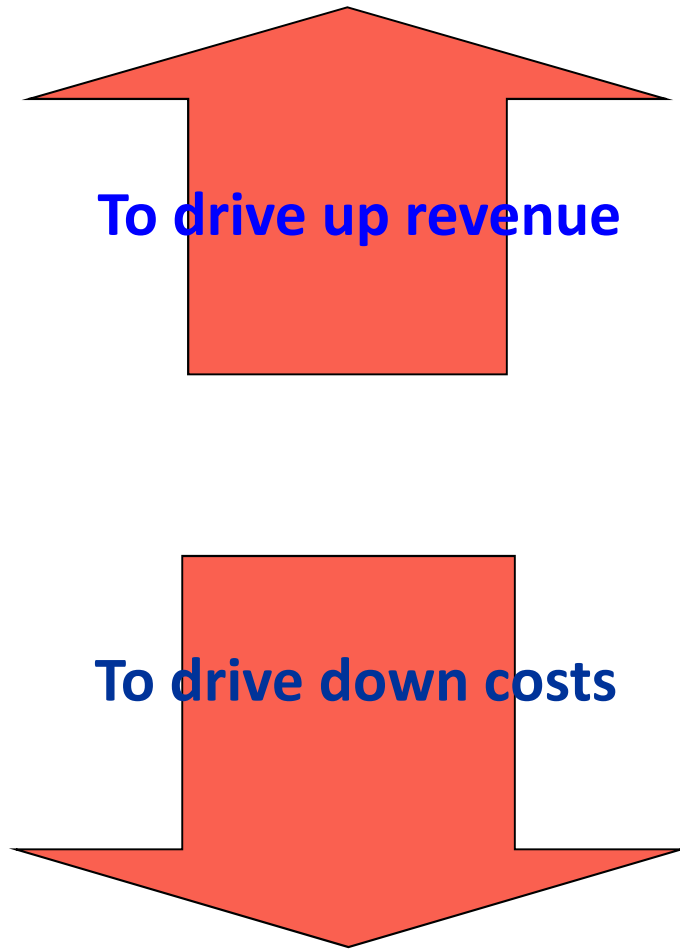


Financial stability

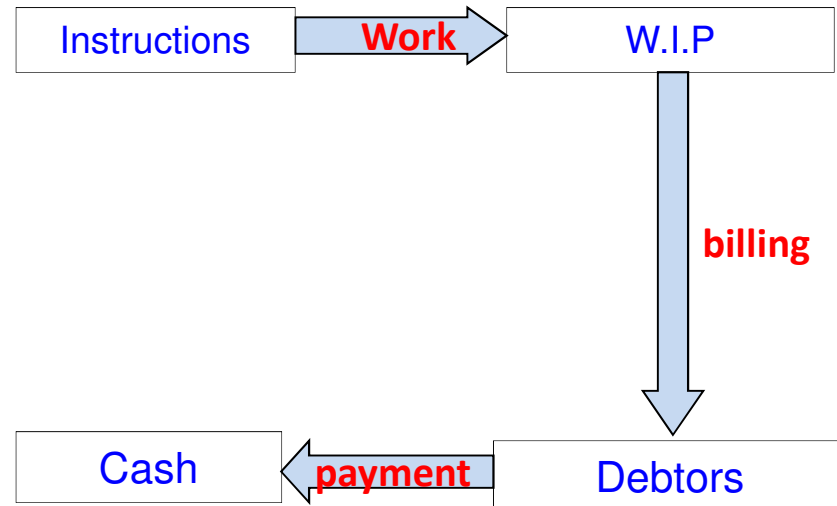
Peter Scott Consulting

www.peterscottconsult.co.uk

Flabby law firms are failing



To drive cash flow



The scope of our session today

Financial management has now become a compliance matter –

1. Understanding what is required under the SRA Code of Conduct
2. Identifying and dealing with law firms' priority financial stability challenges

Putting “financial stability” into context

Extracts from a speech of 18 April 2013 by Samantha Barrass , Executive director SRA

- ❑ *“We expect firms to report financial concerns to us as soon as they become apparent, and to engage and cooperate with us fully.”*
- ❑ *“We will not tolerate the reckless trading of firms into insolvency and where this happens we will pursue enforcement action under Principle 8, including referral to the Solicitors Disciplinary Tribunal where appropriate.”*

Understanding the financial stability requirements of the SRA Code of Conduct

SRA Principle 8 requires you to ‘run your business or carry out your role in the business effectively and in accordance with proper governance and sound financial and risk management principles’

Outcome 0(7.4)

“You maintain systems and controls for monitoring the financial stability of your firm ... and take steps to address issues identified”

What systems and controls do you have in place for monitoring your financial stability?

Acting in the following ways may tend to show that you have achieved these outcomes

Chapter 7 – Code of Conduct

Indicative behaviour (7.2) – controlling budgets, expenditure and cash flow

Indicative behaviour (7.3) – identifying and monitoring financial risks including
credit risks and exposure

Financial monitoring and reporting

Chapter 10 – Code of Conduct

Indicative behaviour (10.2) – actively monitoring your financial stability and viability to identify any risks to the public

Indicative behaviour (10.3) – notifying the SRA promptly of any indicators of **serious financial difficulty**, such as inability to pay your professional indemnity insurance premium, or rent or salaries, or breach of bank covenants

Indicative behaviour (10.4) – notifying the SRA promptly when you become aware that your business may not be financially viable to continue trading as **a going concern**, for example because of difficult trading conditions, poor cash flow, increasing overheads, loss of managers or employees and / or loss of sources of revenue.

An extract from a 'going concern' statement in the accounts of a law firm LLP

After making enquiries, the management team has a reasonable expectation that the LLP has adequate resources to continue in operational existence for a period of no less than 12 months from the date of signing the financial statements. Accordingly, we continue to adopt the going concern basis in preparing the annual report and financial statements”

'Going concern'?

- Did the SRA intend to use '**going concern**' in its technical accounting and audit sense, as defined by company law, and if so, what could be the implications of that for law firms?
- If not intended to be used in its technical sense, then what does it mean?

SRA Update – 23 April 2013

“We have used our experience with firms that have suffered severe financial difficulties to draw up a list of good behaviours to aim for and poor behaviours to avoid. These lists are not exhaustive”

Poor behaviours

- Drawings exceeding net profits
- High borrowing to net asset ratios
- Increasing firm indebtedness by maintaining drawing levels
- Firms controlled by an "inner circle" of senior management
- Key financial information not shared with "rank and file" partners
- Payments made to partners irrespective of "cash at the bank"

Poor behaviours continued

- All net profits drawn, no "reserve capital pot" retained
- Short-term borrowings to fund partners' tax bills
- VAT receipts used as "cash received" resulting in further borrowings to fund VAT due to HMRC
- Partners out of touch with office account bank balances
- Heavy dependence on high overdraft borrowings

Good behaviours

- All partners regularly receive full financial information including office account bank balances
- Drawings are linked to cash collection targets and do not exceed net profits
- Provision is made to fund partners' tax from income received
- A capital element is retained from profit, and a capital reserve account built up
- Premises costs are contained
- Profitability levels are tested and unprofitable work is (properly) dropped

What other things do you consider should be –

- Good behaviours (to aim for)?
- Bad behaviours (to avoid)?

Who should be responsible for financial stability?

- FD?
- COFA?
- COLP?
- All owners of the business?
- All of the above?

2. Measure what matters

Review financial measurement and reporting

“If you cannot measure it, then you will not be able to manage it”

Are you measuring what matters?

Establish an **'audit trail'**

“If you cannot demonstrate compliance we may take regulatory action”

- Measure what matters
- Report effectively
- Train your people
- Take advice if issues arise

What is the purpose of financial measurement and reporting?

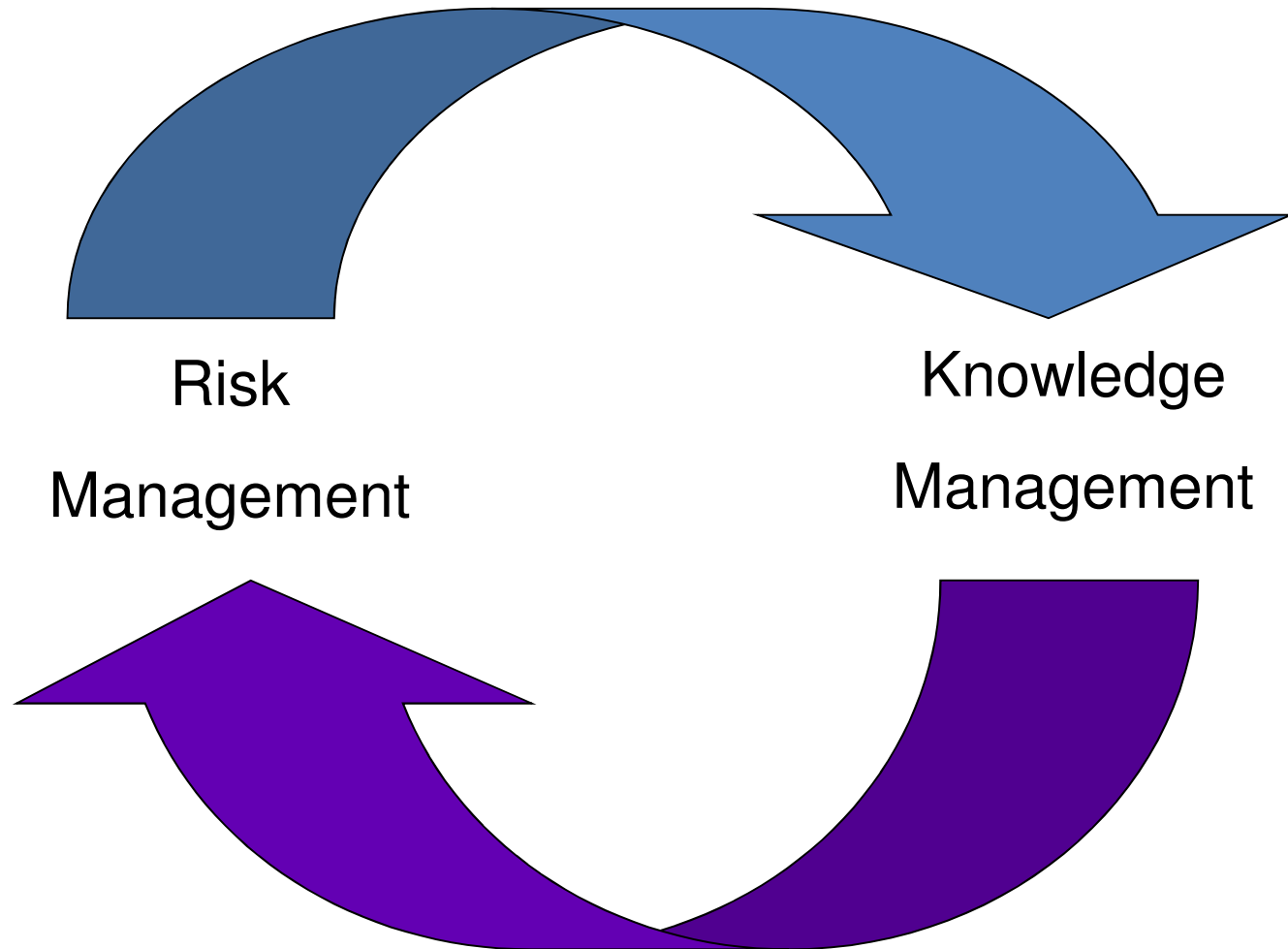
**To provide clear information to those
running the business to enable them to:**

- Know what is happening / will happen in the business
- Make decisions based on sound knowledge
- Take effective **action**

Financial measurement and reporting

- creates **KNOWLEDGE**
- manages **RISKS**

Risk and Knowledge Management



Financial measurement enables a
business to manage **performance**

What do you measure?

What do you report on?

Is your financial measurement and reporting helping or preventing you achieving your objectives?

Do you produce data or information?

How do you **use** the financial information you produce?

In a law firm what needs to be measured
- and why?

Examples of **what matters**

- How can we measure the financial performance of each part of our firm?
- How profitable / loss making are each of our clients?
- Which parts of our firm generate good cash flow or soak up cash?

Do you measure things which **do not need to be measured** in order to run you business

- more effectively?
- more profitably?
- to generate more cash?

Do you / your people use everything you
measure / report?

If not – why do you measure it / report it?

**Is there anything you should
measure which you do not currently
measure and report on?**

Your key performance indicators?

Test your KPIs

- Why do we produce this information?
- Does it tell us what we need to know about our business?
- What does it not tell us about our business?
- Do we ever use this information?
- If not then why do we produce it?

Real time or historical information?

For example

- billings
- input

Hard copy or available on line?

Frequency of reporting?

NB - inaccurate reports destroy credibility

Who needs what?

How far do you disseminate financial information in your firm?

- and for what purpose?

Financial education and training

“I don’t have a clue about the financial reports I receive”

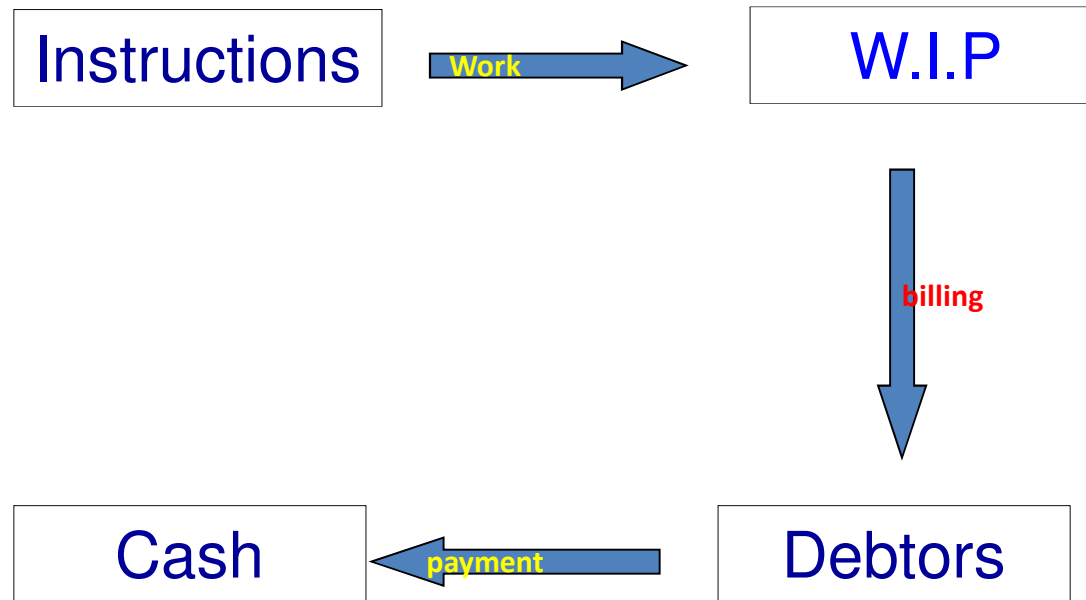
- What do you want each partner / fee earner to financially manage?
- What do they need to know to be able to do this?

Do your partners / other fee earners have financial knowledge gaps?

Do they understand why you provide them with financial reports?

Do they understand why you are asking them to take a certain action?

Take control of your cash management – to maintain financial stability



Cash management priorities

- taking instructions
- Managing the WIP
- Managing debtors

Above all – manage partners!

Adopt zero tolerance and partner accountability instead of this

“That’s a great idea ...for the rest of you!”



Take appropriate advice, act on it and document it

NB – COLP's and COFA's responsibilities

Outcome O (10.1) – you ensure you comply with all the reporting and notification requirements in the Handbook that apply to you

Indicative behaviour IB (10.5) – notifying the SRA of any serious issues identified as a result of monitoring referred to in IB (10.1) and IB (10.2) and producing a plan for remedying issues that have been identified

Responding to an approach from the SRA?

1. Admit nothing!

2. Respond with:

Thank you for your call and I note your concerns. Obviously I will need to discuss this with my financial team and my accountant. I will respond to you once I have had their responses.

3. Contact your accountant and explain the phone call and get their professional input on refuting the comments from the SRA.

Establish an **'audit trail'**

“If you cannot demonstrate compliance we may take regulatory action”

- Measure what matters
- Report effectively
- Train your people
- Take advice if issues arise



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Questions and Conclusion

Mike Holloway

Relationship Director

RBS

